Public Comment

Proposed Amendments

2002

AD HOC ADVISORY GROUP ON ORGANIZATIONAL SENTENCING GUIDELINES

Public Comment and Information for November 14, 2002 Public Hearing

INDEX TO PUBLIC COMMENT
REQUESTED BY ORGANIZATIONAL ADVISORY GROUP

(Issued August 21, 2002)

Advisory Group on Organizational Guidelines to the United States Sentencing Commission

REQUEST FOR ADDITIONAL PUBLIC COMMENT REGARDING THE U.S. SENTENCING GUIDELINES FOR ORGANIZATIONS

Over the last several months the Ad Hoc Advisory Group on Organizational Sentencing Guidelines has received public comments and has undertaken its own initial evaluation of both the terminology and the application of Chapter Eight of the Guidelines. The public advice received so far has been instructive, including specific suggestions for changes as well as the advice of some to the effect that Chapter Eight of the Guidelines works well and need not be changed. In the course of continuing its work the Advisory Group has identified several specific areas of concern and generated a list of key questions in an effort to focus and stimulate additional public comment prior to preparing its report to the United States Sentencing Commission.

Written public comment regarding these questions, set forth below, should be received by the Advisory Group not later than October 5, 2002. Commentators are urged to be specific in their recommendations and, where appropriate, include references to the relevant provisions of the Chapter Eight Guidelines. For example, if a commentator suggests definitional clarification, specific language should be provided. Comments submitted to the Advisory Group will be made available to the public and will be posted on the Commission's website at http://www.ussc.gov. Public comment should be sent to: United States Sentencing Commission, One Columbus Circle, N.E., Suite 2-500, Washington, D.C. 20002-8002, Attention: Michael Courlander. The Advisory Group requests that, if practicable, commentators also submit an electronic version of their comments as an attachment in either Word Perfect or MS Word to an e-mail addressed to pubaffairs@ussc.gov.

Questions

1. Should the Chapter Eight Guidelines' criteria for an "effective program to prevent and detect violations of law" at §8A1.2, comment 3(k)(1-7), be clarified or expanded to address the specific issues designated below? If so, how can this be done consistent with the limitations of the Commission's jurisdiction and statutory authority at 28 U.S.C. §994 *et. seq.*?

a. Should §8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2) further define what is intended by "specific individual(s) within high-level personnel of the organization" (*see also*, §8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"

b. To what extent, if any, should Chapter Eight specifically mention the responsibility of boards of directors, committees of the board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?

c. Should modifications be made to §8A1.2, comment 3(b) (defining "high-level personnel") and §8A1.2, comment 3(c) (defining "substantial authority personnel")? Should modifications be made to §8C2.5, comments 2, 3, or 4, relating to offenses by "units" of organizations and "pervasiveness" of criminal activity?

d. Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?

e. Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently §8A1.2, comment 3(k)(4) provides:

"The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, ***e.g.***, by requiring participation in training programs **or** by disseminating publications that explain in a practical manner what is required."(Emphasis added).

The use of the "*e.g.*" can be interpreted to mean that "training programs" and "disseminating publications" are illustrative examples, rather than necessary components, of "communicating effectively." The use of "or" can be interpreted to mean that "training programs" and "disseminating publications" are alternative means for satisfying the "communicating effectively" requirement.

Should the preceding language be clarified to make clear that both training and other methods of communications are necessary components of "an effective" program? If so, should the term "disseminating publications" be replaced by more flexible language such as "other forms of communications?"

f. Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage:

i.. whistleblowing protections;
ii. a privilege or policy for good faith self-assessment and corrective action (*e.g.*, 15 U.S.C. §1691(c)(1) (1998));
iii. the creation of a neutral or ombudsman office for confidential reporting; or,
iv. some other means of encouraging reporting without fear of retribution?

g. Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?

h. Should §8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, *e.g.*, should there be credit given to organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected in rewards and compensation?

2. While the Chapter Eight Guidelines currently provide a three-level decrease in the culpability score of organizations that are found to have implemented an "effective program to prevent and detect violations of law" (at §8C2.5(f)), should this provision be amended to provide an increase for organizations that have made no efforts to implement such a program? If so, what is the appropriate magnitude of such an increase?

3. How can the Chapter Eight Guidelines encourage auditing, monitoring, and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?

4. 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)(7)(I) adequately address them? If not, how can Chapter Eight better address any unique concerns and obstacles faced by small and medium-sized organizations? What size organization requires unique/special treatment (*e.g.*, 50 employees, 200, 1000, 5000)?

a. How frequently do small and medium-sized organizations implement "effective programs[s] to prevent and detect violations of law" within the meaning of Chapter Eight of the Sentencing Guidelines? If the frequency is low, to what factors is this attributable, and how may Chapter Eight be modified to promote

increased awareness and implementation of effective compliance programs among small and medium-sized organizations?

b. According to §8C2.5(f), if an individual within high-level personnel or with substantial authority "participated in, condoned, or was willfully ignorant" of the offense, there is a rebuttable presumption that the organization did not have an effective program to prevent and detect violations. Does the rebuttable presumption in §8C2.5(f), for practical purposes, exclude compliance programs in small and medium-sized organizations from receiving sentencing consideration? If so, is that result good policy and why?

c. In addition to the rebuttable presumption in §8C2.5(f), §8C2.5(b) also provides an increase in the culpability score (from 1 to 5 points) where an individual within high-level personnel or with substantial authority participated in, condoned, was willfully ignorant or tolerant of the offense. Is that good policy and why?

d. Should the rebuttable presumption in §8C2.5(f) continue to apply to large organizations and if so, why?

5. Should the provision for "cooperation" at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?

6. Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?

The Advisory Group plans to hold a public hearing regarding these questions on **November 14, 2002.** The hearing will be held at the Thurgood Marshall Building, One Columbus Circle, N.E., Washington, D.C. 20002, from 8:30 a.m. to 5:00 p.m. The Advisory Group will invite witnesses to testify on the issues specified prior to the hearing. Any person desiring to testify should request to do so in writing prior to or in conjunction with submitting public comment. Timely submission of written testimony is required for testifying at the public hearing. All written testimony must be received by the Commission not later than **October 30, 2002.** The Advisory Group reserves the right to select persons to testify at the hearing and to structure the hearing as the Advisory Group considers appropriate and the schedule permits.

ADVISORY GROUP ON ORGANIZATIONAL GUIDELINES
PUBLIC COMMENT SUMMARIES

Question 1 (Generally): Criteria for Effective Compliance Program

Ethics Resource Center
Washington, DC

Current statement in Chapter Eight is too vague given severity of consequences that result. At a minimum Guidelines should follow responsibilities outlined in Sarbanes-Oxley Act, particularly Section 906 (stating certifications CEOs and CFOs must make and individual punishments).

Novartis International AG
Peter Tobler, Group Compliance Officer
Basel, Switzerland

For multinational organizations, specific requirements in the Guidelines may make little sense or even be impossible to fulfill under diverging foreign laws. Any revisions to the Guidelines should consider differences in the laws of foreign countries. Specifically, the following type language should be added to the Guidelines:

> "In situations in which, by virtue of the applicability of foreign laws, a foreign company is not able to lawfully completely comply with any specific element of effectiveness set forth in these Guidelines or if such compliance would not have the effect intended by these Guidelines, it shall be sufficient if such company has taken reasonably equivalent steps or adopted reasonably equivalent practices that serve the same objective."

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients
Washington, DC

The current approach was wisely chosen and should by re-emphasized in the Advisory Group's report to the Commission. The broad, flexible criteria now articulated in the Guidelines are essential to maintain their relevance to the broad range of organizations they cover. Relatedly, compliance programs must be customized to fit the particular organization in order to be truly effective. This flexible and particularized approach requires each individual organization to take responsibility for assessing its own environment and risk profile and empowers organizations to use all of their experience and creativity in crafting a compliance program. Finally, a flexible approach is critical to encourage compliance innovation and improvements. In sum, the structured but flexible approach now embodied in the Guidelines has been important in fueling compliance progress.

Probation Officers Advisory Group
Cathy A. Battistelli, Chair

The Guidelines appeared to be geared to large organizations, while the "normal" organizational case is a small organization and sometimes already defunct. Thus, perhaps

specific offense characteristics for small businesses (those with less than ten people) should be included.

Section 8C2.5(c)(1)(B) currently requires adjudication(s) based upon two or more prior instances of similar misconduct to impose a one-level enhancement. Some POAG members believe that points should be assessed if the organization had one prior incident of similar misconduct.

Detention/prevention programs which foster whistle blowers without retribution are effective deterrents.

Probation officers face post-sentencing problems. Supervision is difficult due to a lack of expertise in the variety of offense conduct. There are few remedies for non-compliance thus resulting in little incentive for an organization to remain in compliance. Penalties are necessary if a company fails to meet its financial obligations.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council
Washington, DC

The criteria for an effective compliance program do not need to be expanded or more detailed. As a practical matter, these criteria have come to be viewed as principles for an effective compliance program. The present level of generality properly permits organizations to fashion the system that best fits their operations, structure and culture and allows sentencing courts to apply the criteria on a case-by-case basis.

Question 1(a): Oversight of Compliance Programs

Epstein, Becker & Green, P.C., for Health Care Industry Clients
Washington, DC

Chapter Eight should not delineate specific responsibilities for particular high-level personnel within the organization or define individual(s) within high-level personnel related to health care organizations because it would impede needed flexibility:

- unique organization of different companies and individual responsibilities
- irrespective of title, some individuals better suited for the role
- one-size-fits-all approach not suitable for wide variety of organizational types and sizes

Ethics Resource Center

Requirement for oversight should be coupled with responsibility to report results to the Audit Committee of the Board.

Phillip Morris Companies, Inc.
David I. Greenberg, Senior Vice President and Chief Compliance Officer
New York, NY

Philip Morris endorses the link between senior management and a company's compliance program but also endorses the need for flexibility in the designation of high-level personnel responsible for compliance oversight depending on the organization's size and type of business operations.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

Prescribing specific responsibilities for high-level officials would result in unfortunate micro-management, and the existing Guidelines appropriately address these issues. Such specific responsibilities need to be determined within the context of a specific organization, reflecting industry-specific and company-specific risk profile, and must be re-evaluated and refined as the risk profile changes. Because uniform compliance job descriptions for every organization cannot provide the flexibility necessary to accommodate these essential kinds of considerations, they will not serve the government's interests.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

Specifying the responsibilities of particular functions, expanding the definitions of "high-level personnel," or providing additional comments on what is intended by "specific individual(s) within high-level personnel of the organization" would decrease the Guidelines flexibility.

Question 1(b): Oversight by Boards and Directors

Epstein, Becker & Green, P.C., for Health Care Industry Clients

The Guidelines should not provide further details about the responsibilities of the boards of directors because of differences (primarily size) among organizations.

Ethics Resource Center

Chapter Eight provisions should underscore fiduciary responsibility of the board and audit committee and should comment on inherent conflicts of interest to be avoided and need for independence. *See* Section 301 of Sarbanes-Oxley Act for possible guidance.

Phillip Morris Companies, Inc.

Corporate governance and compliance practices have developed so that boards of directors and their committees are responsible for overseeing compliance programs and senior management's compliance with the organization's business and operations' legal requirements. The Guidelines should reflect these developments, particularly, for instance, section 301 of the Sarbanes-Oxley Act, which directs a company's Audit Committee to establish procedures for anonymous internal reporting of accounting irregularities.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

Guidelines should add language emphasizing that a strong compliance program requires active oversight by the board and appropriate committees and reporting systems that provide all of the organization's top leadership with the information needed for effective oversight. Language spelling out detailed responsibilities for boards and their committees is not necessary. Nor would detailed corporate governance prescriptions be appropriate, given the diverse group of organizations covered by the Guidelines and their different types of governance structures.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

The Guidelines should not provide detail on the responsibilities of boards of directors or equivalent governance bodies in overseeing compliance programs. Not all organizations have such bodies. The Guidelines already embody the principle that compliance programs should be

supervised by high-level personnel. And the issue of director (or equivalent) responsibilities is obviously a topic of considerable federal legislative, regulatory, and self-regulatory attention. Suggesting specific governance responsibilities could create conflicts with the Sarbanes-Oxley Act or with regulatory acts. Moreover, non-regulated companies are currently considering the same issues and the Advisory Group should avoid creating unnecessary conflicts.

Question 1(c): Modifications to Definitions of "High-Level Personnel" and "Substantial Authority Personnel"

Ethics Resource Center

Definition of personnel with responsibility for ethics oversight is adequately clear but need more clarity regarding the ease of access of such persons to the board and audit committee. Access to the ultimate authorities must be clear and unfettered

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

Comment 4 of §8C2.5 should further clarify the distinction between pervasive and non-pervasive conduct among the business units of an organization. Specifically, comment 4 should articulate that if conduct is not pervasive among business units, the conduct of one business unit should not be imputed to other business units, by adding the following suggested language:

> "If specific conduct is not shared by more than one business unit, then there should not be a finding of pervasiveness within the organization as a whole. The conduct of one business unit should not be imputed to the conduct of another business unit."

Question 1(d): Propensity to Engage in Illegal Activities

Epstein, Becker & Green, P.C., for Health Care Industry Clients

The Guidelines should further clarify what is meant for a person to have a "propensity to engage in illegal activities"; further clarity would be beneficial and should include flexibility for organizations to employ individuals with "youthful indiscretions" in their past.

Ethics Resource Center

Some modification is necessary about "propensity to engage in illegal activities" and the current inclusion of such an ill-defined requirement may weaken the overall set of guidelines.

Key considerations:

- Should the modification consider whether a criminal record is a bar, or whether it must be much more directly related to fiduciary responsibilities and white collar crime? Also, if not, does this constitute a form of discrimination?
- Is the freedom from the propensity sufficient, or should there be some demonstrated ability and skills to handle the authority for oversight of compliance and ethics?
- Also, the presence or absence of identifiable indicators that predict presence of misconduct or a climate that supports such misconduct may be factored in here:

The indicators are job dissatisfaction, awareness of unethical/illegal conduct by others, and pressure to perform illegal acts or violate organizational standards.

Phillip Morris Companies, Inc.

"Propensity to engage in illegal activities" should be clarified.

Question 1(e): Training and Communication Aspects

Epstein, Becker & Green, P.C., for Health Care Industry Clients

No more specificity is needed: the Guidelines should permit flexibility in determining the most effective ways to communicate with their employees. Do not change language about training because it would suggest that written training programs are not appropriate, which is wrong message to send in light of proliferation of interactive technology advances.

Ethics Resource Center

More important than specific methodologies for training are required measurable outcomes (*e.g.*, awareness of a company code, familiarity with the code's content, familiarity with what constitutes violation of code, awareness of how to integrate code with decision making processes, awareness of resources provided by company to assist with the decision making, means for reporting suspected violations of the code, etc.). Guidelines should specify or identify that the goals for effective communication and training are to maintain a heightened awareness among employees of performance expectations of an organization regarding ethical business practices, and the development and reinforcement of ethical business behaviors among individuals and groups.

Phillip Morris Companies, Inc.

Companies should be afforded the flexibility to determine which methods of communication and training are best suited to the organization, its size, structure, compliance policies and procedures, and other factors and circumstances specific to an individual company or organization.

Question 1(f): Reporting Systems Without Fear of Retribution, Including Whistleblowing Protections, Privilege for Self-Assessment and Corrective Action, Ombudsman, Other Means

American Express Company
John Parauda, Managing Counsel
New York, NY

Clarify comment 3(k)(5) regarding "reporting system without fear of retribution" and make it more specific to encourage the creation of a neutral or Ombuds office for confidential reporting. This is consistent with Section 301 of the Sarbanes-Oxley Act which requires audit committees of publicly traded companies to "establish procedures for the confidential, anonymous submission by employees . . . of concerns regarding questionable accounting or

auditing matters." Ombuds office are an important means of encouraging employees to report concerns without the fear or retribution. Cites internal survey results for support.

Compliance Systems Legal Group
Joe Murphy, Partner
Haddonfield, NJ

Recommends a modified approach for the Guidelines that reflect how the Guidelines have been applied by those organizations that are serious about compliance, specifically:

- No fine may be imposed against an organization because of an act of an employee or agent if the organization can demonstrate by a preponderance of the evidence that it, 1) exercised due diligence to prevent and detect misconduct, 2) reported on a reasonably prompt basis any such misconduct, and 3) acted reasonably promptly and with due diligence and good faith to correct the causes of such misconduct.
- Commentary (details provided in his submission) should accompany this approach and explain the requisite due diligence and good faith.

Eastman Kodak Company
A. Terry VanHouten, Assistant General Counsel
Rochester, NY

Office of the Ombuds is an excellent mechanism, providing a neutral, confidential conduit for information to overcome the reluctance of employees to report wrong conduct. Its existence in public and private organizations and its usage by employees and outside entities are testament to its value.

Epstein, Becker & Green, P.C., for Health Care Industry Clients

Guidelines sufficiently address reporting systems within companies and thus, no further guidance is needed on "reporting without fear of retribution." Creation of an ombudsman office could be duplicative in light of role of compliance officer and individuals within high-level management who are responsible for overseeing compliance.

Ethics Resource Center

All four criteria (whistleblowing protection privilege or policy for good-faith assessment and corrective action, creation of neutral or ombudsman office for confidential reporting, or some other means of reporting without fear of retribution) deserve consideration; effective programs do not need all four but if they have fewer it should be incumbent upon organization to provide evidence that system is safe and effective for whistle blowers.

Caveat should be included for multi-national companies, since in many cultures this approach will not work, as empirically demonstrated. Guidelines should provide equivalent consideration when an organization can show that their approach is reasonably effective in the context of foreign cultures.

Ombudsman Association
John S. Barkat, Ph.D, President
Hillsborough, NJ

Recommends that the creation of an Ombuds Office be specifically included in the revisions to commentary. Ombuds Office offers an early warning capability, a resolution capability, an option for employees who want to raise concerns without fear of retaliation, and a mitigating factor in risk and in the sentencing process. Recommends inclusion of reference to "Creation of an organizational ombudsman for confidential reporting" in the commentary.

Phillip Morris Companies, Inc.

The existing language of comment 3(k)(5) already encourages organizations to establish reporting mechanisms, and thus it is questionable whether it would necessarily be helpful for the Guidelines to specify the types of mechanisms that should be adopted. This type of implementing decision appears to be best made by individual organizations, based upon their specific circumstances. Offering protection to employees would enhance the effectiveness of an organization's compliance program but there are practical limitations on such protections: an absolute promise of confidentiality may not survive litigation discovery or cooperation with a government investigation; an organization can assure no internal employment sanctions but cannot protect against the consequences of external actions. The Advisory Group should develop recommendations to address the underlying problems that currently prevent organizations from offering such assurances.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

The current Guideline language already encourages companies to create mechanisms for employees to report misconduct without fear of retribution; the Guidelines should not be amended to prescribe the specific type of mechanism companies should adopt. The creation of a neutral or ombudsman office, while perhaps valuable in enhancing a compliance program, should not be mandated. Moreover, there are limits on the company's ability to extend protections to employees: employees cannot be given an unqualified assurance of confidentiality if their reports are subject to discovery or required by the government as part of cooperation. The ability to offer these kinds of assurances to employees could create barriers to employee reporting. The Advisory Group should adopt recommendations designed to mitigate the underlying problems that limit companies' ability to provide such assurances.

Redmond, Williams & Associates
New York, NY

Support the recommendation that §8A1.2 include either creation of an Ombudsman function or provide an incentive to create such offices by designating Ombuds offices as a factor in determining whether an organization has a reporting system which allows reporting without fear of retribution.

A proven vehicle for providing early detection of criminal activity and mitigating risk is a confidential, neutral and informal Ombudsman office where mishandling of data, accounting irregularities, employee fraud, discrimination and other wrongdoing can be reported. An Ombudsman provides unique benefits because it provides reporting anonymity while preserving the right to further escalate an issue without posing serious danger to a person or detriment to the

firm, provides a confidential channel for early detection and prevention of criminal activity thus promoting reporting, provides direct access to senior management, provides independence from other organizational entities, brings senior leader position judgment to potential criminal activity, provides concentrated oversight to detect early trends and effect systemic changes, keeps no records and thus no discovery, is neutral, and works with individuals to promote compliance.

In contrast, an ethics officer often reports to a department and is not independent but instead responsible to a third party, conducts investigations, and formally handles issues; as a result of these functions, an ethics officer usually keeps records and cannot assure anonymity.

Hotlines also differ. They are part of and report to a formal department and thus are not independent; they cannot report directly to the board or CEO; they are often staffed with employees lacking extensive management experience; conversely, they are sometimes staffed by senior officers who are viewed as part of the problem; by their nature, they are passive call recipients, and not proactive change agents; they are sometimes outsourced and thus their employees lack institutional knowledge; they are faceless entities and can find it difficult to build reputation and trust; and they are not freely used in many cultures.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

Section 8A1.2, comment 3(k)(4)'s flexibility regarding internal communication should be maintained:

More specificity regarding whistle blower protection is not necessary. Guidelines already clearly state that internal reporting should be without fear of retribution, and many statutes already provide specific whistle blower protection. Adding more specific whistle blower provisions might create conflicts with existing laws, be duplicative, or even create loopholes resulting in less protection.

The Commission cannot create a privilege for self-assessments or corrective action. Guidelines should recognize that organizations should not be required to waive their legally-recognized privileges in order to receive cooperation benefit

A neutral ombudsman is not necessary to an effective compliance program. It may create the implication that responsibility for compliance oversight lies with an ombudsman, not management, and that management is not to be trusted. It would also be burdensome for small and medium-sized organizations.

United Technologies
Patrick J. Gnazzo, Vice President, Business Practices
Hartford, CT

Comment 3(k)(5) to §8A1.2 should incorporate guaranteed confidentiality to promote reporting. It would be helpful for compliance programs to have Commission data on how the guidelines have been applied to those organizations that chose to have or to ignore the seven criteria for an effective compliance program

University of San Diego School of Law
Lynne L. Dallas, Professor of Law

The Guidelines should expressly encourage the creation of a neutral or ombudsman office for confidential reporting. The ombudsman should be appointed by the independent directors of

the organization, meet standards of independence, serve for a fixed non-renewable terms, and receive board-determined and fixed-amount compensation.

Question 1(g): Auditing and Monitoring Issues

Ethics Resource Center

Greater emphasis should be given to the indicators of program outcomes and effectiveness by auditing and monitoring. Monitoring should be independent and done by outsiders. Effectiveness should be defined solely in terms of known violations but should be a climate assessment of conditions within the organization to predict the likelihood of future unethical and/or criminal activity.

Epstein, Becker & Green, P.C., for Health Care Industry Clients

Guidelines adequately address that a compliance program must ensure sufficient auditing and monitoring; additionally emphasizing the issue will result in a tacit requirement that organizations must engage outside auditors.

Phillip Morris Companies, Inc.

Guidelines should encourage auditing as a basic element of an effective compliance program and should also note the importance of training for either inside or outside auditors who conduct compliance audits. Requiring specific types of audits or methodologies would detract from the flexibility currently provided by the Guidelines' criteria for effective compliance programs. The Guidelines could suggest types of audits (*e.g.*, process audits or substantive audits) that companies should consider within the context of their overall compliance programs.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

Organizations should be free to adopt auditing and monitoring approaches best suited to their specific needs and to alter their auditing and monitoring strategy as factors such as their experience, changes in industry practice, or new research results suggest the potential for improvements. It may be helpful to add language specifying that systems audits of the organization's compliance program represent one example of an auditing and monitoring technique that organizations may find appropriate to their needs by amending note 3(k)(5) of §8A.2 to read:

> "The organization must have taken reasonable steps to achieve compliance with its standards, *e.g.*, by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents (which may consist of periodic auditing of the effectiveness of the organization's compliance systems, as appropriate) and publicizing a reporting system whereby employees . . . could report criminal conduct . . . without fear of retribution."

Question 1(h): Consistent Discipline and Assessment of Employees' Performance on Compliance

Ethics Resource Center

Supports reinforcement of the positive aspects of consistent discipline; employee evaluations should be more than "check the box" as with the notable exception of Royal Dutch Shell which it posits as a good example (requires Country Chairman to submit an annual letter answering a number of questions regarding numbers of employees trained, joint ventures not undertaken because of failure to meet standards, unique ethical challenges, and plans to overcome them).

Guidelines should expect organizations to make systematic and sustained efforts. Actions of the organization to manage the climate and culture should be observable, measurable, and open to audit. Thorough assessment of senior management (including board of directors) actions regarding exceptions to policy, preferential treatment of employees, selection/promotion practices and disciplinary employee actions should reveal consistency with legal requirements, stated organizational values and ethical business practice.

Phillip Morris Companies, Inc.

Individual companies should be afforded the flexibility to design job performance criteria tailored to the organization's structure and culture, specific job functions, supervisory responsibilities, and other relevant factors.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

These kinds of measures should not become minimum requirements for all of the organizations covered by the Guidelines, without which they will be deemed to have an ineffective compliance programs.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

Section 8A1.2, comment 3(k)(6)'s discussion of discipline should not be expanded to include details such as making compliance an element of employee performance evaluations, because it raises many complicated human resources and labor relation issues with a variety of views on the appropriateness of such strategies.

Question 2: Increase in Culpability Score for Failure to Maintain Effective Compliance Program

Epstein, Becker & Green, P.C., for Health Care Industry Clients

No enhancement for failure to implement an effective compliance program because those organizations will have an increased culpability score because they will not be eligible for the compliance reduction. Implementing the enhancement may result in the compliance reduction being limited to extraordinary programs. Moreover, small companies, for instance, may not warrant a compliance program yet if implemented, the lack of a compliance program would be tantamount to punishable misconduct

Ethics Resource Center

The Guidelines should increase culpability in some manner for companies that fail to have a program that had little likelihood of success or insufficient efforts. Such a negative score would discourage organizations from "going through the motions." Absence of an effort to create an effective program, as well as deceptive efforts to create the appearance of an effective program, should be punished. Deception may even be more worthy of punishment than the absence of a program

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

These kinds of measures should not become minimum requirements for all of the organizations covered by the Guidelines without which they will be deemed to have an ineffective compliance program.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

Guidelines should not increase criminal penalties for organizations that do not implement an effective compliance program. Such amendment would create a new offense with its own penalties. The Guidelines already have provisions for upward adjustments for organizations that tolerated the offense or where high-level personnel participated in the offense or willfully ignored it; separately penalizing an organization for its compliance program would thus be double-counting; not having a formal compliance program is not the equivalent to tolerating or being willfully ignorant of criminal conduct. Further, not every downward adjustment in the Guidelines is accompanied by a "mirror image" upward adjustment; mandating matching upward and downward adjustments for each element would imply a wholesale review of the Guidelines.

Question 3: How to Encourage More Auditing, Monitoring, and Self-Disclosure in Light of Risk of Third-Party Litigation and Enforcement Actions

American Express Company

Clarify comment 3(k)(5) regarding "reporting system without fear of retribution" and make it more specific to encourage the creation of a neutral or Ombuds office for confidential report. This is consistent with Section 301 of the Sarbanes-Oxley Act which requires audit committees of publicly traded companies to "establish procedures for the confidential, anonymous submission by employees . . . of concerns regarding questionable accounting or auditing matters." Ombuds office are an important means of encouraging employees to report concerns without the fear or retribution. Cites internal survey results for support.

Epstein, Becker & Green, P.C., for Health Care Industry Clients

Guidelines already encourage auditing, monitoring, and self-reporting. The Guidelines could, however, specify further benefits beyond a three-point reduction in the culpability score (such as, if the conduct at issue was self-reported, the culpability score could be reduced to zero).

Ethics Resource Center

Support an approach to protect findings of self-audits and monitoring from "random subpoenas" perhaps by limiting availability to indictment and determination of "probable cause" or some other reasoned basis that balances the policy considerations.

Phillip Morris Companies, Inc.

An explicit statement that cooperating with and providing substantial assistance to the government does not require disclosing privileged information would reduce (if not eliminate) the risk that voluntary self-policing could increase an organization's legal exposure and thus reduce the disincentives that now exist for self-policing. The Commission should further support, or at least facilitate a discussion regarding, a self-evaluative privilege relating to compliance activities. Another course of action would be to increase the §8C2.5(f) credit for an effective compliance program and thus encourage organizations to develop and maintain strong compliance programs by increasing the benefits.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

With the exception of clarifying the meaning of "cooperation" (*see* response to question 5), the Guidelines do not have to be revised to encourage auditing, monitoring, or self-reporting.

Guidelines do not need to further emphasize auditing and monitoring. Doing so could incorrectly imply that they are more important than other elements of a compliance program. A great deal of guidance already exists on how to create auditing programs and how to conduct audits.

Question 4 (Generally): Compliance Obstacles Confronting Small and Medium-Sized Organizations

Epstein, Becker & Green, P.C., for Health Care Industry Clients

The second sentence of comment 3(k)(7)(I) should be preceded by a statement indicating that it is only an example or should be modified to include other examples; otherwise, it appears that the only justified difference between small and large organizations is the formality of the compliance program.

Ethics Resource Center

Guidelines could offer small and medium-sized organizations the opportunity to benefit from culpability decreases available to larger organizations by offering evidence of alternative means of meeting stated standards: *e.g.*, formal and informal communications, strategies and programs, employee discipline records, evidence of ethics and compliance as topics of executive briefings, third-party assessments of the culture, etc.

Sidley Austin Brown & Wood LLP, for the American Chemistry Council

As a preliminary manner, these series of questions require significant empirical research. Moreover, attempting to create unique provisions in the Guidelines for small and medium-sized businesses would require the Commission to discern which obstacles are unique to such businesses and draw arbitrary lines between which businesses would qualify for any unique provisions.

Question 4(a): Frequency of Compliance Programs among Small and Medium-Sized Organizations

Epstein, Becker & Green, P.C., for Health Care Industry Clients

A number of the firm's small and medium sized clients have implemented compliance programs. In the health care industry, the OIG has encouraged all organizations to adopt a compliance program.

Ethics Resource Center

ERC's 2000 National Business Ethics Survey assessed likelihood of written ethics standards based on organizational size; percentage with written standards begins to drop sharply among those with fewer than 100 employees.

Question 4(b): Effect of Rebuttable Presumption §8C2.5(f) on Small and Medium-Sized Organizations

Ethics Resource Center

Rebuttable presumption should not be a function of organization's size since evidence required to demonstrate a good faith effort to create an effective program may vary with size.

Phillip Morris Companies, Inc.

Because compliance programs can deter but cannot prevent all misconduct by determined individuals, there should not be a rebuttable presumption that an organization did not have an effective compliance program, unless it is shown that the offense conduct was pervasive (*i.e.*, a significant number of individuals with substantial authority to act on behalf of the organization participated in the misconduct).

Question 4(c): Increase in Culpability Score for Involvement of High-Level Personnel

American Bar Association, Antitrust Law Section
Chicago, Illinois

Reiterated its earlier comments: 1) amend calculation of the culpability score to allow a reduction for maintenance of an effective compliance program despite participation of high-level personnel in the offense, and 2) Guidelines should affirmatively state that waiver of attorney/client privilege and work product protection should not be a factor in determining cooperation reduction.

Ethics Resource Center

Agrees with stated policy. Organization should be understood as increasingly culpable if it creates and sustains leaders who participate in, condone, or tolerate illegal or unethical behavior.

Question 4(d): Application of Rebuttable Presumption of §8C2.5(f) to Large Organizations

American Bar Association, Antitrust Law Section

Amend §8C2.5(f) to eliminate the rebuttable presumption that participation of high-level personnel in an offense means that organization's compliance program was ineffective. In the antitrust context, this rebuttable presumption becomes conclusive because management is almost always involved in pricing authority and thus an isolated act by a single employee in direct contravention of corporate policy eliminates the benefit that should result from a otherwise effective compliance policy. Instead of the current language, this section should read:

> "If there is a dispute concerning whether the organization's program was effective to prevent and detect violations of law, the government must establish the organization's lack of due diligence in seeking to prevent and detect criminal conduct by its employees and other agents."

Ethics Resource Center

Rebuttable presumption of §8C2.5(f) is valuable regardless of size. Burden of proof should rest with organization to demonstrate that program was effective but should be clear that "effective" does not mean perfect.

Question 5: Relationship between Credit for Cooperation and Waiver of Legal Privileges

American Bar Association, Antitrust Law Section

Amend comment 12 to §8C2.5 to state affirmatively that waiver of attorney client privilege should not be a factor in determining whether cooperation reduction is warranted. The following language should thus be added to comment 12:

> "Provided, however, that an organization's decision concerning whether or not to disclose information or material subject to the attorney/client privilege or work product doctrine should not be considered in determining whether cooperation has been thorough or otherwise affect the determination of the sentence to be imposed on the organization."

Epstein, Becker & Green, P.C., for Health Care Industry Clients

The Guidelines should clarify that the waiver of existing legal privileges is not required to qualify for a reduction either in culpability score or as a predicate to a substantial assistance motion by the government. OIG's Voluntary Disclosure Protocol encourage self-reporting without waiver, and the Guidelines should do the same. Preservation of legal privileges is an important public policy objective and will encourage self-disclosure, which in turn will foster settlements rather than protracted litigation.

Phillip Morris Companies, Inc.

An explicit statement that cooperating with and providing substantial assistance to the government does not require disclosing privileged information would reduce (if not eliminate) the risk that voluntary self-policing could increase an organization's legal exposure and thus reduce the disincentives that now exist for self-policing. The Commission should further support, or at least facilitate a discussion regarding, a self-evaluative privilege relating to compliance activities. Another course of action would be to increase the §8C2.5(f) credit for an effective compliance program and thus encourage organizations to develop and maintain strong compliance programs by increasing the benefits.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

These questions involve reducing existing disincentives for vigorous self-policing. Vigorous self-policing can create a documentary road map that can be used against a company yet only exists because of the company's own voluntary efforts. Case law establishes that privileged documents that are voluntarily disclosed to the government are discoverable by private plaintiffs. All of this penalizes voluntary self-policing efforts. Consequently, language should be added to the Guidelines to clarify that cooperating with and providing substantial assistance to the government do not require the disclosure of privileged documents or any documents generated by an organization's bona fide voluntary self-policing activities.

The following language is suggested for §8C2.5, note 12:

> "To qualify for a reduction under subsection (g)(1) or (g)(2), cooperation must be both timely and thorough. . . . To be thorough, the cooperation should include the disclosure of all pertinent information known by the organization. A prime test . . . is whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible . . . . <u>However, "cooperation" shall not be deemed to require the waiver of legal privileges, or to require the disclosure of documents generated by the organization as part of an effective program to prevent and detect violations of law, whether or not such documents are considered privileged</u> . . . ."

The following language is suggested for §8C4.1, note 1:

> "Departure under this section is intended for cases in which substantial assistance is provided in the investigation or prosecution of crimes committed by individuals not directly affiliated with the organization or by other organizations. . . . <u>"Substantial assistance" shall not be deemed to require the waiver of legal privileges, or to require the disclosure of documents generated by the organization as part of an effective program to prevent and detect violations of law, whether or not such documents are considered privileged</u>."

The Advisory Group should recommend that the Commission educate government enforcement personnel about the importance of the self-evaluative privilege in spurring self-policing, perhaps

by sponsoring educational or research programs that could produce a better understanding of this problem and prompt government officials to re-examine counterproductive practices.

Sidley Austin Brown & Wood, LLP, for the American Chemistry Council

Waiving existing legal privileges should not be a factor in determining whether an organization has cooperated with or provided substantial assistance to the authorities. The privileges maintain incentives to audit, monitor, investigate and self-report, all of which are essential to an effective compliance system. Waiving legal rights should not become a standard for measuring cooperation. The privileges promote candid communication, which may be inhibited if the privileges are waived; waiver may also interfere with Guideline provisions that encourage internal investigation and protection of whistleblowing employees. Finally, the Guidelines should not become a platform for diminishing existing legal protections.

Question 6: Role of Ethics Within Organizational Guidelines

Epstein, Becker & Green, P.C., for Health Care Industry Clients

The Guidelines should not be modified to encourage compliance with the intent of regulatory schemes. To begin with, federal health care programs have a very technical regulatory scheme. Moreover, in health care, there are a number of laws and regulations subject to various interpretations of "intent." Thus, compliance needs to remain an objective standard and not further confused by the imposition of a "wholly subjective standard of 'intent.'"

Ethics Resource Center

No specific response.

Phillip Morris Companies, Inc.

Organizations should be encouraged to employ a values-based approach in formulating their conduct and compliance programs. ("Values"-based is a preferred term to "ethics"-based because it is more neutral). In order for a compliance program to become part of a company's culture, senior management must define a set of shared values and standards for conduct.

PricewaterhouseCoopers, LLP, and Arnold & Porter for Pharmaceutical Clients

It would be inappropriate – and unworkable – for the Guidelines to make the adoption of an "ethics-based" approach a criterion for judging the effectiveness of a compliance program, because it would result in cosmetic changes or require more problematic and contentious changes. This approach could essentially punish organizations for failure to comply with the "intent" of a regulatory scheme and fails to recognize that organizations and individuals alike should be able to rely on the actual written regulations as the "best evidence" concerning the intent of a regulatory scheme.

Sidley Austin Brown & Wood LLP, for the American Chemistry Council

The Commission does not function to encourage organizations to create an "ethics infrastructure" "beyond compliance" with criminal law. It should not expand its role outside of the sentencing context and into general issues of corporate social responsibility or ethics that are not directly regulated by federal criminal laws. This is particularly true given that there is no

agreed-upon set of ethical criteria against which organizations can be measured and that can be the basis for setting criminal penalties.

University of San Diego School of Law

The Guidelines should encourage the fostering of ethical cultures because value-based compliance systems result in less unethical conduct. Employee surveys are the most common method for assessing the ethical climate. Other methods for ascertaining organization climates include interviewing employees (particularly exit interviews), conducting employee focus groups, and monitoring employee hotlines. Somehow employees' perceptions of the organizations' ethics and practices should be incorporated into the Guidelines to gauge the organizations' ethical culture. An organizations' ethical culture is reflected in its corporate values, business decision-making, leadership, reward structure, guidance, and monitoring.

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October 11, 2002

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Re: August 21, 2002 Request for Public Comment

Dear Mr. Jones:

On behalf of the American Chemistry Council ("Council"), we appreciate the opportunity to respond to the Advisory Group on Organizational Guidelines to the United States Sentencing Commission ("Advisory Group") regarding its August 21 request for comments on specific questions related to its review of Chapter Eight of the U.S. Sentencing Guidelines ("*Organizational Guidelines*"). We also appreciate the Advisory Group's invitation to participate in the public hearing scheduled for November 14, 2002, and by this letter request the opportunity for a Council representative to testify at that hearing. As requested by the Advisory Group, we will submit written testimony by October 30.

The Council represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make our lives better, healthier and safer. The Council is committed to compliance and good corporate governance through Responsible Care®, common sense advocacy designed to address major public policy issues, and extensive research and product testing. The business of chemistry is a $460 billion-a-year enterprise and a key element of our nation's economy. It is the nation's #1 exporting sector, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other industry.

Before we turn to the specific questions raised in the Advisory Group's August 21 notice, we suggest, as a general matter, that the work of the Advisory Group should be guided by the following principles:

- The *Organizational Guidelines* should continue to be understood and evaluated in the criminal sentencing context -- that is, the jurisdictional scope of the Sentencing Commission -- and

should not be expanded to address more general policy matters, such as general ethical issues.

- The evaluation of the *Organizational Guidelines* and any proposed changes to them should be based on objective evidence and a demonstrable need for those changes by those who implement and use the *Guidelines*.

- The *Organizational Guidelines* should remain capable of being implemented by organizations of any size or sector, and should not become a compilation of "best practices" that many small or medium-sized organizations may not be capable of implementing.

- The *Organizational Guidelines* should not be revised to provide general guidance on designing, implementing or auditing compliance systems. There is a vast quantity of such guidance already available in the marketplace, and it is not the function of the Sentencing Commission to provide such general educational assistance.

We elaborated on these points in our May 20, 2002 comments to the Advisory Group, which are attached to these comments. We also encourage the Advisory Group, in the future, to seek public comment through the Federal Register. It is likely that many potentially interested parties, particularly small and medium-sized businesses, were not aware of the Advisory Group's August 21 posting on the Sentencing Commission's website.

Question 1

The Advisory Group asked for comment as to whether a number of the *Organizational Guidelines* criteria for an effective compliance program (§ 8A1.2, comment 3(k)(1-7)) should be clarified or expanded. As a general matter, we do not believe that the criteria should be expanded or made more detailed. The *Organizational Guidelines* were established to outline factors to be considered in making sentencing decisions, not establish to enforceable standards for compliance programs. As a practical matter, these criteria have come to be viewed as principles for an effective compliance assurance system. Their present level of generality properly leaves it to implementing organizations to fashion the system that best fits their operations, structure and culture. Their generality also allows sentencing courts to apply the criteria on a case-by-case basis.

- Specifying the responsibilities of particular functions (e.g., CEO or CFO), expanding the definitions of "high level personnel," or providing additional comments on what is intended by "specific individual(s) within high-level personnel of the organization" would decrease the flexibility that is currently an outstanding feature of the *Organizational Guidelines*.

- The *Organizational Guidelines* should not provide detail on the responsibilities of boards of directors or equivalent governance bodies in overseeing compliance programs. First, not all organizations, particularly smaller ones, have such governance bodies. Second, the *Organ-*

izational Guidelines already embody the principle that compliance programs should be supervised by "high level" personnel. Third, the issue of director (or equivalent) responsibilities is obviously a topic of considerable federal legislative, regulatory and self-regulatory attention.

Suggesting specific corporate governance responsibilities at the sentencing level could create conflicts with the requirements just created by Congress in the Sarbanes-Oxley Act of 2002 and being implemented or considered by various regulatory and self-regulatory bodies that have primary responsibilities for corporate governance, such as the Securities & Exchange Commission, the New York Stock Exchange and the National Association of Securities Dealers.[1] While many organizations subject to the *Organizational Guidelines* are not publicly traded companies, the same governance issues are currently being considered carefully within such companies, and the Advisory Group should proceed cautiously to avoid creating unnecessary conflicts in this area.

- The flexibility in §8A1.2, comment 3(k)(4) regarding internal communication should be maintained. The use of "e.g." and "or" in this comment provide organizations several options in communicating compliance standards and procedures to employees. For example, not every organization will find that a formal training program is the most effective communications strategy.

- The Advisory Group seeks comment on whether § 8A1.2, comment 3(k)(5), concerning implementing a reporting system without fear of retribution be made more specific to encourage: (i) whistleblowing protection: (ii) a privilege or policy for good faith self-assessment and corrective action; (iii) the creation of a neutral ombudsman office for confidential reporting; or (iv) some other means of encouraging reporting without fear of retribution.

    - More specificity regarding whistleblower protection is not necessary. We agree that whistleblowers must be completely protected from acts of retribution. However, the *Organizational Guidelines* already clearly state that internal reporting should be without fear of retribution. Further, many statutes already provide specific whistleblower protections.[2] Adding more specific whistleblower provisions in the *Organizational Guidelines*

[1] *See, e.g.*, "SEC, NY Attorney General, NYSE, NASD, NASAA Reach Agreement on Reforming Wall Street Practices" (Oct. 3, 2002) www.sec.gov/news/press/2002-144.htm (announcing joint effort to conclude investigations regarding analyst research and IPO allocations and to formulate industry-wide rules and structural reforms to govern in these areas); New York Stock Exchange, Corporate Governance Rule Proposals (submitted to SEC Aug. 15, 2002) (proposing requirements for independent corporate directors, creation of audit committees comprised of independent directors, shareholder approval of equity compensation plans, and adoption of corporate governance standards and code of business conduct and ethics).

[2] *See, e.g.*, Age Discrimination in Employment Act, 29 U.S.C. § 623; Occupational Safety and Health Act, 29 U.S.C. § 660; Job Training and Partnership Act, 29 U.S.C. § 1574; Safe Drinking Water Act, 42 U.S.C. § 300(f)-(j); Surface Transportation Act, 49 U.S.C. § 31105. A compilation of whistleblower laws can be found at www.whistleblowerlaws.com.

might create conflicts with existing substantive laws, be duplicative, or even create loopholes that might result in less protection.

- The Sentencing Commission cannot create a privilege for self-assessments or corrective action. Evidentiary privileges in federal courts are the province of the Federal Rules of Evidence Advisory Committee and Congressional review process.[3] In state courts, such privileges are generally established by either the judiciary or legislature.[4] However, as we note below in response to Question 5, it would be helpful if the *Organizational Guidelines* recognized that organizations should not be required to waive their legally-recognized privileges in order to be deemed to have "cooperated" with government authorities.

- A neutral "ombudsman" is not necessary to an effective compliance assurance program. Indeed, many effective compliance programs are those that are well-integrated into the organization and which senior management is directly supervising. Insisting that a neutral ombudsman is a necessary element of any effective compliance program may create the implication that the real responsibility for compliance oversight lies with an ombudsman, not management, and that management is not to be trusted. It would also be a very burdensome provision for many, if not most, small and medium-sized organizations.

- It is not necessary to increase the emphasis on auditing and monitoring in the *Organizational Guidelines*. These components are already clearly mentioned, and increasing the emphasis on them could incorrectly imply that they are more important than other elements of a compliance program. Further, a great deal of guidance already exists on how to create auditing programs and conduct audits.

- The discussion of discipline in § 8A.1.2, comment 3(k)(6) should not be expanded to include details such as making compliance an element of employee performance evaluations. Linking compliance to employee performance or compensation – while perhaps attractive at first blush -- raises many complicated human resources and labor relations issues. There are a variety of views on the appropriateness of such strategies. Therefore, such a complicated proposal should not be included as a basic element of an effective compliance assurance program.

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[3] *See generally,* 28 U.S.C. §§ 2072-74; I WIGMORE ON EVIDENCE § 6.3 (Tillers rev. 1983 & Supp. 2001-2002).

[4] *See generally,* WRIGHT & GRAHAM, FEDERAL PRACTICE AND PROCEDURE: EVIDENCE § 5422 & n.49 (1980 & Supp. 2002).

Question 2

The *Organizational Guidelines* should not be revised to provide for an increased criminal penalty for organizations that do not implement an effective compliance program.

- To the extent that compliance programs are not required by law, this approach would be using the *Organizational Guidelines* to create a new offense with its own penalties. Only Congress has the authority to create new offenses.[5]

- The *Organizational Guidelines* already have provisions for upward adjustments of criminal penalties for organizations that tolerated the offense or where high level personnel participated in the offense or were willfully ignorant of the offense. *See, e.g.*, § 8C2.5(2). To separately penalize an organization for not having a compliance program would be double-counting in light of these provisions. Further, not having a formal compliance system is not equivalent to tolerating or being willfully ignorant of criminal conduct.

- Not every element of the *Organizational Guidelines* that directs a downward adjustment is accompanied by a "mirror image" upward adjustment. Mandating matching upward and downward adjustments for each element would imply a wholesale review of the entire *Organizational Guidelines*.

Question 3

With the exception of a clarification of the meaning of "cooperation" addressed below in Question 5, the Organizational Guidelines do not have to be revised to encourage auditing, monitoring and self-reporting. Our members recognize the importance of these activities and would be conducting them even in the absence of the *Organizational Guidelines*. Further, the *Organizational Guidelines* clearly direct that such activities are an essential element of an effective compliance program, and we are not aware of anything in the *Organizational Guidelines* that currently creates a barrier to such activities. Lastly, it is not the function of the Sentencing Commission to address whatever disincentives to auditing might be posed by third-party litigation.

[5] Where Congress does require organizations to implement compliance programs or controls, as it has in the recent Sarbanes-Oxley legislation, it may be appropriate to impose penalties for the failure to comply with those specific requirements.

Question 4

The Advisory Group asks a series of questions about the potential obstacles faced by small or medium-sized businesses in implementing effective compliance programs. Many of these questions (e.g., those related to how often small and medium-sized implement effective compliance programs) will likely require significant empirical research. Whatever obstacles such businesses face will not be lessened by increasing the level of detail or complexity in the *Organizational Guidelines*. Further, attempting to create unique provisions in the *Organizational Guidelines* for small and medium-sized businesses would require the Sentencing Commission to be able to discern which obstacles are unique to such businesses and to draw arbitrary lines between which businesses would "qualify" for any unique provisions and which would not.

Question 5

The Advisory Group asks whether § 8AC2.5, comment 12, or § 8C4.1 (which provide respectively for a downward adjustment for "cooperation" with or "substantial assistance" to authorities) should be clarified to state that waiver of existing legal privileges is not necessary in order to qualify for these reductions. We agree that waiving existing legal privileges should not be a factor in determining whether an organization has cooperated with or provided substantial assistance to the authorities.

- Allowing organizations to maintain their existing legal privileges will keep a current incentive for organizations to conduct the auditing, monitoring, investigations and self-reporting that the *Organizational Guidelines* recognize are essential to an effective system to prevent, detect and correct suspected misconduct.

- An organization's degree of cooperation with or assistance to the authorities should not be measured against the extent to which the organization waives or gives up legitimate legal rights.

- Privileges exist for the purpose of encouraging candid communication. Enshrining a principle that would require waiving the privilege may inhibit the candid exchanges the privilege is supposed to promote. This could also potentially conflict with provisions of the *Organizational Guidelines* that encourage internal investigations and the protection of employees who report suspected wrongdoing.

- This modification would be appropriate because it would not change existing legal privileges or establish new ones. Just as the *Organizational Guidelines* should not be a platform for establishing new substantive legal obligations, so should they not be used to diminish existing legal protections.

Question 6

The Advisory Group asks whether the *Organizational Guidelines* should be used to encourage organization to foster "ethical cultures" to ensure compliance with the "intent" of the law as opposed to "technical compliance." Our members certainly support ethical conduct by organizations, and recognize that encouraging organizations to create an "ethics infrastructure" that goes "beyond compliance" with criminal law is a laudable goal. However, that is not the function of the Sentencing Commission.

The principal function of the Commission is to promulgate "detailed guidelines prescribing the appropriate sentences for offenders convicted of federal crimes." U.S. Sentencing Commission, Guidelines Manual, Ch. 1, Pt. A, p. 1 (November 2000). In Section 805(a)(5) of the Sarbanes-Oxley Act of 2002, Congress specifically directed the Commission to ensure that the Organizational Guidelines "are sufficient to deter and punish criminal misconduct." The Commission should not to expand its role outside of the sentencing context and into general issues of corporate social responsibility or ethics that are not directly regulated by the federal criminal laws.

Individuals and organizations are convicted and sentenced because of specific violations of specific statutory provisions. They cannot be convicted or sentenced because they may in some manner be generally unethical or lack integrity, or because they may have violated the intent but not the letter of the law. Thus, the threat of increased criminal penalties should not be used to "encourage" organizations to revise their compliance assurance systems into "ethics programs." The focus of the *Organizational Guidelines* should remain on systems that assure compliance with legal requirements, not ethics programs that may focus on important questions in a wider domain. This is particularly true given that there is no agreed-upon set of ethical criteria against which organizations can be measured and that can be the basis for setting criminal penalties.

We look forward to participating in the hearings on November 14. If you have any questions about these comments, please contact me at 202-736-8111, or my colleague Chris Bell at 202-736-8118.

Sincerely,

David T. Buente

cc: James Conrad
(American Chemistry Council)

[7]

Attachment

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May 20, 2002

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Re: Request for Public Comment

Dear Mr. Jones:

On behalf of the American Chemistry Council ("Council"), we appreciate the opportunity to respond to the request for comments of the Advisory Group on Organizational Guidelines to the United States Sentencing Commission on the nature and scope of its activities as it reviews Chapter Eight ("Sentencing of Organizations") of the U.S. Sentencing Guidelines ("*Organizational Guidelines*"), with particular attention to the criteria for compliance assurance systems.

The Council represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make our lives better, healthier and safer. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and extensive health and environmental research and product testing. The business of chemistry is a $460 billion-a-year enterprise and a key element of our nation's economy. It is the nation's #1 exporting sector, accounting for 10 cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other industry.

We agree that the Advisory Group should, at the outset, clarify the nature and scope of its activities. We believe that the Advisory Group should be guided by the following principles:

[9]

- The *Organizational Guidelines* should continue to be understood and evaluated in the criminal sentencing context -- that is, the jurisdictional scope of the Sentencing Commission -- and should not be expanded to address more general ethical issues.
- The evaluation of the *Organizational Guidelines* and any proposed changes to them should be based on objective evidence and a demonstrable need for those changes by those who implement and use the *Guidelines*.
- The *Organizational Guidelines* should remain capable of being implemented by organizations of any size or sector, and should not become a compilation of "best practices" that many smaller organizations may not be capable of implementing.

We elaborate on these points below. We also encourage the Advisory Group, in the future, to seek public comment through the Federal Register. It is likely that many interested parties were not aware of the Advisory Group's posting on the Sentencing Commission's website.

I. The Organizational Guidelines Should Continue To Focus On Criminal Conduct

The principal function of the Commission is to promulgate "detailed guidelines prescribing the appropriate sentences for offenders convicted of federal crimes."[1] The purpose of the *Organizational Guidelines* is to "further the basic purposes of criminal punishment: deterrence, incapacitation, just punishment, and rehabilitation." Id. In particular, the *Organizational Guidelines* are "designed so that the sanctions imposed upon organizations and their agents, taken together, will provide just punishment, adequate deterrence, and incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct."[2] Therefore, the role of the *Organizational Guidelines* is to address the specific issue of criminal noncompliance with legal requirements and not to expand into general issues of corporate social responsibility or ethics that are not directly regulated by criminal law.

Some of the suggestions raised in the comments submitted to the Commission in response to the Federal Register notice that led to the formation of the Advisory Group[3] would have the Commission expand its charter beyond its authority to address violations of criminal law. For example, requiring an "integrity and ethics based system," however admirable, is not necessarily related to preventing, detecting or reporting criminal conduct. Some commenters are beginning to erroneously refer to "ethics and compliance programs" as if the two concepts are interchangeable or identical. Criminal conduct is defined in a discrete set of federal statutes. Individuals and organizations are convicted and sentenced because of specific violations of specific statutory provisions. They are not convicted or sentenced because they may in some manner be unethical or lack integrity – even if that is the case.

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[1] U.S. Sentencing Commission, Guidelines Manual, Ch. 1, Pt. A, p. 1 (November 2000).
[2] USSG Ch.8 intro. comment.
[3] 66 Fed. Reg. 48306, (September 19, 2001).

The focus of the Commission should remain on systems that assure compliance with legal requirements, not ethics programs that focus on important questions in a wider domain. This is particularly true given that, unlike the defined realm of criminal offenses, there is no agreed-upon set of ethical criteria against which organizations can be measured. Encouraging organizations to create an "ethics infrastructure" that goes beyond compliance with criminal law is a laudable goal. However, the presence or absence of such an ethical infrastructure should not have consequences in the very serious context of sentencing those convicted of crimes.

For example, one commenter urged that the *Organizational Guidelines* be revised to "move this world from 'obeying the law because I have to' to 'doing what is right because I want to,'" recommending that "violations of ethical standards carry penalties similar to the violation of regulatory standards." This comment implies that the Commission has the authority to recommend punishment for acts that have not violated the law. This is asking the Commission to go beyond its mandate and do what only Congress can do. Issues raised by other commenters also go beyond the legal authority of the Commission, such as evaluating the impact of "qui tam" legislation on compliance assurance systems.

The *Organizational Guidelines* are used by courts to sentence those convicted of crimes. Therefore, proposed changes to the *Organizational Guidelines* should <u>always</u> be assessed in terms of how they would be used in the very serious context of sentencing in a court of law. However, almost all of the comments submitted to the Commission thus far treat the *Organizational Guidelines* as a guidance manual or educational tool on how to implement effective compliance systems, and do not discuss how these changes would be implemented in the <u>sentencing</u> context. For example, drawing upon some of the suggestions in the comments submitted to the Commission, should an organization's criminal sentence be adjusted if it:

- has a compliance assurance system that focuses on preventing, detecting and correcting criminal conduct, but does not address "ethics" generally;
- has a compliance officer, but does not have an "ethics officer" who does not have "at least three university level, full – term courses in ethics;" or
- has a system for confidential internal reporting of potential or actual misconduct (e.g., a 1-800 "hotline"), but does not have a "neutral ombudsman?"

In each case, we believe the answer is "no." The current *Organizational Guidelines* properly focus on effective systems directed at preventing criminal behavior.

In the 10+ years since they were first issued, the *Organizational Guidelines* have clearly taken on a significant secondary role as an inspiration and template for the development of effective corporate compliance programs. These programs in turn have frequently grown into, or been merged with, more general programs designed to foster ethical behavior and that extend beyond notions of law-abidance.

This is a good development, whether or not foreseen by Congress or the Commission. But it is not the function that Congress or the Commission intended the *Organizational Guidelines* to accomplish. Nor should the *Organizational Guidelines* be expanded now to encompass these broader but ultimately irrelevant purposes. It is a happy development that the *Organizational Guidelines* are being integrated with aspirational ethics programs. It would be wrong, however, for organizations now to be punished more severely for not having taken these "leading," "best practice" steps The threat of increased criminal penalties should not be used to "encourage" organizations to upgrade their compliance assurance systems into "ethics programs." The *Organizational Guidelines* have considerable consequences in criminal sentencing. Therefore, it is appropriate that they set out general principles and be free of extraneous detail so that they are adaptable to a wide range of organizations. They should also avoid vague aspirational directions that are not directly related to detecting and preventing crime.

II. Proposed Changes To The Organizational Guidelines Should Be Based On Objective Evidence

The process of evaluating and proposing changes to the *Organizational Guidelines* should be based on facts rather than unsupported theory. The factual inquiry should focus on how compliance systems based on the *Organizational Guidelines* have been implemented and performed. Thousands of organizations have invested substantial resources and time implementing compliance systems based on the *Organizational Guidelines*. Organizations will generally feel compelled to overhaul these systems to conform to any changes in the *Organizational Guidelines*, again at potentially significant cost. Therefore, the *Organizational Guidelines* should not be lightly changed, and any change should be supported by facts, including a demonstrated need by the community of organizations implementing them.

The factual inquiry should focus on the performance of organizations that have implemented compliance systems based on the *Organizational Guidelines*. The alleged criminal or unethical activities that currently are high-visibility issues in the media, courts and Congress are not necessarily directly relevant to the Advisory Group's task. General public or political concern about crime or ethics is not evidence that the *Guidelines* are not working or that they need improvement, though it might indicate that more widespread implementation of the *Guidelines* would be beneficial. The issue for the Advisory Group is whether the *Organizational Guidelines* work when they are implemented. We are not aware of any evidence indicating that sentences under the current guidelines have been too lenient, or that current criminal cases have resulted, despite the existence of compliance programs meeting the *Guidelines'* criteria, that would have been prevented if the organization also had an ethics program in place.

As the Commission noted in the Federal Register notice, the "organizational guidelines have had a tremendous impact on the implementation of compliance and business ethics programs over the past ten years."[4] We are unaware of evidence in the docket created for this mat-

[4] 66 Fed. Reg. 48307.

ter, Congressional testimony, or judicial opinions, indicating that the Organizational Guidelines do not work when they are implemented in good faith.. The comments in the docket do not identify any deficiencies in the *Organizational Guidelines* that need to be corrected, or any difficulties that courts or organizations have had in implementing them. Unless its work uncovers compelling evidence that there is a problem to be solved, the Advisory Group should be cautious in recommending changes. Material changes to the *Organizational Guidelines* should only be considered after a showing that the *Organizational Guidelines* are flawed or defective, and that there is a demand in the implementing community for the changes.

III. The Organizational Guidelines Must Remain Practical And Generally Applicable To All Organizations In All Sectors

The *Organizational Guidelines* properly set forth the essential steps that any organization must take to have an "effective program to prevent and detect violations of law." These criteria should remain applicable to all organizations, public or private, large or small, in all industrial and service sectors. Given the diversity of organizations and subject matter covered by compliance programs, the Commission should not attempt to prescribe additional criteria for compliance programs which are not at the same level of general applicability as the current *Organizational Guidelines*.

Any proposed changes to the requirements of the *Organizational Guidelines* should take into account the small and medium-sized organizations that constitute the vast majority of U.S. businesses. The current *Organizational Guidelines* offer the flexibility needed to allow organizations of all sizes and types to implement effective compliance programs. This is not a theoretical concern. The Commission's own statistics reveal that in fiscal year 2000, approximately 87% of organizations sentenced under Chapter 8 employed fewer than 200 persons, a figure that was 94% in fiscal year 1999.[5] In fiscal year 2000, approximately 65% of the sentenced organizations employed fewer than 50 individuals, a value that was almost 80% in fiscal year 1999.[6] Increasing the requirements or detail in the *Guidelines* may create a model that cannot be practically implemented by many small and medium-sized organizations. For example, most organizations are not likely to have the resources to have an "ethics officer," a "compliance officer," and a "neutral ombudsman."

The "best practices" of the most sophisticated companies should not become the model for what all organizations, no matter how small or limited in resources, must do to avoid serious consequences in the criminal justice system. Any time a change to the *Organizational Guidelines* is proposed, the Advisory Group should always consider whether a small business could implement the change and whether it might actually discourage the widespread implementation of compliance assurance systems by such organizations. The "leading edge" organizations that

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[5] *Sourcebook of Federal Sentencing Statistics*, Table 54 (U.S. Sentencing Commission 1999 and 2000).
[6] Id.

have already implemented "best practices" do not need changes to the *Organizational Guidelines* to continue down that path. On the other hand, organizations with fewer resources should be implementing effective compliance assurance systems based on the principles in the existing *Organizational Guidelines*, but should not be potentially subject to increased criminal penalties if they cannot attain a "best practices" level. Indeed, "raising the bar" might have the undesirable effect of discouraging many organizations from attempting to implement effective compliance assurance systems.

The Advisory Group should also take into account the proliferation of sector-specific and public and private sector guidance documents on compliance assurance programs. This is not to say that all of these documents should be incorporated into the *Organizational Guidelines*. To the contrary, the *Organizational Guidelines* should remain generic, applicable to all organizations. The Advisory Group should recognize that a vast literature on compliance assurance systems is available to the user community and that the *Organizational Guidelines* do not have to be revised to address all conceivable compliance assurance system issues.

Many federal agencies have been developing guidance on compliance assurance systems tailored to specific legislative programs. For example, the Department of Health and Human Services ("HHS") has launched a number of compliance assurance program initiatives, including:

- *Model Compliance Plan for Clinical Laboratories,* 62 Fed. Reg. 9435 (March 3, 1997).
- *Compliance Program Guidance For Medicare+Choice Organizations,* 64 Fed. Reg. 61893 (November 15, 1999).
- *Draft Compliance Program for Individual and Small Group Physician Practices,* 65 Fed. Reg. 36818 (June 12, 2000).

In all, HHS has issued compliance program guidance for nine healthcare industry sectors.[7] HHS bases these programs on the Sentencing Guidelines, but tailors them to specific sectors because it "recognizes that there is no 'one size fits all' compliance program."[8] HHS continues to develop tailored compliance program guidance, recently soliciting comments on compliance programs for the ambulance[9] and pharmaceutical industries.[10]

HHS is not alone among federal agencies in developing detailed guidance. For example:

- The Securities and Exchange Commission recently announced a list of factors, including the existence of internal compliance programs and procedures, that it will take into account in deciding whether to prosecute a matter. *Report of Investigation Pursuant to Section 21(a) of*

[7] 66 Fed. Reg. 31246, 31247, n.3 (June 11, 2001).
[8] 65 Fed. Reg. at 36819.
[9] 65 Fed. Reg. 50204 (Aug. 17, 2000).
[10] 66 Fed. Reg. 31246 (June 11, 2001).

the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Co-operation to Agency Enforcement Decisions, (SEC, October 23, 2001).

- The U.S. Department of Justice has developed general prosecutorial policies that take into account an organization's compliance assurance systems and has also developed such policies for particular types of crimes. *Federal Prosecution of Corporations* (U.S. DoJ, June 16, 1999); *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance* (U.S. DoJ, July, 1991).
- The U.S. Customs Service has established compliance programs, such as one encouraging those engaged in international trade to implement programs to comply with the so-called "drawback" customs requirements, 19 C.F.R. § 191.191 *et. seq.*, and an "importer compliance monitoring program," 66 Fed. Reg. 38344 (July 23, 2001).
- The Occupational Safety and Health Administration ("OSHA") has devoted considerable resources to compliance programs, issuing sector-specific guidance such as the *Framework for a Comprehensive Health and Safety Program in Nursing Homes* (U.S. Dept. of Labor/OSHA, January 3, 2001).
- Though the *Organizational Guidelines* do not cover environmental crimes, the U.S. Environmental Protection Agency has provided guidance on what constitutes an effective environmental management system aimed at complying with the law. See, e.g., *Compliance – Focused Environmental Management Systems – Enforcement Agreement Guidance* (U.S. EPA, January 2000); *Incentives for Self – Policing, Discovery, Correction and Prevention of Violations*, 65 Fed. Reg. 19618 (April 11, 2000); *Code of Environmental Management Principles for Federal Agencies*, 61 Fed. Reg. 54062 (October 16, 1996).

In some situations, guidance established by federal agencies has extended to enforceable regulations on compliance assurance systems, such as the detailed, systems-oriented, process safety management regulations promulgated by OSHA.[11]

The private sector has also produced prodigious guidance on designing, evaluating and implementing compliance assurance systems. The past decade has seen an explosion of literature, trade press, conferences, guidance and educational material on not only compliance assurance systems, but also on the more general topic of ethics and integrity programs. This is reflected in the comments the Commission received from organizations such as the Coalition for Ethics and Compliance Initiatives, the Ethics Resource Center and the Alliance for Health Care Integrity.

The growth of interest in compliance assurance systems and ethics programs has not been limited to the United States. For example:

[11] 29 C.F.R. § 1910.119.

- In 2000, the Organization of Economic Cooperation and Development ("OECD"), to which the U.S. belongs, published its revised its *OECD Guidelines for Multinational Organizations*, which establish a "code of conduct" on a range of issues, including labor, bribery, occupational safety and environmental.
- A coalition of private sector and non-governmental organizations has created *Social Accountability 8000*, which applies management systems principles to labor and social issues and is typically implemented in conjunction with accredited third-party auditors to verify conformance.
- The International Labor Organization ("ILO") this year published its *Guidelines on Occupational Health and Safety Management Systems.*
- A number of guidance documents have been developed on implementing systems to identify and meet environmental goals and obligations. These include the International Organization for Standardization's ISO 14001 environmental management systems standard (which has been implemented by over 1,000 facilities in the U.S. and 30,000 world-wide) and a number of sector-specific guidance documents such as the American Chemistry Council's Responsible Care® program and the American Forest & Paper Association's Sustainable Forestry Initiative.

Multi-national organizations that wish to achieve consistent and acceptable levels of conduct world-wide are looking to these and other documents to assist them implement systems that will be effective in the U.S. and abroad. Adding detail to the *Organizational Guidelines* could create conflicts with these other efforts, particularly for multi-national organizations that are developing comprehensive world-wide compliance assurance systems.

This brief review of the landscape on compliance assurance systems reveals that the implementing community does not suffer from an absence of guidance on implementing effective compliance assurance programs. Therefore, the Advisory Group should determine if there is a "market need" for the Commission to provide even more. Indeed, the Advisory Group should consider the potential impact of increasing the level of detail contained in the *Organizational Guidelines* on these various initiatives. Specific guidance on compliance programs has already been developed and continues to be refined in public and private, tailored to the needs and interests of specific areas of regulation. Adding detail to the *Organizational Guidelines* could create conflicts with these other efforts, leading to practical implementation problems.

Thank you for this opportunity to comment on the *Organizational Guidelines*. We look forward to continuing to work with the Advisory Group on these issues. If you have any questions about these comments, you may contact me at 202-736-8111 or my colleague Christopher Bell at 202-736-8118.

Sincerely

David T. Buente

cc: James W. Conrad, Jr. (American Chemistry Council)

[17]

American Express Company
General Counsel's Office
200 Vesey Street
49th Floor
New York, NY 10285

October 4, 2002

United States Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
Washington, D.C. 20002-8002
Attention: Michael Courlander

Re: Responses to Request for Public Comment to Advisory Group on Organizational Guidelines to the U.S. Sentencing Commission

Dear Mr. Courlander:

I am recommending that the Chapter Eight Guidelines' criteria for an "effective program to prevent and detect violations of law" at §8A1.2, comment 3(k)(1-7), be clarified, with respect to comment 3(k)(5), which addresses implementing and publicizing a reporting system that fosters reporting without fear of retribution.

I recommend that comment 3(k)(5) be made more specific to encourage the creation of a neutral or Ombudsperson ("Ombuds") Office for confidential reporting. This recommendation is consistent with Section 301 of the Sarbanes-Oxley Act of 2002 which requires Audit Committees of publicly traded companies to "establish procedures for the confidential, anonymous submission by employees ... of concerns regarding questionable accounting or auditing matters."

Organizational ombuds are independent, neutral, and confidential offices for issue resolution and provide a variety of services, such as coaching, discussing possible options, etc. to employees to assist them in identifying and resolving workplace issues, including concerns over unethical and possible illegal actions. Many employees who contact the ombuds office to discuss issues have been hesitant or unwilling for a variety of reasons to go through internal company channels such as their leaders, general counsel's office or human resources.

Ombuds offices provide additional valuable non-confidential information to an organization's management through trend reports without compromising the confidentiality of employee communications. American Express Company has an Office of the Ombudsperson. In 2001, more than 3,000 employees contacted the Ombuds Office. Eighty-five percent of these calls resulted in a change or information provided to resolve an issue.

In response to a recent survey, 97% of respondents indicated they would use or recommend the Ombuds Office and 95% were satisfied with the office's services. While an Ombuds office does not replace our human resources, legal and compliance departments, it does provide a valuable service to American Express by providing a neutral, confidential environment to report issues that may not otherwise be raised.

Ombuds offices are an important means of encouraging employees to report concerns and suspected misconduct without the fear of retaliation and should be encouraged by the organization guidelines promulgated by the U.S. Sentencing Commission.

Sincerely,

John Parauda

John Parauda
Managing Counsel

SECTION OF ANTITRUST LAW

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AMERICAN BAR ASSOCIATION

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September 25, 2002

Via Federal Express and Facsimile

Advisory Group on Organizational Guidelines
c/o Office of Public Affairs, US Sentencing Commission
Suite 2-500 S. Lobby, One Columbus Circle, NE
Washington, DC 20002

Ladies and Gentlemen:

On behalf of the American Bar Association Section of Antitrust Law, the enclosed comments are being submitted for your consideration in response to your Request for Additional Public Comments on the Organizational Guidelines of the U.S. Sentencing Commission.

Please note that these views are being presented only on behalf of the Section of Antitrust Law and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the position of the American Bar Association.

If you have any questions after reviewing this report, we would be happy to provide further comments.

Sincerely,

Robert T. Joseph

Robert T. Joseph
Chair, Section of Antitrust Law

Enclosure

[20]

RESPONSE OF THE SECTION OF ANTITRUST LAW OF THE AMERICAN BAR ASSOCIATION TO THE REQUEST FOR ADDITIONAL PUBLIC COMMENT REGARDING THE U.S. SENTENCING GUIDELINES FOR ORGANIZATIONS

[21]

On June 27, 2002, the American Bar Association's Section of Antitrust Law submitted comments in response to the Request for Public Comment by the Advisory Group on Organizational Guidelines to the United States Sentencing Commission dated March 19, 2002. The Section included a proposal that the calculation of the culpability score be amended to allow a reduction for the maintenance of an effective compliance program despite the participation of high level personnel in the offense. Also, the Section proposed that the Guidelines affirmatively state that waiver of the attorney/client privilege and work product protection should not be a factor in determining whether an organization's sentence should be reduced for its cooperation with the government.

Both of these issues are reflected in the Advisory Group's recent Request for Additional Public Comment. Accordingly, the Section submits this supplement to its previous comments and responds to specific issues raised by the Advisory Group. Just as before, the views expressed herein are presented on behalf of the Section of Antitrust Law. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and should not be construed as representing the policy of the Association.

I. ISSUES RAISED BY PARAGRAPH 4 OF THE REQUEST FOR ADDITIONAL PUBLIC COMMENT

In Paragraph 4(d), the Advisory Group focuses specifically on the sentencing effect of the participation of high-level personnel in the offense. It asks whether such participation should continue to support a rebuttable presumption that the organization's compliance program was not effective, and, therefore, that the culpability score should not be reduced. Basically, the Advisory Group asks whether § 8C2.5(f) should be amended to change the approach on this issue.

In its initial comments, the Section described how the rebuttable presumption of § 8C2.5(f) effectively becomes conclusive in almost all antitrust prosecutions, and precludes a company from receiving this sentencing consideration. Antitrust offenses are almost always committed by individuals who have management or pricing authority for the organization. The nature of the offense eliminates the possibility that the organization's culpability score will be reduced because of the implementation of a program to prevent and detect criminal conduct. In essence, an isolated act by a single employee that directly contravenes corporate policy can be sufficient to eliminate the benefit that should be realized from a compliance program that is pursued diligently and is otherwise very effective.

This situation is not confined to large companies, nor is it dependent on the size of the organization. Nearly every company will find itself addressing this problem when confronted by an antitrust offense committed by one of its employees. The unfortunate effect of § 8C2.5(f) is to reduce the incentive to implement the compliance programs contemplated by § 8A1.2 which are at the core of the Organizational Guidelines.

The Section proposes that the Guidelines focus on the facts relating to the design, implementation and enforcement of the organization's compliance program. The participation of management personnel in the offense should not be a determinative or overriding issue, particularly in the antitrust context. Thus, the reference to the participation of high level personnel and the rebuttable presumption should be deleted. Instead, this section of the Guidelines should state:

> If there is a dispute concerning whether the organization's program was effective to prevent and detect violations of law, the government must establish the organization's lack of due diligence in seeking to prevent and detect criminal conduct by its employees and other agents.

The Section submits that such an approach would implement a fact-based assessment of the organization's good faith and due diligence, and would not place undue emphasis on what could be nothing more than isolated conduct that was inconsistent with corporate policy and culture. The Section wishes to make clear that the Antitrust Division of the U.S. Department of Justice does not agree with this proposal.

II. ISSUES RAISED BY PARAGRAPH 5 OF THE REQUEST FOR ADDITIONAL PUBLIC COMMENT

In paragraph 5, the Advisory Group focuses specifically on whether an organization should be expected or required to waive its legal privileges in order to qualify for a sentencing reduction because of its cooperation with the government. The Advisory Group asks whether the Guidelines should be amended to reiterate and reinforce the importance and continued need for the protection afforded by the attorney/client privilege and work product doctrine.

In its initial comments, the Section noted that many federal prosecutors require an organization to waive the attorney/client privilege and work product protection to secure the sentencing benefits for cooperation under § 8C2.5(g). Although the Antitrust Division of the United States Department of Justice does not seek or require such a waiver, the issue affects organizations in many other investigations and prosecutions.

The possibility that such a waiver and disclosure will be required in the course of the government's investigation can inhibit the ability of attorneys for the organization to provide legal advice based on a full and candid factual disclosure. Companies may be dissuaded from conducting a thorough internal investigation of alleged wrongdoing, and employees may be reluctant to provide information if they must be concerned that the company eventually will be required to disclose all privileged information it collects to the government. Without such

information from its employees, it is often impossible for a company to obtain all of the facts and engage in a full assessment of their legal significance.

The possibility that disclosure of attorney-client information will be required undermines fundamental objectives of the Guidelines. Organizations may be deterred from conducting thorough investigations because of a fear that information will have to be disclosed to the government which will support not only a criminal proceeding but generate and fuel extensive private civil damage litigation. Virtually all antitrust criminal actions are followed by private damage actions which are potentially more costly to the corporation than the criminal penalties imposed. Also, organizations would refrain from self reporting, including the Antitrust Division's leniency program, which has been an enormously successful vehicle for uncovering major antitrust conspiracies without the requirement of waiver of the attorney-client privilege.

The Section proposes that Comment 12 to § 8C2.5 be amended to state affirmatively that waiver of these legal privileges and protections should not be a factor in determining whether a sentencing reduction is warranted for cooperation with the government. The Section recommends that Comment 12 be amended to include:

> Provided, however, that an organization's decision concerning whether or not to disclose information or material subject to the attorney/client privilege or work product doctrine should not be considered in determining whether cooperation has been thorough or otherwise affect the determination of the sentence to be imposed on the organization.

The Section submits that such an amendment would provide unequivocal support for long standing and well established legal protections, and advance the fundamental objectives of the Guidelines.

III. CONCLUSION

The Section believes a periodic review of the operation of the Guidelines is important, and it appreciates the opportunity to provide these comments. The Section stands ready to provide additional comments or information if requested by the Advisory Group.

University of San Diego
School of Law

October 5, 2002

United States Sentencing Commission
One Columbus Circle, N.E., Suite 2-500
Washington, D.C. 20002-8002
Attention: Michael Courlander

Response to Request for Additional Public Comment
Regarding the U.S. Sentencing Guidelines for Organizations

Dear Advisory Group,

I am a law professor at the University of San Diego School of Law, a former lawyer at the law firm of Sullivan & Cromwell, and a graduate of the Harvard Law School. I am responding to your request for public comment regarding the U.S. Sentencing Guidelines for Organizations. I respond below to Questions No. 6 and No. 1(f)(iii).

No. 6.
(A) Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purposes of the law or regulation?

Yes, I believe that this is very important. Actually, modern ethics and ethical compliance systems within organizations that are adopted by good U.S companies are values-based rather than merely compliance or rule-based systems. Experts in this field support values-based systems. A recent survey found, for example, that ethical compliance programs that are values-driven, that is, are established to adopt a shared set of values to guide behavior lower observed unethical conduct.[1]

It is clear that those organizations that do not have ethical climates contribute to unethical/illegal decision making by their employees. That is, there is substantial evidence in the literature that individual factors are insufficient to explain unethical/illegal behavior. The social environment is a contributing factor that influences four aspects of ethical behavior: "moral awareness" which is

[1]Chris Moon & Clive Bonny, "Attitudes and Approaches," in Business Ethics 29-30 (2001)

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interpreting a situation as raising an ethical issue, "moral decision making" which involves deciding which course of action is morally right, "moral intent" which is deciding that moral values should take priority over non-moral values, and "moral behavior" which constitutes executing and implementing the moral decision. At each step the corporation's climate influences employees.

(B) If, so, how would an organization's performance in this regard be measured or evaluated?

Ethical climates are not difficult to assess. After all, the ethical climate is the employees' perceptions of the corporation's policies and practices as they relate to ethics and ethical behavior. There are a number of methods to ascertain ethical/unethical climate. Employee surveys are the most common. Questionnaires are available from nonprofit groups, such as The Ethics Center, academicians, and businesses who specialize in corporate cultures. These surveys address a number of issues. For example, they may ask whether employees have observed unethical behavior in the workplace (generally and specifically, such as theft, accounting irregularities), whether they perceive their leaders and peers to be ethical and to behave ethically, whether they believe that behaving ethically is consistent and in furtherance of the missions and goals of their organization, and whether unethical behavior is punished and ethical behavior rewarded. Although many organizations have a dominant climate, subgroups within the organization may have different ethical climates which suggests the advisability, in some organizations, of subunit questionnaires.

Other methods for ascertaining organizational climates consist of interviewing employees, conducting employee focus groups, and monitoring employee hotlines. Also, interviewing employees leaving the organization (exit interviews) is particularly helpful. These interviews may also be conducted by outside professionals to obtain unbiased feedback.

(C) How would that be incorporated into the structure of Chapter Eight?

Organizational ethics and ethics compliance is, in essence, part of an "effective program to prevent and detect violations of law." Under existing guidelines, however, there is no reference to obtaining employees' perceptions of the organization's policies and practices respecting ethics and ethical compliance.

Consider, for example, the following brief description that I gave at a recent USD alumni event concerning Enron's ethical culture:

> 1. The philosophy of the company was based on the neoclassical economic view that markets are superior and self-regulating. They tried to simulate a competitive market among employees within the firm. Consistent with this view they believed that rules constrained innovation, creativity and productivity rather than creating a foundation for them.

2. Enron employees were placed in competition with one another with huge rewards for the winners and disgrace and possible firings for the losers. The objective was to book as much profit as possible and to get around the law and company rules to make money. An egregious example is an employee who used 30 million dollars worth of company hardware and enlisted the help of 380 Enron employees to develop a trading system that the CEO was on record as opposing. The employee was not reprimanded because the trading system made money. Employees were judged based on the outcome of their efforts with no attention given to whether ethical means had been used to achieve those outcomes. In addition, contrary to the market model this system became highly political with employees -- when facing precarious futures but the possibility of huge bonuses-- became fearful of criticizing superiors for fear of retaliation -- and there is substantial evidence of retaliation at Enron. As a result of this system, the managers who emerged to run Enron's new businesses were not necessarily the most competent in those businesses, but they were the most competent in playing the game for power and recognition at Enron. Employees became adept at earnings management at Enron for internal reasons -- to maximize the chances for bonuses and to avoid disgrace and firing.

The ethical climate of Enron came from the top. The rhetoric from Kenneth Lay was that the company values were RICE, standing for Respect, Integrity, Communication and Excellence, but it is significant that on the day when internal Enron whistleblower, Sharon Watkins, met with Lay to discuss her allegations of accounting irregularities, Enron's law firm delivered a memo on the "consequences of firing someone who makes allegations of accounting irregularities." After Enron's problem had become public and just before it filed for bankruptcy, Lay knew what to do. He wrote to employees:

-"Enron's values will have more importance in employee evaluations;" and that

-"We are all responsible for how we treat our coworkers and customers."

It was too little -- too late.

I attach as Appendix A to this letter some dimensions that I have found in my research to be relevant to establishing and maintaining an ethical corporate climate. These dimensions concern corporate values, business decision making, leadership, reward structure, guidance, and monitoring.

I will complete my article on this subject in the next couple of weeks and would be pleased to send it to you at that time for any help that it may provide.

No. 1(f) Should 8A1.2, comment 3(k)(5) concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution be made more specific to encourage: ...(iii) The creation of a neutral or ombudsman office for confidential reporting.

I believe that this suggestion has great merit. I recommend that the ombudsman be appointed by the independent directors of the organization, meet standards of independence, serve for a fixed non-renewable term, and receive compensation that is determined by the independent directors and which is a fixed amount and not based on a percentage of the CEO's salary, corporate profits, or stock value of the organization.

Some time ago I wrote an article recommending boards to have a "board ombudsman" to keep the independent directors better informed and to provide, among other things, for "early identification of unlawful or unethical activity." This article is not directly on point because the recommendation was made in connection with the suggestion that corporations establish two boards, a "conflicts board," which would be composed solely of independent directors, to decide enumerated managerial conflicts of interest issues and a business review board, which would consist of independent and non-independent directors, to decide all other issues. However, the part of this article on ombudsmen may be useful if you substitute in your reading the term "independent directors" for "conflicts board." The article may be found in volume 54 of the Washington and Lee Law Review, beginning at page 91, and is entitled "Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson."

If I can be of any further assistance, please do not hesitate to contact me. My e-mail address is dallas@sandiego.edu and my telephone numbers where I can be reached during the day are 619-284-4278 and 619-260-4295.

Sincerely yours,

Lynne L. Dallas

Lynne L. Dallas
Professor of Law

APPENDIX A TO LETTER OF PROFESSOR DALLAS

Values.

Ethical behavior is highly valued in the organization and is as important, if not more important, in business decision making than profits.

The importance of ethical behavior is acknowledged by the leadership and in the organization's reward structure.

Ethical behavior consists of considering the consequences to all organizational stakeholders of business decisions.

The organization supports a values-based approach, not just a rule compliance-based approach, to ethical decision making.

Business Decision Making.

Ethical standards influence business decision making.

Ethical standards are taken into account in day-today decision making by all employees.

Business decisions are framed in ethical terms.

The consequences of business decisions to corporate stakeholders are considered by the employee decision maker.

Employees assume responsibility for the consequences of their decisions. Diffusion of responsibility is avoided.

The employee's role is to consider ethical standards and the consequences of his/her business decision on others.

Employees recognize that business decision should be based on ethical values and not just on compliance with rules.

Leadership

Leaders view their ethical responsibilities as important as any other responsibility that they have for the organization's operations.

Leaders model ethical practices.

Leaders are consistent in their words and actions with respect to encouraging and supporting ethical behavior and discouraging unethical behavior.

Reward structure.

Compliance with ethical standards are included in the assessment of employees for purposes of compensation and promotion.

Ethical behavior is rewarded.

Unethical behavior is not rewarded.

Outcome-based compensation systems that base compensation only on outcomes are rejected in favor of behavior-based compensation systems that also consider the ethical manner in which outcomes have been achieved.

Leaders are held responsible for the ethical/unethical behavior in the business units that they oversee..

There is no retaliation for good faith reporting of violations of ethical standards to appropriate persons within the organization.

Guidance

The organization has a code of ethics that provides guidance to employees in their decision making.

The organization's code of ethics contains guidance respecting common ethical dilemmas faced by employees.

The organization's code of ethics is distributed to all employees, including managers and lower-level employees.

Employees know whom to seek guidance from in the organization concerning ethically ambiguous situations and are encouraged to seek such guidance.

The organization provides employee training programs that provide opportunity for employee discussions and role playing and that are tailored to deal with business ethical dilemmas relevant to the employees involved.

The organization's training programs attempt to make employees self-aware of factors leading to unethical decision making.

Monitoring

A person with authority and high status in the organization has primary responsibility for gathering information, monitoring and reporting on ethics and ethical compliance within the organization and recommending changes in the corporation's policies and practices as they relate to ethics and ethical compliance.

The board of directors or a board committee periodically reviews reports, discusses, and makes decisions concerning organizational personnel, policies and practices relating to ethics and ethical compliance within the organization.

The organization periodically makes a self-assessments of its ethics, ethical climate, and ethical compliance record.

The organization conducts employee surveys that apply to the organization as a whole, divisions, departments and other relevant sub-unit, and employees at various levels and job-classifications within the organization.

The organization interviews employees, particularly on their exiting the organization, and conducts employee focus groups, to assess ethics and ethical compliance within the organization.

The organization provides a method for employees to report violations of the code which method provide for their anonymity.

The organization's employees periodically acknowledge their understanding and compliance with the organization's code of ethics.

The organization's leaders periodically certify that:

!. Ethical behavior is highly valued in the organization and is as important, if not more important, in business decision making than profits;.

2. The organization's climate encourages and supports ethical decision making by employees;

3. Ethical decision making is rewarded, and unethical decision making is not rewarded, in the organization: and

4. A reasonably system is in place to review, monitor and modify if necessary the corporation's ethical climate.

The organization when deemed advisable seeks outside audits and advice on the organization's

ethics and ethical compliance.

The reference to "employees" include the managers of the corporation. The reference to "organizations" include divisions, departments or other relevant sub-units of the organization.

October 5, 2002

United States Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
Washington, DC 20002-8002

Attention: Michael Courlander

Among the several purposes of the Sentencing Guidelines are to punish wrongdoers and to deter others from engaging in wrong conduct. Companies, their executives and board members need to be particularly attentive to these issues in light of the Guidelines and the recent events implicating numerous companies, their executives and board members. There must be a shared sense of urgency to ferret out wrongdoing and remediate any environment that has permitted it to occur.

In these efforts a potentially significant impediment is human nature. History tells us that there is a reluctance for an employee to report potentially wrong conduct by a co-employee or more particularly a supervisor or manager. Whether that is attributable to a perceived loyalty, fear of retaliation or any other human barrier is irrelevant if we accept the proposition that it exists. The question then becomes how to get past the barrier.

A neutral, confidential conduit for information, one which assures the anonymity of the information source, properly constructed, recognized and implemented can be a critical element in an overall corporate governance plan to break down the barrier. Such a conduit is available through an Office of the Ombuds. This Office has an established and highly regarded history in Europe, the United States and elsewhere. The greatest compliment to its effectiveness in the U.S. is its adoption by corporations and public institutions. This Office offers a unique mechanism to surface issues of perceived or actual wrongdoing to the appropriate internal corporate investigatory body, i.e., Audit, Security, Legal, while maintaining the confidentiality and, if requested, anonymity regarding the individual surfacing the matter. Traditional channels of management cannot provide these offerings.

The unique characteristics of the Office of the Ombuds contribute to the effectiveness of an overall corporate government plan by offering an early warning capability, a resolution capability and, in tandem, a mitigating factor in the sentencing process. Numerous states within the United States, agencies within government, a number of large corporations and now Congress through the Sarbanes Oxley Act of 2002 have recognized and endorsed the value of the Office of the Ombuds. Its existence as well as usage by employees and entities outside the corporation, e.g., suppliers and customers, are testament to the value of this function.

Eastman Kodak Company would welcome the opportunity to provide testimony relative to this subject.

Very truly yours,

A. Terry VanHouten

A. Terry VanHouten
Eastman Kodak Company

ATV:ddl

[35]

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ETHICS RESOURCE CENTER

Our Vision is an Ethical World

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October 4, 2002

United States Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
Washington, D.C. 20002-8002

Attn: Michael Courlander

Dear Mr. Courlander:

The Advisory Group on Organizational Guidelines to the United States Sentencing Commission requested additional public comment prior to preparing its report to the United States Sentencing Commission.

The Ethics Resource Center's comment based on the Advisory Group's questions is attached. A copy has also been sent electronically to pubaffairs@ussc.gov as requested.

Thank you for the opportunity to participate in this important process.

Sincerely,

Patricia J. Harned

Patricia J. Harned, Ph.D.
Managing Director of Programs

[36]

Public Comment From the Ethics Resource Center (ERC) Regarding the U.S. Sentencing Guidelines for Organizations

For the past several months, the Advisory Group on Organizational Guidelines to the United States Sentencing Commission has received public comments and has undertaken its own initial evaluation of both the terminology and application of Chapter Eight of U.S. Sentencing Guidelines for Organizations. As part of their work, the Advisory Group identified a series of concerns and created a list of key questions to focus and stimulate additional public comment.

As one of the oldest non-profit business ethics organizations in the United States, the Ethics Resource Center has earned international recognition for its expertise in implementing organizational ethics and compliance programs. The following constitutes the ERC's response to the Advisory Group's questions.

Questions

1. Should the Chapter Eight Guidelines' criteria for an "effective program to prevent and detect violations of law" at §8A1.2, comment 3(k)(1-7), be clarified or expanded to address the specific issues designated below? If so, how can this be done consistent with the limitations of the Commission's jurisdiction and statutory authority at 28 U.S.C. §994 *et. seq?*

a. Should §8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO, and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2), further define what is intended by "specific individual(s) within high-level personnel of the organization (*see also,* §8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"

ERC Response

The guidelines should, as a minimum, follow the responsibilities outlined in the Sarbanes-Oxley Act of 2002.[1]

CFOs and other high level personnel should adhere to what is required of them under the FSGO and Sarbanes-Oxley. The current statement in Chapter Eight Guidelines requiring these persons to "...oversee compliance with such [compliance] standards (as the organization has established)" is too vague given the severity of the consequences of failure to meet the standard.

[1] President George W. Bush signed the Sarbanes-Oxley Act of 2002 into law on July 30, 2002.

The Sarbanes-Oxley Act of 2002, on the other hand, specifically delineates the responsibilities of high-level personnel. Section 906 of Sarbanes-Oxley states what certification CEOs and CFOs must make and what punishments are possible on an individual basis if as (high-level personnel) they willfully violate the provision. The level of clarity achieved ties specific acts to potential punishments in very vivid fashion.

In essence, this legislation requires business executives to attest to the integrity of their organizations. Such an outcome is only possible if ethics and compliance programs receive oversight beginning at the top. While exceptional business models do develop reporting structures of this nature on their own, it should be expected that the vast majority of organizations will require encouragement through legislation and enforcement.

The requirement to oversee should be coupled with the responsibility to report the results of the oversight to the Audit Committee of the Board. This suggests that the designated person(s) need direct and unfettered access to that committee. There is a further implied notion that this person(s) should also have direct and unfettered access to the CEO and CFO. This would be a difficult reach today for many such designees (ethics officers) because their positions in the organizational hierarchy distance them from the CEO/CFO/Audit Committee by several levels of management.

b. To what extent, if any, should Chapter Eight specifically mention the responsibility of Boards of Directors, committees of the Board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?

ERC Response

These provisions in Chapter Eight go a long way toward specifying the responsibilities of Boards, Audit committees and of senior management. Nevertheless, we advocate going a step further. The provisions should underscore the fiduciary responsibility of the board and audit committee. The provisions should comment on the inherent conflicts of interest of those charged with such oversight responsibilities and should focus on the need for audit committee members to be independent directors in all regards.

This is somewhat an articulation of §301 of the Sarbanes-Oxley Act that states that each member of the audit committee shall be a member of the board of directors of the issuer, and shall otherwise be independent. In the meaning of Sarbanes-Oxley, "independent" means not receiving, other than for service on the Board, any consulting, advisory, or other compensatory fee from the issuer, and not being a person affiliated with the issuer, and/or any subsidiary of the issuer.

c. Should modifications be made to §8A1.2, comment 3(b) (defining "high-level personnel" and §8A1.2, comment 3(c) (defining "substantial authority personnel")? Should modifications be

made to §8C2.5, comments 2, 3 or 4, relating to offenses by "units" of organizations and "pervasiveness" of criminal activity?

ERC Response

The current definition describing various personnel with responsibility for ethics oversight is adequately clear in terms of who they are. What is not as clear is the ease of access such personnel have to the CEO, CFO and Audit Committee of the Board (or Board as a whole, if there is no such committee). Access to the ultimate authorities and responsible parties must be clear and unfettered, especially in the case of "substantial authority" personnel and units of an organization other than those under the direct oversight of those personnel (this ties back to our answer to Question 1(a).)

d. Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?

ERC Response

Some modification/clarification is called for but the ERC review group is uncertain what the eventual language should address. In fact, review of this section raises even more questions that need to be answered. For example:

- How does one determine a "propensity to engage in illegal activities?" Does a prior criminal record indicate such a propensity? Does considering a criminal history unrelated to fiduciary misconduct or white collar crime constitute a form of discrimination that can be legally challenged? Are there observable organizational behaviors indicating a climate exists that *supports* individuals with a propensity to engage in illegal activities?

- Should the reference also require that the person deemed competent and to whom substantial discretionary authority is granted demonstrate necessary skill, knowledge and judgment to be entrusted with that authority? In other words, is freedom from propensities to engage in illegal activities enough or should other demonstrated skills, knowledge and abilities be required?

- Consideration should be given to replacing the word "propensity" with a term or description that more clearly describes the concern. Does the issue one of conflict of interest coincide with the opportunity and means to act illegally? Should there be a corresponding requirement that calls for a greater amount of independent oversight of individuals?

- Does the inclusion of an ill-defined criterion in some way weaken the entire set of guidelines?

The whole question of determining propensities to engage in illegal activities has been frequently visited in popular culture, in addition to the business context. It is not wholly unrelated that in science fiction (most recently in the film *Minority Report*) questions of morality and legality have been raised, particularly with regard to actions that are reasonable to expect, given a propensity for certain types of behavior. Whereas in fiction the attempt to determine such propensity and predict future criminal activity on an individual basis always fails, in business and law, we cannot necessarily come to the same conclusion.

Recent research into the ethical climate of organizations indicates there are at least three readily identifiable indicators which may predict the presence of misconduct or of a climate that supports misconduct within an organization. This is discussed further in the ERC response to Question 1(g) on page 7 of this document.

e. Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently, §8A1.2, comment 3(k)(4) provides:

"The organization must have taken steps to communicate effectively standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required "(emphasis added).

"The use of the "e.g." can be interpreted to mean that, "training programs" and "disseminating publications" are illustrative examples, rather than necessary components of "communicating effectively." The use of the word "or" can be interpreted to mean that "training programs" and "disseminating publications" are alternative means for satisfying the "communicating effectively" requirement.

Should the preceding language be clarified to make clear that both training and other methods of communications are necessary components of "an effective" program? If so, should the term "disseminating publications" be replaced by more flexible language such as "other forms of communications"?

ERC Response

Specific methodologies are less important than required measurable outcomes. The goals for effective communication and training are to:

- Maintain a heightened awareness among all employees about the performance expectations of the organization regarding ethical business practices. This includes awareness of the means to clarify individual understanding or report misconduct.

- Develop and reinforce ethical business behaviors among individuals and groups. Training-related social science goes against the notion that there is a "best" training methodology. For at least fifty years there has been an understanding that there are a variety of "learning styles" which then necessitate a variety of teaching styles.

For example, in 1984 David Kolb identified four types of learners in *Experiential Learning: Experience as the Source of Learning and Development.*[2] Kolb postulated that individual learners develop preferred learning styles based on the manner in which they perceive and process information:

- **Activists** – These individuals learn best through active experimentation and prefer to have material presented in small group activities, group discussions, reading assignments and through peer interaction.

- **Pragmatists** – Pragmatic learners absorb material best when it is presented in laboratory situations, through observation or in real life field events.

- **Reflectors** – The Reflective learner seldom takes anything at face value. Reflective learners tend to look at trainers or facilitators as "experts" and want them to serve as authorities that are providing guidance.

- **Theorists** – Theorists prefer to discover how concepts relate rather than being told what relationships exist. They like to think about what they are being asked to learn and find a high-level of group or instructor interaction to be of little benefit.

Other theories of learning exist including the VAK Learning Styles (Vision, Auditory and Kinesthetic)[3], the Myers Briggs Type Indicators[4] and Howard Gardner's Multiple Intelligences.[5] Regardless of which model you select, the common thread is that people learn differently and, to be universal and successful, all training programs and/or disseminating publications need to consider the differences in ways people learn.

The guidelines would be better suited to define desired or required outcomes – e.g. awareness of a company code, familiarity with the code's content, familiarity with what constitutes a violation of the code, awareness of how to integrate the code into one's decision making processes, awareness of the resources provided by the organization for obtaining clarification of code provisions, means for reporting suspected violations of the code, etc., rather than specifying training modalities.

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[2] Kolb, David A., *Experiential Learning: Experience as the source of learning and development.* New Jersey: Prentice Hall, (1984).

[3] The Visual Auditory Kinesthetic Learning Model is widely accepted although statistics concerning the percentages of individuals in each of the designated learning styles has not been scientifically validated.

[4] Thorne, Alvin and Gough, Harrison, *An MBTI Research Compendium*, CAPT, Gainesville, Florida, (1999).

[5] Gardner, Howard, *Frames of Mind: The Theory of Multiple Intelligences,* Basic Books, New York, (1993).

However, some consideration should be given to acknowledge that training and communications need to be multi-dimensional to meet varying learner needs.

Regarding the use of training programs or disseminating publications – use of "or" would give the option, but "disseminating publications" is too limiting. We believe that both are needed, but that even together they remain insufficient.

- Publications can help to inform and maintain awareness.
- Effective training can change and reinforce behavior to be consistent with ethical business practices.
- However, organizational systems that select personnel for positions, measure and reward performance, and fund organizational activities further communicate and educate what the organization values and expects.

All of these forms of "communication" are necessary for a program to be deemed "effective." Training, communications and organizational systems must be congruent and all are needed to ensure desired behavior is achieved.

Ultimately, must to be clear in this section is that the organization has an affirmative obligation to ensure that every employee understands what is required or expected and has obtained the knowledge, skills and abilities necessary to meet the desired performance expectations

It is not enough to require compliance... a support mechanism has to be in place to make compliance possible. Employees need to be made aware of the resources available to support ethical decision-making and know how to utilize those resources when they are faced with an ethical dilemma or decision.

Any contradictory messages from leadership, training, formal and informal communications, systems or operational practices need to be identified and amended so that the message is consistent. Once this is accomplished, the communication about ethical expectations can be considered effective absent empirical evidence to the contrary.

f. Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage.

   i. Whistle blowing protections;
   ii. A privilege or policy for good faith self-assessment and corrective action (e.g., 15 U.S.C. §1691 (c) (1); (1998);
   iii. The creation of neutral or ombudsman office for confidential reporting or,
   iv. Some other means of encouraging reporting without fear of retribution?

[42]

· ERC Response

All four criteria mentioned deserve consideration. Effective programs need not have all four – but if they have fewer it is incumbent upon the organization to provide evidence that the system is safe and effective for whistleblowers to use and that employees see it that way as well.

To better identify potential ethics issues and to reduce the risks associated with them, organizations rely on employees to report the misconduct they observe and to raise their ethics concerns. However, for various reasons, employees are often unwilling to take such actions. Research on whistle blowing within the Federal Government suggests that the top two reasons employees fail to report misconduct are: (1) a belief that nothing will be done and (2) fear of retaliation.[6]

There are similar findings regarding employees in businesses and other organizations. Two in five employees do not report the misconduct they observe. Senior and middle managers are more likely to report misconduct than are lower level employees.[7]

The reporting issue has been extensively researched within the ERC Fellows program and the results of that research published in 1999.[8] Among other suggestions were protection of the identity of a reporting source from discovery, ability of an organization that has an in-house reporting system to assert protection on behalf of the reporting source, and discretionary exception to the rule for disclosures necessary to protect life or property.

As for the four items cited in §8A1.2, comment 3(k)(5), a caveat should be included for multi-national organizations or those with foreign subsidiaries or partners.

Reporting systems in certain parts of the world are greatly divergent than ours. For example, former communist states are still very sensitive to the impact of the KGB. Reporting based on their past experience may have dire consequences and is often assiduously avoided. In parts of Europe and Africa the embedded culture sees reporting as a sign that the individual lacks a network of trusted colleagues and, therefore, the report itself may not be trusted or accepted as valid.

In other cultures, there are boundaries (e.g., it is acceptable to report to a family member or trusted elder but not an employer), which may make communication of a concern more roundabout than is common in U.S. culture. A recent experience with a focus group in mainland China indicated a total reluctance on the part of employees to criticize their "employer" or employer practices in any way. While participants

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[6] U.S. Merit Systems Protection Board, "*Whistleblowing in the Federal Government: An Update*," October 1993, p.13.

[7] Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

[8] See sample text from the *ERC Fellows Model Reporting Source Protection Act* that is attached to this document.

were willing to talk about routine matters, requests for information that might be construed to be critical were met with stony silence.

All this suggests that reporting may be encouraged, but as we employ a multi-cultural workforce or operate outside the U.S., we are likely to encounter resistance to the process, and alternative processes should be considered. That consideration should include giving the company equivalent credit if their alternative can be shown to be reasonably effective in the context of their culture.

g. Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?

ERC Response

Yes, greater emphasis should be given to auditing and monitoring – especially those indicators of program outcomes and effectiveness, not just whether programs are in place.

Monitoring should be done, but it should be done independently from outside the organization – not by the organization itself – to ensure an impartial and thorough examination.

Further, effectiveness should not be defined solely in terms of known violations. Rather, there should be a climate assessment of conditions within the organization to predict the likelihood of future unethical and/or criminal activity.

In the 2000 National Business Ethics Survey (NBES)[9], the ERC collected reliable data on key ethics and compliance outcomes for use in benchmarking by interested organizations. The data help identify and better understand ethics issues that are important to employees within the United States.

In organizations where employees see values applied frequently, there are fewer instances of misconduct at work. Employees feel less pressure to commit misconduct and are more satisfied with their organizations.

As a corollary, NBES 2000 provides statistical evidence that the opposite conditions serve as three predictors of unethical/criminal conduct: job dissatisfaction, awareness of unethical/illegal conduct by others, and pressure to perform illegal acts or violate organizational standards.

[9]Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

The effect of finding these predictors in an organization is cumulative:

- The presence of any one is a concern.
- The presence of any two is a warning.
- The presence of all three is cause for serious concern about an organization.

There are also valid baseline data regarding factors that influence employee conduct: trust in one's leadership, existence of double standards and the belief that one's immediate superiors are dishonest.

These types of behaviors should be monitored, measured and used in conjunction with criteria such as the perceived effectiveness and safety of using the organization's reporting systems.

Over time, comparison of a combination of those results will generate even stronger statistical evidence about the thresholds of program effectiveness, without necessarily having to experience actual criminal conduct.

h. Should §8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, e.g., should there be credit given to the organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected rewards and compensation?

ERC Response

Yes. We would encourage the reinforcement of the positives, not just punishment of the negatives. Experience with hundreds of organizations suggests that this is easier to conceptualize than to put into action. Very few organizations have effectively implemented employee evaluations that included anything more significant than a check box on ethics and compliance – check if there were no reportable violations.

A notable exception is Royal Dutch Shell. Shell has required each of its 168 Country Chairmen (CC) to submit an annual letter to his/her Managing Director answering a number of questions regarding the effectiveness of implementing Shell's General Business Principles (SGBP) in his or her particular country.

The annual letter includes several items such as: numbers of employees trained, joint ventures or partnership not entered into because the potential partner failed to meet SGBP standards, unique challenges, and plans to address the challenges. The letters and subsequent one-on-one interviews with Country Chairmen are a significant

portion of the CC's performance evaluations. The Country Chairmen promulgate the process throughout lower levels of management.

2. While the Chapter Eight Guidelines currently provide a three-level decrease in the culpability score of organizations that are found to have implemented an "effective program to prevent and detect violations of law" (at §8C2.5(f)), should this provision be amended to provide an increase for organizations that have made no efforts to implement such a program? If so, what is the appropriate magnitude for such as increase?

   ERC Response

   Yes, and more so. Culpability should increase for creating a program that had little likelihood of success or for which there were insufficient efforts made to determine the probability of, or ensure the actuality of, success.

   Such an increase in culpability would discourage organizations from "going through the motions" and creating the appearance of having an effective program. A typical example of such "appearance" programs is found in the many organizations that require employees to sign a form attesting to having received, read and understood the code of conduct, when in fact no such thing happened. Employees are all too often coerced by their immediate supervisor to "just sign the paper."

   The same holds true for ethics training – there is anecdotal evidence in many organizations that pressure is exerted to sign a form attesting to attending a training session when in fact the employee did no such thing.

   The absence of an effort to create an effective program, as well as deceptive efforts to create the appearance of an effective program, should be punished. Perhaps the deception is even more worthy of punishment than absence of a program.

   If the program is ineffective, it should be treated as if the organization has no program and has not made a good faith effort to create one.

   The magnitude of the punishment should be sufficient to encourage good faith efforts. Since a three-level decrease in the culpability score is specified in §8C2.5(f), it would seem appropriate to call for a three-level increase for deliberate attempts to circumvent the requirement for "effective program to prevent and detect violations of law."

3. How can the Chapter Eight Guidelines encourage auditing, monitoring and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?

ERC Response

It may be possible to encourage self-audits and monitoring but protect those findings from "random" subpoenas. Perhaps the solution would be to ensure that such data can only be "discovered" through an indictment and the presumption of probable cause.

If prosecutors are allowed to access these data on "fishing expeditions," there would continue to be great reluctance to conduct and document such self-audit or monitoring efforts. For more information, the ERC Fellows report on "privilege" addresses this issue.[10] See Attachment A.

4. 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)(7)(I) adequately address them? If not, how can Chapter Eight better address any unique concerns and obstacles faced by small and medium-sized organizations? What size organization requires unique/special treatment (e.g., 50 employees, 200, 1000, 5000)?

ERC Response

Chapter Eight could offer small and medium-sized organizations the opportunity to benefit from the culpability decreases available to larger organizations by offering evidence of alternative means of meeting the current stated standards. If they can demonstrate effective efforts made to ensure an ethical and compliant work environment and business culture, the specific program elements might be less of an issue than the evidence of a good faith effort to create such a culture.

Evidence of such culture initiatives could include: formal and informal communications; strategies and programs; employee discipline records; evidence of ethics and compliance as topics of executive briefings, staff meetings and other employee gatherings; as well as evidence of how employee reports of questions and/or concerns were handled. Third party assessments of the culture, employee survey data on several standardized ethics and compliance questions, or other records of how ethics concerns were surfaced and addressed could be used as well.

a. How frequently do small and medium-sized organizations implement "effective programs to prevent and detect violations of law" within the meaning of Chapter Eight of the Sentencing Guidelines? If the frequency is low, to what factors is this attributable, and how may Chapter Eight be modified to promote increased awareness and implementation of effective compliance programs among small and medium-sized organizations?

[10] See sample text from the *ERC Fellows Model Reporting Source Protection Act* that is attached to this document

ERC Response

The ERC's 2000 National Business Ethics Survey[11] assessed the likelihood of written ethical standards based on organizational size. What size organization requires unique/special treatment (e.g., 50 employees, 200, 1000, 5000)?

We found:

Number of Employees	% Organizations with Written Ethics Standards
2 – 24	54%
25 – 99	76%
100 – 500	86%
500 – 1,999	89%
2,000 – 9,999	93%
10,000 or more	95%

As can be seen in this chart, the percentage of organizations with written standards begins to drop sharply among those with fewer than 100 employees. What may differ most dramatically between organizations with fewer than 100 employees and those with more than 100 employees is the amount of formalized communications about ethics programs. Communications may be less formal in smaller organizations and the presence of supporting infrastructure may not be necessary. Similar patterns have been found regarding organizations that provide ethics training and mechanisms for obtaining ethics advice.

b. According to §8C2.5(f), if an individual within high-level personnel or with substantial authority "participated in, condoned, or was willfully ignorant" of the offense, there is a rebuttable presumption that the organization did not have an effective program to prevent and detect violations. Does the rebuttable presumption in §8C2.5(f), for practical purposes, exclude compliance programs in small and medium-sized organizations from receiving sentencing consideration? If so, is that result good policy and why?

ERC Response

The rebuttal presumption should not be a function of organization size. What may vary with size is the evidence required to demonstrate a good faith effort to create an effective program. As stated immediately above, the components of a program that are likely to prove effective may differ with organizational size. But program components, that are deemed reasonably likely to be effective afford small and

[11] Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

medium-sized organizations the same protections and rebuttable presumptions as the components specified for larger organizations.

c. In addition to the rebuttable presumption in §8C2.5(f), and §8C2.5(b), also provides an increase in the culpability score (from 1 to 5 points) where an individual within high-level personnel or with substantial authority participated in, condoned, was willfully ignorant or tolerant of the event. Is that good policy and why?

ERC Response

We agree with the stated policy. Leaders create organizational culture by their actions and by their inactions. When "an individual within high level personnel or with substantial authority participated in, condoned [or] was willfully ignorant or tolerant of" an offense, that person communicates to all employees who are aware of the action what the organization will condone, tolerate and/or expect. If that action (or inaction) is not punished, it is reasonable to expect that a recurrence of such behavior becomes more likely.

The nature of leadership is that leaders are, and should be, held to a higher standard, not an equal or lesser standard, since they are role models and shape the culture of organizations. The organization should be understood as increasingly culpable if it creates and sustains leaders who choose to participate in, condone [or] be willfully ignorant or tolerant of illegal or unethical behavior.

5. Should the rebuttable presumption in §8C2.5(f), continue to apply to large organizations and, if so why?

ERC Response

The rebuttable presumption is valuable regardless of organization size as indicated above. What may vary with size is how the necessary elements of an "effective program" are defined. Criminal or unethical conduct is sufficient grounds for presumption that the ethics program was not effective.

The burden of proof should reside with the organization to demonstrate that the program was effective, and that the criminal act in question could not reasonably have been prevented, despite the presence of an effective program. That presents a difficult challenge because one could be argued that an offense is proof positive of a program's lack of effectiveness. We would argue that "effective" does not mean "perfect". Every program has limits and a determined individual can often subvert or work around even the best-designed and best-intentioned program.

6. Should the provision for "cooperation" at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in

culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?

ERC Response

The ERC does not have responses to the questions raised regarding paragraph §8C2.5, comment 12 and/or §8C4.1.

a. Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?

ERC Response

We agree that the FSGO should expect organizations to make systemic and sustained efforts to form an organizational culture and climate that fosters ethical business practices and ethical employee behavior. The behaviors of individuals within organizations are strongly affected by the perceived and real expectations of peers and supervisors.

These expectations are formed over time and are based upon personal experience of behavior that is modeled, punished and/or rewarded. One's understanding of what is modeled, rewarded and punished forms his or her belief of what is truly valued by the organization. This belief system often leads the individual employee to act upon assumptions and without reflection. The ultimate goal of compliance efforts should be to instill belief systems that nurture performance expectations to act ethically.

Actions of the organization to manage the climate and culture should be observable, measurable and open to audit. There should be a demonstrated alignment of the organization's mission, goals, values, code of conduct, policies, compliance activities and performance management with integrity as a foundational element.

A thorough assessment of senior management's (including the Board of Directors) actions regarding exceptions to policy, preferential treatment of employees, selection/promotion practices and disciplinary employee actions should reveal consistency with legal requirements, stated organizational values and ethical business practice.

ERC Fellows Model Reporting Source Protection Act

Model 1: Reporting Source Protection Act

Overview:

The scope of Model 1 is the protection of the identity of a reporting source from discovery, both from within and outside the organization. This proposed privilege would shield the reporting source's identity from being discovered in any civil, administrative, legislative or criminal proceeding or hearing. This proposed privilege would also relieve the organization from the obligation of having to confirm in the course of such litigation that the reporting source utilized an in-house reporting system. This Model, however, does not protect from disclosure the substance of designated communications to an in-house reporting system.

Model 1 protects only the identity of a reporting source who did not participate in the wrongdoing and who uses an in-house reporting system in good faith. This protection is analogous to aspects of the Confidential Informant (CI) privilege long enjoyed by the government to aid law enforcement and recognized by the United States Supreme Court in *United States v. Roviaro*, 353 U.S. 53 (1957). The CI who is not a wrongdoer but merely an observer of potential illegal activity may be reluctant to provide evidence that will be attributed to him or her, frequently because of a concern for personal safety. Under the CI privilege, the government uses the information from the CI to initiate its investigation and develops independent evidence to corroborate the CI's allegations. The government then prosecutes the case based on this independent evidence without needing to divulge the identity of the CI who provided the initial "lead." While this Model does not preclude an organization from taking disciplinary action against an employee based solely on the word of a single reporting source, prudent companies would probably not pursue such a course of action because it would unnecessarily expose them to liability and undercut the trust that is essential to encourage the flow of information for effective ethics and compliance programs.

A key aspect of this Model is that the organization would have standing to assert the privilege on behalf of the reporting source, and the reporting source would have the ability to waive the privilege. However, an organization's failure to adequately protect the privilege would not give rise to a new cause of action by the reporting source against the organization. This privilege is in addition to, and not in derogation of, any other privileges and protections that the parties may have available.

Draft Legislation:

§1. Purpose.

The adoption of voluntary ethics and compliance programs by organizations enhances compliance with laws and promotes the use of ethical business practices in the United States, to the benefit of all citizens. It is the policy of [this legislature] to encourage such programs and the steps necessary to make them effective. One such step is the operation of in-house reporting

systems to encourage employees and other agents to report to an organization misconduct without fear of retribution.

Protecting the identity of a source who uses an in-house reporting system in good faith is an important way to protect him or her from retaliation and to encourage use of such reporting systems. This requires protecting the source's identity from discovery and use in any civil, administrative, legislative, or criminal proceeding or hearing. It does not give rise to a new cause of action by a reporting source against the organization in the event the organization does not adequately protect the identity of a source.

§2. Definitions.

¶a Source - A source is any person who is not a participant in the wrongdoing, including individuals and outside organizations (as defined in 18 U.S.C. §18), who in good faith uses an in-house reporting system to report wrongdoing, suspected wrongdoing, or any other information of concern to the source about unethical conduct.

¶b Good faith - A report is made in good faith if it is based on the belief in the accuracy of the information or concern being reported.

¶c In-house reporting system - An in-house reporting system is any system established by an organization to meet the standards of an effective program to prevent and detect violations of law, as defined in the United States Sentencing Commission Guidelines (hereinafter referred to as USSC Guidelines) §8A1.2. Application Note 3(k)(5), in order to provide employees and other agents with a means to report misconduct to the organization without fear of retribution.

¶d Organization - An organization is any entity defined in 18 U.S.C. §18, including but not limited to corporations, partnerships, associations, joint stock companies, unions, trusts, pension funds, unincorporated associations, governments and political subdivisions thereof, and non-profit organizations, that has made a bona fide effort to implement and maintain an effective program to prevent and detect violations of law, as defined in USSC Guidelines §8A1.2. Application Notes 3(k)(1)-(7).

§3. Protection of Sources.

¶a No person, organization or governmental entity shall have access through litigation, or in response to any legal process, to the reporting source's identity or any information likely to lead to the disclosure of his or her identity.

¶b The organization that maintains the in-house reporting system shall have standing to assert this protection on behalf of the source.

¶c The protection of the source's identity may be waived by the organization only with the consent of the source unless the organization believes that disclosure is necessary to prevent an imminent threat of serious physical harm.

¶d Except disclosures that are necessary to prevent an imminent threat of serious physical harm to any person, no organization may be compelled to disclose the identity of a source or to confirm that a source has used an in-house reporting system.

¶e The protections of this section shall apply to any civil, administrative, legislative, or criminal proceeding or hearing. These protections are to be construed broadly to give full effect to the Purpose of this Act.

¶f Waiver of the protections provided by this section may not be made a condition or inducement for any benefit or favorable treatment by any governmental office or agent. Assertion of these protections by an organization or individual is fully consistent with a cooperative approach to law enforcement.

§4. Other Protections and Privileges Preserved.

The protections provided in this Act are in addition to, and not in derogation of, any other privileges and protections that may be applicable.

§5. Effective Date.

This Act shall take effect upon its passage and shall apply to any civil, administrative, legislative, or criminal proceeding or hearing that is pending on, or instituted after, its effective date.

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October 7, 2002

VIA ELECTRONIC MAIL,
U.S. MAIL AND FACSIMILE

Mr. Michael Courlander
United States Sentencing Commission
One Columbus Circle, NE, Suite 2-500
Washington, DC 20002-8002

Re: U.S. Sentencing Guidelines for Organizations

Dear Mr. Courlander:

This letter is submitted in response to the Advisory Group on Organizational Guidelines to the United States Sentencing Commission's request for additional comments on whether the Sentencing Guidelines should be modified. We are submitting these comments on behalf of several of our firm's clients in the health care industry, such as hospital systems, physicians and physician groups, managed care companies, pharmaceutical and medical device manufacturers, and other ancillary services providers.

Set forth below are various of the questions raised in the Advisory Group's request for comments along with our response.

Question 1(a): *Should §8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2) further define what is intended by "specific individual(s) within high-level personnel of the organization"?*

Response: We do not believe that the Sentencing Guidelines should delineate specific responsibilities for particular high-level personnel within the organization or further

define individual(s) within high-level personnel related to health care organizations because:

- each company may be organized differently whereby similarly titled individuals may have different job responsibilities within their respective organizations;

- irrespective of job title, due to differences in experience, training and temperament, some individuals are better suited to oversee compliance than others; and

- different organizations have different numbers of employees and contractors and it would be imprudent to attempt to establish a "one-size fits all" approach to compliance.

Accordingly, it is important to allow organizations to maintain flexibility with respect to the particular personnel structure of their compliance programs.

Question 1(b): *To what extent, if any, should Chapter Eight specifically mention the responsibility of boards of directors, committees of the board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?*

Response: Given the substantial differences in which boards of directors may be organized, the Sentencing Guidelines should not provide further details about the responsibilities of either the boards and/or the various committees of the boards. As set forth below, §8A1.2, comment 3(k)(7)(I) addresses that smaller organizations may have less formality in how they develop a compliance program. Therefore, the role of the board of directors for a large organization composed of board members who do not otherwise serve as officers of the organization would be very different than the board of directors for a smaller, closely held corporation in which the Board otherwise consists of all of the high-level managers who otherwise are responsible for overseeing the compliance program functions. In small organizations, board oversight may be implicit in the operation of the organization's compliance program, even if not formally stated.

Question 1(d): *Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?*

Response: We believe that this comment is deserving of additional clarity as organizations may struggle with what is meant for a person to have a "propensity" to engage in illegal activities.

- Does it mean that one has been convicted of a crime even if the crime was many years ago and/or unrelated to the individual's present duties?

- Does it only include felonies or also misdemeanors?

Therefore, further clarity on this issue would be beneficial to the extent it promotes flexibility for organizations to hire and maintain qualified employees who may have "youthful indiscretions" in their pasts.

Question 1(e): *Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies?*

Response: There are numerous methods by which organizations communicate compliance standards to employees and other agents: live, in-person training sessions, video tape training sessions, teleconferences, written exercises, interactive and/or web-based education sessions. Therefore, there is no single type of communication modality that has been proven to be most effective for every type of organization. The Sentencing Guidelines should provide organizations with sufficient flexibility in determining the most effective ways to communicate with their employees.

We also do not recommend modifying the language in the comment whereby the "or" would become an "and" in the examples of different forms of training and communication. By adopting this change, the Sentencing Guidelines would appear to be suggesting that written training programs are not appropriate and that training must be conducted using a different modality (e.g., in-person, live training). In light of the proliferation of interactive technology, we do not believe such a modification is appropriate.

Question 1(f): *Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution be made more specific to encourage: whistleblower protections, a privilege or policy for good faith self-assessment, the creation of a neutral or ombudsman office for confidential reporting, or some other means?*

Response: We believe that the Sentencing Guidelines sufficiently address this issue and that providing any further guidance on this would be superfluous. Moreover, the creation of an "ombudsman" office is duplicative in light of the role of the compliance officer and those individual(s) within high level management who are responsible for overseeing compliance as set forth §8A1.2, comment 3(k)(2).

Question 1(g): *Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employee and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program effectiveness.*

Response: We believe that the Sentencing Guidelines adequately address that a compliance program must ensure that sufficient auditing and monitoring occur.

We are concerned that to the extent the comments provide any additional emphasis on this issue, it will lead to a tacit requirement that organizations must engage outside auditors to conduct these reviews. Audits conducted internally may, in fact, be an effective means of conducting this type of monitoring.

Question 2: *While the Chapter Eight Guidelines currently provide a three-level decrease in the culpability score of organizations that are found to have implemented an "effective program to prevent and detect violations of law" should this provision be amended to provide an increase for organizations that have made no efforts to implement such a program?*

Response: We do not believe it is necessary to modify the Sentencing Guidelines because organizations that have not adopted an "effective" corporate compliance program will, in effect, have an increased culpability score in relation to organizations having compliance programs, as they otherwise will not be eligible for a decreased culpability score. To the extent an increase would be created, organizations with an effective compliance program not only would benefit from the three level decrease but they would also benefit from not having an increase level imposed. This could potentially double the current effect on the culpability score of having a compliance program.

We further believe that by adding this provision, it would require organizations to prove that they have an "extraordinary" compliance program in order to qualify for the reduction in the culpability score, as mere compliance efforts alone may be viewed only as awarding the increase.

In addition, there may be legitimate reasons (e.g., the small size of an organization) that might justify not establishing a formal compliance program. By including an increase in culpability score when an organization has not established a compliance program, such organizations not only would not be able to benefit by a decrease in culpability, but would receive the "double whammy" of an increase in culpability.

Finally, while compliance programs should be encouraged, a "penalty" for not implementing a compliance program would be inappropriate, as lack of a compliance program should not be considered "misconduct" on the part of an organization.

Question 3: *How can the Chapter Eight Guidelines encourage auditing, monitoring, and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring, and self-reporting?*

Response: The Chapter Eight Guidelines already encourage auditing, monitoring, and self-reporting as essential elements for an effective corporate compliance program. To the extent an organization does not engage in these activities, they otherwise would not be eligible for a decrease in culpability score as their program would not be "effective."

In the health care arena, the Department of Health and Human Services' Office of Inspector General ("OIG") has promulgated a Voluntary Disclosure Protocol whereby health care providers are encouraged to voluntarily disclose instances of potential fraud and abuse which may have given rise to corporate liability. (See 63 Fed. Reg. 58,402 (October 30, 1998).) Organizations participating in the Voluntary Disclosure Protocol have benefited from more favorable treatment in instances of Medicare billing infractions. Similarly the Guidelines could specify further benefits beyond a 3 point reduction in the culpability score. For instance, the culpability score could be reduced to zero if the conduct at issue was self-reported or restitution, without the imposition of a fine, could be permitted within the discretion of the court.

Question 4: *Are different considerations or obstacles faced by small and medium sized organizations in designing, implementing and enforcing effective program to prevent and detect violations of law. Does §8A1.2, comment 3(k)(7)(I) adequately address them?*

Response: Yes, small and medium size organizations face different obstacles. Although the first sentence of comment 3(k)(7)(I) adequately addresses these issues, the second sentence could be interpreted as stating that the only difference is in the degree of formality of the compliance program of a large organization versus a smaller one — that is, a larger organization should have established written policies defining the standards and procedures. However, this is only one, of many, differences, between large and small organizations' compliance programs. Therefore, the second sentence should either be preceded with a statement indicating that it is only an example (i.e., by including "e.g.,") or should be modified to include other examples.

Question 4(a): *How frequently do small and medium sized organizations implement a corporate compliance program?*

Response: Although we are not aware of the statistics and frequency in which smaller organizations have adopted compliance programs, a number of our clients are small and medium sized organizations that have implemented compliance programs. In the health care industry, the OIG has encouraged all organizations, irrespective of size, to adopt a compliance program. In fact, in order to encourage smaller physician group practices to adopt compliance programs, the OIG issued Compliance Guidance specifically directed to that segment of the health care industry encouraging the adoption of a program with less formality than other large health care organizations (e.g., hospitals, clinical laboratories, etc.).

Question 5: *Should the provision of cooperation at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?*

Response: Yes, the Sentencing Guidelines should clarify that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as a predicate to a substantial assistance motion by the government. Waiver of legal privileges has been a significant issue in the development of the OIG's Voluntary Disclosure Protocol, with OIG initially taking a position requiring waiver, but then substantially modifying its position in order to encourage self-reporting. To the extent a clarifying statement were included in the Guidelines that waiver is not required, the issue could be affirmatively resolved for other segments of the industry. Preservation of legal privileges is an important public policy objective. Moreover, preservation of legal privilege will encourage self-disclosure, which in turn will foster settlements rather than protracted litigation.

As to additional incentives, see Response to Question 3 above.

Question 6: *Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?*

Response: Chapter Eight of the Sentencing Guidelines should not be modified or "clarified" so as to encourage compliance with "the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation." First, the regulatory scheme centering around the manner with which health care entities are paid by the federal health care programs is, in fact, a very technical area of law. Second, in health care, there are a number of laws and regulations that are extraordinarily broad and have been subject to various interpretations of the "intent" requirement both by the regulatory agencies responsible for interpreting and enforcing the laws as well as by the courts. For example, there are a number of very technical exceptions and safe harbors to the Federal Health Care Program Anti-Kickback Statute (42 USC 1320-7b(b)) and organizations that structure transactions or financial relationships in order to satisfy the requirements of the exceptions or safe harbors should not be perceived as having "circumvented" the intent of the law.

Therefore, it would be inappropriate for an organization to be determined to be in violation of a law with which it is compliant based on the imposition of a wholly subjective standard of "intent." Compliance needs to remain an objective standard, and courts should be bound to enforce and interpret the laws without imposing moral judgment or subjective notions of ethical conduct.

* * *

We appreciate the opportunity to comment on the US Sentencing Guidelines for Organizations. Please feel free to contact us if you have any questions or require further information.

Sincerely,

David E. Matyas

Carrie Valiant

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United States Sentencing Commission
One Columbus Circle, NE
Washington, DC 20002-8002

September 30, 2002

Re: Review of the Organizational Sentencing Guidelines

The Commission is to be commended for conducting this review of the Organizational Sentencing Guidelines. I believe these guidelines represent an enormous step forward in public policy toward preventing and detecting organizational misconduct. I also believe that the definition for an effective compliance program set forth in the Guidelines has much to commend it.

I recommend that the Commission not revise the Guidelines to add much additional detail, or to make the Guidelines too rigid. Corporate crime and misconduct continue to evolve, and the methods used to prevent and detect this misconduct need to be flexible. Having said this, however, there are areas where the Guidelines would have benefited from a somewhat different focus.

I have proposed below a modified approach for the Guidelines with respect to compliance issues. The standards set out below more closely reflect how the Guidelines have been applied, in practice, by those companies that are serious about compliance.

I hope that you find these useful. I am happy to provide additional information on this material or to respond to questions (856) 429-5355.

Respectfully submitted,

Joseph E. Murphy

[61]

NEW GUIDANCE FOR THE GUIDELINES

1. No fine may be imposed against an organization because of an act of an employee or agent if the organization can demonstrate by a preponderance of the evidence that it:
    a. Exercised due diligence to prevent and detect misconduct;
    b. Reported on a reasonably prompt basis to an appropriate governmental agency, or directly to those harmed by the misconduct, any such misconduct it discovered; and
    c. Acted within a reasonably prompt time with due diligence and good faith to correct the causes and effects of such misconduct.
2. An organization that fails to meet all of the requirements of 1) may nevertheless use in evidence its compliance due diligence in mitigation of any fine that might otherwise be imposed.

Commentary

Compliance due diligence to prevent and detect misconduct is characterized by a management commitment to avoid misconduct and to conduct business in an ethical manner. To meet this standard, an organization must have an effective compliance program, although it need not be a perfect one. Compliance due diligence also includes the exercise of good faith. If an owner or high level person participates in misconduct or is willfully blind to such misconduct, and other owners and/or high level personnel are not diligent in taking steps to prevent, detect, report and correct such misconduct, then the entity cannot be credited with using due diligence.

Good faith includes a willingness to cooperate with governmental authorities in the investigation of misconduct. Good faith is fully consistent, however, with an organization's assertion of any citizen's right to protect confidential communications, including the attorney-client privilege.

The compliance program need only reflect a good faith assessment of the risks of misconduct faced by organizations in similar circumstances, and need not have specifically addressed the risk at issue in the case before the court.

An effective compliance program that meets the due diligence standard will draw from the twelve standards set out below. Meeting all of these standards will create a rebuttable presumption of compliance due diligence. The absence of one of those elements will not negate the existence of compliance due diligence, but no presumption will apply.

Compliance due diligence is characterized by these types of steps:

1. The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably designed to prevent and detect misconduct.
2. A senior officer or officers with sufficient clout must have been assigned by the highest governing body of the organization overall responsibility to oversee the compliance program.
3. There must be active senior management participation in and support of the program.
4. The program must have appropriate resources and infrastructure so that it is reasonably capable of reducing the prospect of misconduct throughout all parts of the organization.
5. The organization should establish and apply diligent personnel practices, including measures to prevent delegation of authority to those likely to engage in wrongdoing.
6. There should be effective and results-oriented communication of the compliance standards and procedures, including practical training and publications.
7. There should be systems to measure compliance performance, including auditing, monitoring, and self-assessments.
8. The organization should have systems for employees to report misconduct without fear of retribution, and for information about the company's compliance performance to reach the highest governing body of the organization.
9. An effective program will use discipline, employee evaluation systems, incentives and rewards designed to a) deter misconduct; b) deter management practices that permit or encourage misconduct; and c) promote ethical behavior.
10. When there are violations or allegations of violations, there will be reasonably prompt responses, including appropriate investigations and enhancing the program to prevent recurrence of violations.
11. An effective program is characterized by ongoing efforts to keep the program diligent, and at least as good as industry practice.
12. An organization's diligence will be documented.

Acting with due diligence to correct the causes and effects of misconduct includes, as appropriate:

1. Promptly terminating the offensive conduct;

2. Disciplining the wrongdoers, including those who unreasonably failed to detect the misconduct and those who unreasonably failed to manage in a way to reduce the risk of misconduct;
3. Repairing any harm caused and making reparations to those who have been injured; and
4. Examining the causes of the misconduct and implementing appropriate measures to prevent its recurrence.

Peter Tobler
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Group Compliance Officer

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United States Sentencing
Commission
attn. Mr. Michael Courtlander
One Columbus Circle, N.E., Suite
2-500
Washington ,D.C. 20002-8002

October 4, 2002

Dear Mr. Courtlander,

Please find below our comments on the proposed revision of the Sentencing Guidelines, following the Request for Comments by the Advisory Group. Novartis AG, als holding company of the Novartis group,is potentially affected by the planned revision as it is quoted on the N.Y.S.E. The comments are filed on its behalf.

Our comments relate to the fact that, as a foreign company having affiliates all over the world, we have to comply not only with U.S. laws and regulations, but also with numerous and often diverging other national laws and regulations. To a certain extent, our situation is similar to the one facing U.S. Multinationals having affiliates outside the US, the difference being that for us it is not only that many of the affiliates are incorporated outside the U.S. but also Group Headquarters. In some instances, specific requirements in the Sentencing Guidelines may make little sense or even be impossble to fulfil under such diverging foreign laws. This may occur e.g. if the applicable foreign company law assigns different legal responsabilities to the main company officers or provides for a structure of the company that does not correspond to the U.S. model.

The comments are therefore as follows:

"Novartis AG is committed to strenghtening the effectiveness of its Code of Conduct, its Corporate Citizenship Policiy and iths ethics and law compliance program. In this connection, we find the elements set forth at 18 USCS Appx Section 8A1.2, comment 3(k)81-7), of value describing the minimum steps an organisation must take in order to have an effective compliance program. In response to the invitation of the Advisory Group on Organisation Guidelines to the United States Sentencing Commission, we propose, however, that any revised version of the Sentencing Guidelines provide sufficient consideration of differences in laws of foreign countries that may govern the conduct or institutions of foreign corporations. Specifically, we propose the addition of language along the lines of the following:"In situations in which, by virtue of the applicability of foreign laws, a foreign company is not able to lawfully completely comply with any specific element of effectiveness set forth in these Guidelines or if such compliance would not have the effect intended by

these Guidelines, it shall be sufficient if such company has taken reasonably equivalent steps or adopted reasonably equivalent practices that serve the same objective."

We hope that the above comments will be taken into consideration when redrafting the Sentencing Guidelines, since they adress a concern that both U.S. and foreign Multinationals share. If you are intersted in further details on the problems underlying the above comments, please call or write.

Yours sincerely

P. Zalla

Group Compliance Officer

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October 4, 2002

VIA HAND DELIVERY

United States Sentencing Commission
One Columbus Circle, N.E.
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Washington, D.C. 20002-8002
Attention: Mr. Michael Courlander

Re: Request for Additional Public Comment By the United States Sentencing Commission Advisory Group on Organizational Guidelines

Dear Mr. Courlander:

On behalf of the 19 pharmaceutical companies we represent,[1] we are writing in response to the Request For Additional Public Comment recently issued by the United States Sentencing Commission's Advisory Group on Organizational Guidelines.[2]

As we noted in responding to the Advisory Group's initial Request For Public Comment, its work involves subjects of critical importance to the companies in our group. The group of pharmaceutical companies we represent have substantial experience

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[1] These companies are: Abbott Laboratories, Alcon Laboratories, Inc., Allergan, Inc., Amgen Inc., AstraZeneca Pharmaceuticals LP, Aventis Pharmaceuticals Inc., Bayer Corporation, Boehringer Ingelheim Corporation, Bristol-Myers Squibb Company, Fujisawa Healthcare, Inc., GlaxoSmithKline, Johnson & Johnson, Eli Lilly and Company, Merck & Co., Inc., Novartis Pharmaceuticals Corporation, Pfizer Inc, Pharmacia Corporation, Schering-Plough Corporation, and Wyeth Pharmaceuticals.

[2] We are delivering these comments by hand, and as an attachment to an e-mail addressed to pubaffairs@ussc.gov.

with voluntary compliance programs, and a long-standing commitment to compliance. That commitment is reflected both in individual companies' compliance efforts, and in a variety of collective efforts to improve compliance practices. Along with a number of other pharmaceutical companies, the group's members have been meeting semi-annually for several years to identify "best practices" for promoting compliance. Last year, the group's members joined together to submit comments to the Department of Health and Human Services Office of Inspector General, which had requested public comments on its plans to develop voluntary compliance guidelines for the pharmaceutical industry. We subsequently met with the Inspector General to discuss pharmaceutical compliance issues and prepared a follow-up submission outlining our suggestions on promoting pharmaceutical compliance goals. We are now preparing comments on the draft pharmaceutical compliance guidelines just released by the Inspector General, and hope to continue the dialogue with the Inspector General through sponsoring events such as roundtable discussions.

Developing effective strategies to prevent corporate misconduct has become a high-profile topic following the Enron collapse - - but this issue has always been critical, it will remain so once it fades from the front pages, and it deserves the careful study the Advisory Group has undertaken. This is an important task, and we hope our comments can be of some assistance to the Advisory Group as it formulates its recommendations to the Sentencing Commission for improving the Organizational Guidelines. We have addressed below most of the specific questions raised in the Advisory Group's Request For Additional Public Comment. In doing so, we have sought to highlight two key principles: (1) retaining the balance between structure and flexibility now reflected in the Organizational Guidelines, which has successfully fostered effective compliance programs by giving organizations the responsibility and freedom to develop programs tailored to their individual circumstances;[3] and (2) enhancing the impact of the Organizational Guidelines, by reducing the existing disincentives for vigorous self-policing by organizations and full involvement in self-policing efforts by their employees.[4]

* * *

Question 1.a.

1. *Should the Chapter Eight Guidelines' criteria for an "effective program to prevent and detect violations of law" at § 8A1.2, comment 3(k)(1-7), be clarified or expanded to address the specific issues designated below? If so, how can this be done*

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[3] This issue is addressed in our responses to questions 1.a., 1.b., 1.e., 1.f., 1.g., 1.h. and 6.

[4] This issue is addressed in our responses to questions 1.f., 3 and 5.

consistent with the limitations of the Commission's jurisdiction and statutory authority at 28 U.S.C. § 994 et seq.?

a. *Should § 8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO and/or other person(s) responsible for high-level oversight? Should § 8A1.2, comment 3(k)(2) further define what is intended by "specific individual(s) within high-level personnel of the organization" (see also, § 8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"*

Response:

This is one of several questions that raises an overarching issue: the degree of flexibility that organizations need in order to design compliance programs that are genuinely effective. We believe the approach currently reflected in the Organizational Guidelines - - one that defines effective compliance programs in terms of seven broad criteria "deliberately selected in order to encourage flexibility and independence by organizations in designing programs that are best suited to their particular circumstances"[5] - - was wisely chosen, and should be re-emphasized in the Advisory Group's report to the Sentencing Commission. This is true for several related reasons.

First, the Organizational Guidelines apply to a remarkably diverse group of organizations, subject to an equally diverse set of legal obligations. The organizations covered by the Organizational Guidelines include corporations of every size in every line of business, as well as "partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations."[6] The broad, flexible criteria now articulated in the Guidelines are essential to maintain their relevance to the broad range of organizations they cover.

Second, compliance programs must be customized to fit the particular organization in order to be truly effective. In the health care field, for example, the HHS Office of Inspector General has consistently emphasized that a compliance program can only be effective if it becomes ingrained in the organization's operations and culture, which makes a "one size fits all" model unworkable.[7] Consistent with this principle, the

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5 An Overview of the Organizational Guidelines, Paula Desio, Deputy General Counsel, United States Sentencing Commission, available on the Sentencing Commission's website, http://www.ussc.gov.

6 U.S. Sentencing Guidelines, § 8A1.1., Application Note 1.

7 See, e.g., 63 Fed. Reg. 8987, 8988 (Feb. 23, 1998) (OIG Compliance Program Guidance for Hospitals) ("[t]here is no single 'best' hospital compliance program, given the diversity within the industry. The OIG understands the variances and complexities within the hospital industry and is sensitive to the

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Organizational Guidelines wisely provide that "[t]he precise actions necessary for an effective program to prevent and detect violations of law will depend upon a number of factors," including an organization's size, the likelihood that certain offenses may occur because of the nature of its business, its prior history, and the applicable industry practice and the standards called for by any applicable governmental regulation.[8]

This flexible and particularized approach requires each individual organization to take responsibility for assessing its own environment and risk profile: to identify all of the various industry-specific and organization-specific factors that should affect the focus and structure of its compliance program, and build a program carefully tailored to that assessment. At the same time, this approach empowers organizations to use all of their experience and creativity in crafting a compliance program - - to mobilize the assets necessary to tap the full potential of these programs. This can only occur if the compliance program is "owned" by the organization and its individual representatives: if the people who must make the program work have invested their time, energy, and expertise in its design, and feel a stake in its success. In the related context of corporate governance, for example, the committee recently charged with recommending revised standards for companies listed on the New York Stock Exchange emphasized that it sought "to empower and encourage" the directors, officers, and employees of these companies, and thus "to avoid recommendations that would undermine their energy, autonomy and responsibility."[9]

Finally, a flexible approach is critical to encourage innovation and improvements in the compliance arena. Since the Organizational Guidelines went into effect, they have helped to spur a wide range of formal and informal efforts to identify the factors that influence the effectiveness of compliance programs, the ways to measure effectiveness, and the "best practices" to promote compliance with specific legal requirements or within specific industries.[10] Over time, these efforts will provide a more systematic

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differences among large urban medical centers, community hospitals, small rural hospitals, specialty hospitals, and other types of hospital organizations and systems").

[8] U.S. Sentencing Guidelines, § 8A1.2, Application Note 3(k).

[9] Report of the NYSE Corporate Accountability and Listing Standards Committee, June 6, 2002, at 1.

[10] See, e.g., Fraud and Abuse: Compliance Study May Be Finished Soon, Could Shape Industry-Developed Standards, Health Care Daily Rep., Nov. 30, 2001 (describing a multi-year study to identify the compliance program elements effective in reducing or preventing wrongdoing in the health care industry); Jonathan M. Epstein, Exporting Commercial Satellite Technology: Coping in the Current Regulatory Environment, 16 Air and Space Lawyer 17, 19 (Fall 2001) (citing a report on best practices for export control compliance programs prepared by a task force headed by former Senator Sam Nunn and Dr. Paul Wolfowitz); United States Sentencing Commission, Corporate Crime in America: Strenghtening the "Good Citizen" Corporation: Proceeding of the Second Symposium on Crime and Punishment in the

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understanding of how compliance programs in particular industries, or focused on particular legal areas, can be designed and implemented most successfully. They also underscore the limits of our current state of knowledge, and the resulting need to be cautious about detailed prescriptions that could deter innovation and limit companies' ability to incorporate new information and insights into their compliance programs.

In sum, the structured but flexible approach now embodied in the Organizational Guidelines has been important in fueling progress in the compliance workshop, and remains equally important today.[11] It deserves re-emphasis and re-affirmation.

We have elaborated on these points at some length at the outset because they are relevant to many of the Advisory Group's questions. To return to the specific question at hand, we fear that revising the Organizational Guidelines to prescribe specific responsibilities of the CEO, CFO, and others responsible for high-level oversight of compliance programs (or to further define "specific individual(s) within high-level personnel of the organization" or "overall responsibility to oversee compliance") would represent an unfortunate shift toward micromanagement. These issues are addressed appropriately in the existing Guidelines.

Decisions about the exact responsibilities of the CEO, CFO, board, and other high-level personnel charged with overseeing compliance efforts should be made in the context of a specific organization, based on a thoughtful analysis of its individual circumstances. Among other things, the compliance-related duties assigned to specific positions must be based on an industry-specific and company-specific risk profile, and must be re-evaluated and refined on an ongoing basis as the risk profile changes. For example, recent scandals involving financial and accounting misconduct may produce the impression that compliance hinges mainly on financial personnel. But that focus will likely shift with changing circumstances - - and even today, for many companies the most critical compliance efforts involve matters outside the financial sphere. In the

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United States, 140-144 (1995) (presentation by the President of the Council of Ethical Organizations, describing the results of a study on factors that affect organizations' compliance environments).

[11] As the Office of Government Ethics observed in its May 20, 2002 comments to the Advisory Group:

> [T]he [Organizational Guidelines] criteria provide organizations with both sufficient guidance concerning the critical, broad principles necessary to implement and maintain a compliance program, as well as the flexibility to design a program that reflects an organization's features, industry nuances and relevant best practices. We make this recommendation [to retain the existing Guidelines criteria] because the compliance-based executive branch ethics program, which the Office of Government Ethics (OGE) oversees, is well-served by essentially the same criteria as those identified in the Guidelines.

pharmaceutical industry, for example, the many legal and ethical obligations bearing on health and safety necessarily play a central role in shaping companies' compliance programs. Because uniform "compliance job descriptions" for every organization cannot provide the flexibility necessary to accommodate these essential kinds of considerations, they will not serve the Government's interests.

Question 1.b.

b. *To what extent, if any, should Chapter Eight specifically mention the responsibility of boards of directors, committees of the board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?*

Response:

For any organization, a strong compliance program requires active oversight by the board and appropriate board committees (or equivalent governing bodies and their committees), and reporting systems that provide all of the organization's top leadership with the information needed for effective oversight. As discussed above (in response to question 1.a.), we therefore suggest adding language to the Organizational Guidelines expressly recognizing these principles.

These issues have recently gained considerable attention, particularly in connection with preventing financial misconduct in publicly-traded companies. Measures to strengthen the role of directors and officers in certain aspects of compliance oversight have been adopted by Congress (with the enactment of the Sarbanes-Oxley Act), by exchanges such as the New York Stock Exchange (which recently adopted revised listing standards concerning corporate governance matters, now pending approval by the SEC), and by individual companies.[12] We do not mean to suggest that the

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[12] For example, the Sarbanes-Oxley Act (P.L. 107-204) directs the SEC to issue rules: (1) requiring the audit committees of boards to establish procedures for receiving and addressing complaints concerning accounting, internal accounting controls or auditing issues, including providing for company employees to submit concerns regarding questionable auditing and accounting matters on a confidential, anonymous basis; (2) requiring certifications by the principal officers and financial officers of a company that (among other things) they are responsible for establishing and maintaining internal controls, have designed the controls to ensure that material information is made known to them, have evaluated the effectiveness of the controls within 90 days prior to each annual or quarterly report, and have disclosed to the audit committee and auditors any significant deficiencies in the internal controls and any fraud involving persons with a significant role in the system of internal controls; and (3) requiring companies to disclose in their periodic reports whether they have adopted a code of ethics for senior financial officers and any waivers of the code. The revised NYSE listing standards would require board audit committees (among other things) to assist the board's oversight of company compliance with legal and regulatory requirements, obtain an annual report by the independent auditor describing the company's quality-control procedures and any material issues concerning those procedures, and discuss policies regarding risk assessment and risk management;

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Guidelines need revision to reflect these recent measures: they apply to a subset of organizations, and the Guidelines already anticipate new developments affecting compliance practices in specific sectors. Among other things, the Guidelines establish a presumption that an organization with an effective compliance program will incorporate and follow "applicable industry practice" and "the standards called for by any applicable government regulation."[13] Similarly, a member of the Sentencing Commission's staff explained at the Commission's 1995 symposium on the Organizational Guidelines that:

> [T]he definition of an effective compliance program should be viewed as somewhat "elastic" - - in other words, able to accommodate a range of compliance approaches with the ultimate focus of the definition being to encourage companies to devise programs that actually work.
>
> This . . . has an important implication. It means that as certain compliance practices become recognized for their effectiveness, companies should . . . "read them into" the guideline requirements even if the guidelines do not explicitly require these practices.[14]

Thus, the existing Guideline provisions on effective compliance programs are not static. They call for compliance programs to reflect changes both in applicable industry practice (including the industry's recognition of compliance practices that have proved effective) and in standards required by applicable government regulations - - whether these developments relate to board oversight or other matters. This is a sound approach, which suggests that language spelling out detailed responsibilities for boards (or equivalent bodies) and their various committees is not necessary. Nor would detailed corporate governance prescriptions be appropriate, given the diverse group of organizations covered by the Organizational Guidelines and their different types of governance structures.

Question 1.c.

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and would require companies to adopt and disclose a code of business conduct and ethics for directors, officers, and employees.

[13] U.S. Sentencing Guidelines, § 8A1.2, Application Note 3(k).

[14] United States Sentencing Commission, Corporate Crime in America: Strengthening the "Good Citizen" Corporation: Proceeding of the Second Symposium on Crime and Punishment in the United States, 175 (remarks of Mary Didier).

c. *Should modifications be made to §8A1.2, comment 3(b) (defining "high-level personnel" and §8A1.2, comment 3(c) (defining "substantial authority personnel")? Should modifications be made to §8C2.5, comments 2, 3, or 4, relating to offenses by "units" of organizations and "persuasiveness" of criminal activity?*

Response:

Sections 8A1.2 and 8C2.5 recognize that large companies often contain several business units and that the leaders of these business units may hold great authority to act on behalf of the organization. Out of necessity, decision-making authority and accountability are often dispersed widely among such business units. The Guidelines also acknowledge the difference between pervasive and relatively isolated organizational conduct. We believe that comment 4 of Section 8C2.5 should further clarify the distinction between pervasive and non-pervasive conduct among the business units of an organization. Specifically, comment 4 should articulate that if conduct is not pervasive among business units, the conduct of one business unit should not be imputed to other business units.[15]

Question 1.e.

e. *Should § 8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently § 8A1.2, comment 3(k)(4) provides:*

> *The organization must have taken steps to communicate effectively its standards and procedures to all employees*

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[15] Thus, we suggest that Section 8C2.5, comment 4 be revised to read as follows:

> Pervasiveness under subsection (b) will be case specific and depend on the number, and degree of responsibility, of individuals within substantial authority personnel who participated in, condoned, or were willfully ignorant of the offense. Fewer individuals need to be involved for a finding of pervasiveness if those individuals exercised a relatively high degree of authority. Pervasiveness can occur either within an organization as a whole or within a unit of an organization. For example, if an offense were committed in an organization with 1,000 employees but the tolerance of the offense was pervasive only within a unit of the organization with 200 employees (and no high-level personnel of the organization participated in, condoned, or was willfully ignorant of the offense), three points would be added under subsection (b)(3). If, in the same organization, tolerance of the offense was pervasive throughout the organization as a whole, or an individual within high-level personnel of the organization participated in the offense, four points (rather than three) would be added under subsection (b)(2). <u>If specific conduct is not shared by more than one business unit, then there should not be a finding of pervasiveness within the organization as a whole. The conduct of one business unit should not be imputed to the conduct of another business unit.</u>

Question 1.f.

f. *Should § 8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage: (i) whistleblowing protections; (ii) a privilege or policy for good faith self-assessment and corrective action (e.g., 15 U.S.C. § 1691(c)(1) (1998)); (iii) the creation of a neutral or ombudsman office for confidential reporting; or (iv) some other means of encouraging reporting without fear of retribution?*

Response:

As currently written, comment 3(k)(5) states that the organization must have taken reasonable steps to achieve compliance with its standards, citing as an example "by having in place and publicizing a reporting system whereby employees . . . could report criminal conduct by others within the organization without fear of retribution." We believe that a mechanism allowing employees to report suspected misconduct without fear of retribution is fundamental to a strong compliance program (and that, mechanisms aside, employees deserve the assurance that the company does not countenance retaliation for reporting wrongdoing in any circumstance). However, the current Guideline language already encourages companies to create mechanisms for employees to report misconduct without fear of retribution, and we do not believe the Guidelines should be amended to prescribe the specific type of mechanism companies should adopt. Companies need the discretion to make this decision based on thoughtful judgments about what will work best given their individual circumstances.

With regard to a privilege or policy for good faith self-assessment and corrective action, and the creation of a neutral/ombudsman office for confidential reporting, we believe that offering employees these kinds of protections may be valuable in enhancing a compliance program. Again, however, they should not be mandated, and it is important to understand that there are limits on a company's ability to extend these protections to its employees. Employees cannot be given an unqualified assurance of confidentiality if their reports may be discoverable in litigation, or required by the Government as a condition of the company cooperating with the Government; similarly, a company can assure employees that good faith self-assessment and corrective action will not result in inappropriate employment sanctions (provided that the company itself has some assurance that this will not be viewed as "non-cooperation" by government enforcement officials, or subject the company to collateral sanctions such as suspension or debarment), but a fear of employment sanctions is not always the principal deterrent to good-faith self-assessment and corrective action since employees also have confidentiality concerns.[17] The ability to offer these kinds of assurances to employees could remove

[17] See, e.g., Paul Fiorelli and Michael Mutek, The Coalition For Ethics and Confidentiality Initiatives: Renewed Advocacy For Employee Confidentiality and Self-Evaluative Privilege, 36 Procurement Lawyer

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barriers to employee reporting and thereby enhance the effectiveness of compliance programs, and we hope the Advisory Group will adopt recommendations designed to mitigate the underlying problems that limit companies' ability to provide such assurances.[18] However, the Organizational Guidelines should not require or encourage companies to make promises they cannot keep.

Question 1.g.

g. *Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in § 8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?*

Response:

Organizations can make the auditing and monitoring component of their compliance programs most effective given the freedom and encouragement to design it thoughtfully. The types of "systems audits" of a company's compliance program referenced in the Advisory Group's question can offer a powerful tool for evaluating the program's effectiveness, diagnosing deficiencies, and engineering improvements. We do not mean to suggest that these systems audits (or any other specific technique for auditing and monitoring) should be referenced in mandatory-sounding language in the Guidelines. The key principle is that organizations should be free to adopt an auditing and monitoring approach (or a combination of approaches) best suited to their specific needs, and to alter their auditing and monitoring strategy as factors such as their experience, changes in industry practice, or new research results suggest the potential for improvements. While we believe this principle is already reflected in the existing Guideline provisions, it may be helpful to add language specifying that systems audits of the organization's

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22, 23 (Winter 2001) (noting that "organizations must do more than give [employees] conditional promises of confidentiality. They must be free to protect the reporting source's identity, and possibly even the substance of the communication, as part of a comprehensive good faith ethics program"); Judson W. Starr and Brian L. Flack, DOJ Must Address White Collar Prosecutors' Disrespect for Privileged Communications, Andrews Health Care Fraud Litig. Rep. (July 2001) (noting that "[c]ompanies can be most effective in ensuring compliance . . . if their internal corporate practices encourage and reward early and frank disclosure of problems," but that "[e]mployees who believe that their disclosures ultimately will be turned over to the government [due to Government demands for waiver of privileges], resulting in their colleagues or they themselves becoming potential targets of government investigations, are far less likely to offer the important information needed by companies to self-police and take actions necessary to gain compliance").

[18] These problems are discussed further below in our response to questions three and five.

compliance program represent one example of an auditing and monitoring technique that organizations may find appropriate to their needs.[19]

Question 1.h.

h. *Should § 8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, e.g., should there be credit given to organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected in rewards and compensation?*

Response:

The criteria described in Section 8A1.2, comments (k)(1)-(k)(7) are minimum requirements for an effective compliance program.[20] Comment (k)(6) currently provides that the organization's compliance standards "must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense" and that (while the adequate discipline of individuals responsible for offense is a necessary component of enforcement) the appropriate form of discipline will be case-specific. This is an appropriate minimum requirement. We strongly endorse the idea of adopting carefully-designed programs to evaluate the performance of appropriate categories of employees on their fulfillment of job-related compliance criteria, or to give special recognition to employees who have made an outstanding contribution to the organization's compliance efforts. However, these kinds of measures should not become minimum requirements for all of the organizations covered by the Organizational Guidelines, without which they will be deemed to have ineffective compliance programs.[21]

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[19] Thus, we suggest that Section 8A.2, note 3(k)(5) be revised to read as follows:

> The organization must have taken reasonable steps to achieve compliance with its standards, e.g., by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents (which may consist of periodic auditing of the effectiveness of the organization's compliance systems, as appropriate) and publicizing a reporting system whereby employees . . . could report criminal conduct . . . without fear of retribution.

[20] See Section 8A1.2 comment (k) ("[d]ue diligence requires at a minimum that the organization must have taken the following types of steps [specified in (k)(1)-(k)(7)]."

[21] We recognize that the Advisory Group's question asks whether "credit [should be] given to organizations that evaluate employees' performance on the fulfillment of compliance criteria" and might be interpreted as asking whether such an approach should be recognized as an alternative to the consistent

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Questions 3 and 5.

3. *How can the Chapter Eight Guidelines encourage auditing, monitoring, and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?*

5. *Should the provision for "cooperation" at § 8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at § 8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?*

Response:

We have grouped these questions together because they both raise an issue central to achieving the goals of the Organizational Guidelines: how the existing disincentives for vigorous self-policing can be reduced. Reducing these disincentives is important because the Government can magnify the impact of its own enforcement activities by enlisting the full support of private sector organizations and their employees: the parties ideally positioned to serve as the first line of defense in the effort to prevent and detect misconduct.

As the Advisory Group's questions recognize, self-policing activities such as auditing, monitoring and self-reporting can create serious risks for a company - - risks that, unfortunately, do diminish the likelihood of auditing, monitoring, and reporting. Among other things, vigilant self-policing can create a documentary "roadmap" that can be used against a company: a roadmap that only exists because of the company's voluntary efforts to detect and prevent legal violations. Moreover, when companies that make voluntary disclosures to the Government are required to turn these documents over to the Government as a condition of cooperation, they jeopardize their ability to protect privileged or potentially privileged documents in the event of private litigation.[22] All of

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enforcement of compliance standards through appropriate disciplinary mechanisms. However, many would question the prudence of making the "consistent enforcement" criterion optional, and we are not certain the Advisory Group meant to suggest this possibility.

[22] See, e.g., Westinghouse Electric Corp. v. Republic of the Philippines, 951 F.2d 1414 (3d Cir. 1991) (privileged documents voluntarily disclosed to the Government were discoverable by private plaintiffs); In re Steinhardt Partners, L.P., 9 F.3d 230 (2d Cir. 1993) (same).

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this penalizes voluntary self-policing efforts: it puts the "good citizen" corporation at a disadvantage compared to a company that never embraced voluntary compliance; thwarts the goals of the Organizational Guidelines; and undermines the privately-funded "first line of defense" that Government enforcement agencies should seek to bolster.

To help rectify these problems, we strongly support the idea of adding language to the Guidelines clarifying that "cooperating" with the Government and providing "substantial assistance" to the Government do not require the disclosure of privileged documents - - or any documents that the organization generated by bona fide voluntary self-policing activities.[23] While this is a modest reform that would not eliminate the existing disincentives for voluntary self-policing, it would help to reduce these

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The problem of voluntary disclosures to the Government stripping a company of rights it would otherwise have in private litigation is particularly critical because the credit for an effective compliance program "does not apply if, after becoming aware of an offense, the organization unreasonably delayed reporting the offense to appropriate governmental authorities." U.S. Sentencing Guidelines, § 8C2.5(f). Thus, to the extent that companies feel that voluntary disclosures to the Government create unacceptable risks of "unilateral disarmament" in private litigation, the Sentencing Guidelines provide them with no incentive to adopt effective compliance programs.

[23] More specifically, we suggest that Section 8C2.5 note 12 and Section 8C4.1 note 1 be revised to read as follows:

Section 8C2.5., Note 12:

To qualify for a reduction under subsection (g)(1) or (g)(2), cooperation must be both timely and thorough. . . . To be thorough, the cooperation should include the disclosure of all pertinent information known by the organization. A prime test . . . is whether the information is sufficient for law enforcement personnel to identify the nature and extent of the offense and the individual(s) responsible . . . . However, "cooperation" shall not be deemed to require the waiver of legal privileges, or to require the disclosure of documents generated by the organization as part of an effective program to prevent and detect violations of law, whether or not such documents are considered privileged . . . .

Section 8C4.1., Note 1:

Departure under this section is intended for cases in which substantial assistance is provided in the investigation or prosecution of crimes committed by individuals not directly affiliated with the organization or by other organizations. . . . "Substantial assistance" shall not be deemed to require the waiver of legal privileges, or to require the disclosure of documents generated by the organization as part of an effective program to prevent and detect violations of law, whether or not such documents are considered privileged.

The proposed language on documents generated as part of an effective compliance program is important partly because it would allow organizations to preserve the right to assert the self-evaluative privilege in private litigation with third parties. Because there are cases holding that this privilege is not available as against the Government, documents resulting from self-evaluative activities could potentially be considered privileged in the context of private litigation but not in the Governmental context - - but if an organization is required to turn the documents over to the Government, it loses the opportunity to assert the self-evaluative privilege in private litigation.

disincentives and ensure that the Guideline provisions on cooperation and substantial assistance do not undermine the goal of fostering effective compliance programs.

In addition, the Advisory Group can recommend that the Sentencing Commission educate Government enforcement personnel about the importance of the self-evaluative privilege in spurring self-policing, and work to build Government-wide support for this privilege. By encouraging Government enforcement officials to refrain from seeking documents that only exist because of voluntary efforts at self-scrutiny, the Sentencing Commission can strengthen "good citizen" corporations by reducing the risk that they will be penalized for voluntary self-policing. Similarly, the Sentencing Commission can bolster effective compliance programs by encouraging Government agencies to refrain from seeking documents covered by the attorney-client and work product privileges. While the Sentencing Commission cannot proscribe practices that penalize self-policing, it can sponsor educational or research programs that could produce a better understanding of this problem and prompt Government enforcement officials to re-examine counterproductive practices.[24] Given the Sentencing Commission's leadership role in promoting voluntary compliance, it is uniquely positioned to fortify this critical first line of defense against corporate misconduct.

Question 6.

6. *Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?*

Response:

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[24] See 28 U.S.C. § 995(a)(12),(17),(18),(21),(b) (authorizing the Commission to establish a research and development program for specified purposes, to conduct seminars and workshops for persons engaged in the sentencing field, to conduct training programs on sentencing techniques for persons connected with the sentencing process, to hold hearings that might assist it in exercising its powers and duties, and to perform such other functions as may be necessary to carry out the purposes of Title 28 Chapter 58). Similarly, the Commission can work informally to educate Government enforcement personnel. As a member and Vice Chair of the Sentencing Commission recently noted, the Commission is "working to improve its cooperative relationship with . . . various enforcement agencies to ensure that the value of effective compliance programs is more fully recognized and that organizations are encouraged to regularly test and evaluate the effectiveness of their compliance structures without fear that deficient results will be used to punish them." John R. Steer, Changing Organizational Behavior - - The Federal Sentencing Guidelines Experiment Begins to Bear Fruit, 1291 PLI/Corp 131, 153 (Feb. 2002).

The companies in our group view their compliance programs as part of a broader commitment to legal and ethical conduct, and consistently emphasize that commitment to their employees. However, it would be inappropriate - - and unworkable - - for the Organizational Guidelines to make the adoption of an "ethics-based" approach a criterion for judging the effectiveness of a compliance program. Such a modification in the Guidelines would either produce cosmetic changes in compliance programs (e.g., changing the compliance officer's title to "ethics and compliance officer," sprinkling new references to "ethics" here and there in compliance policies), or it would require more problematic and contentious changes. For example, we understand that one comment has suggested that an "effective" program must include an ethics officer who completed at least three university courses in ethics; for many organizations, such a requirement may be impractical or have doubtful utility. In addition, the idea that organizations should be required to adopt programs designed "to ensure compliance with the intent of regulatory schemes as opposed to technical compliance" is fraught with difficulties. This approach could essentially punish organizations (through increased sentences) for failure to comply with the "intent" of a regulatory scheme, and it fails to recognize that organizations and individuals alike should be able to rely on the actual written regulations as the "best evidence" concerning the intent of a regulatory scheme - - that Government regulatory agencies have a responsibility to translate the regulatory intent into specific, clearly-written rules that eliminate guesswork about how organizations and individuals can discern the intent of the regulatory scheme and conform their conduct accordingly.

* * *

We hope that these comments will be useful to the Advisory Group in developing recommendations for improving the Organizational Guidelines and preparing its report to the Sentencing Commission. We would also appreciate the opportunity for a representative of our group to testify at the Advisory Group's November 14, 2002 public hearing. Please feel free to contact either of the undersigned concerning this request. Thank you for your consideration, and for all of your efforts in this critical area.

Sincerely,

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October 11, 2002

United States Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500
Washington, D.C. 20002-8002

Attention: Michael Courlander

Re: Request for Additional Public Comments Regarding the U.S. Sentencing Guidelines for Organizations

Dear Mr. Courlander:

Philip Morris Companies Inc. appreciates the opportunity to submit these comments in response to the "Request for Additional Public Comments Regarding the U.S. Sentencing Guidelines for Organizations," recently issued by the Advisory Group on Organizational Guidelines to the United States Sentencing Commission.

As noted in the Request for Additional Public Comments, the Advisory Group has identified specific areas of concern and developed a list of key questions relating to the terminology and application of Chapter 8 of the Sentencing Guidelines (the "Organizational Guidelines"). The Advisory Group seeks additional public input prior to preparing its report and recommendations for improvement of the Organizational Guidelines to the United States Sentencing Commission. The areas of concern and questions formulated by the Advisory Group relate to the criteria for an "effective compliance program" identified in the Organizational Guidelines.

Philip Morris Companies Inc. ("PM") is the parent of Kraft Foods, Inc., which sells branded food and beverage products; Philip

Morris U.S.A. and Philip Morris International, domestic and international cigarette manufacturers; and Philip Morris Capital Corporation, a financial services company.

Philip Morris Companies Inc. is committed to corporate responsibility. For many years, we have had compliance programs both at the corporate and operating company levels. This commitment is reflected in our enterprise-wide compliance program and in the appointment of a corporate-level Chief Compliance Officer. The corporate Compliance Program is intended to address areas of legal, policy and reputational risk. It has been designed to track the elements of the Sentencing Guidelines' definition of "an effective" program, as well as best practices associated with that definitional standard. In addition, each operating company has its own compliance office and compliance program, which is tailored to the operating company's specific businesses and operations, and also is intended to meet the Sentencing Guidelines and best practice standards.

In the following paragraphs, PM offers comments in response to certain questions posed by the Advisory Group:

Question 1.a: Should §8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2) further define what is intended by "specific individuals(s) within high-level personnel of the organization" (*see also*, §8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"

PM Comment: PM fully endorses the concept in §8A1.2, comment 3(k)(2) that there be a link between senior management and a company's compliance program. PM believes that this is essential to a meaningful and effective compliance program. Accordingly, PM has appointed a full-time, parent company Chief Compliance Officer who

has been charged with oversight of the Company's enterprise-wide compliance programs. The Chief Compliance Officer is a Senior Vice President of PM and a member of the Company's Management Committee. The Chief Compliance Officer has the responsibility to report about compliance programs to the Audit Committee of the Company's Board of Directors.

While PM is firmly committed to the need for high-level, senior management oversight of the Company's compliance program, as demonstrated in its own Company-wide program, PM also endorses the need for flexibility in the designation of high-level personnel responsible for compliance oversight in corporate compliance programs, depending on the organization's size (Fortune 100 or small business) and types of business operations (*e.g.*, centralized or decentralized, domestic or global).

Question 1.b: To what extent, if any, should Chapter Eight specifically mention the responsibility of boards of directors, committees of the board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?

PM Comment: PM believes that developments in corporate governance and compliance practices since the passage of the Organizational Guidelines have given Boards of Directors and their committees the responsibility to oversee compliance programs and senior management's compliance with the legal requirements applicable to their organization's business and operations. Chapter 8 of the Sentencing Guidelines should reflect that role consistent with those developments. The recently enacted Sarbanes-Oxley Act of 2002, as well as the revised listing standards proposed in August 2002 by the New York Stock Exchange (and now pending approval by the SEC), address the role of the Board of Directors, and particularly the Audit Committee, in corporate governance. For example, section 301 of the Sarbanes-Oxley Act, directs a company's Audit Committee to

establish procedures for anonymous internal reporting of accounting irregularities.

Question 1.d: Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?

PM Comment: PM joins in the request for clarification of the term "propensity to engage in illegal activities."

Question 1.e: Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently §8A1.2, comment 3(k)(4) provides: "The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, *e.g.*, by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required." (Emphasis in original.) The use of the "e.g." can be interpreted to mean that "training programs" and "disseminating publications" are illustrative examples, rather than necessary components, of "communicating effectively." The use of "or" can be interpreted to mean that "training programs" and "disseminating publications" are alternative means for satisfying the "communicating effectively" requirement. Should the preceding language be clarified to make clear that both training and other methods of communications are necessary components of "an effective" program? If so, should the term "disseminating publications" be replaced by more flexible language such as "other forms of communications?"

PM Comment: PM recognizes that a literal reading of §8A1.2, comment 3(k)(4) may have created some confusion and views the suggested change as simply clarifying that both training and other forms of communication are important components of an effective program. Companies should, however, be afforded the flexibility to

determine which methods of communication and training are best suited to the organization, its size, structure, compliance policies and procedures, and other factors and circumstances specific to an individual company or organization.

Question 1.f: Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage: (i) whistleblowing protections; (ii) a privilege or policy for good faith self-assessment and corrective action (*e.g.*, 15 U.S.C. §1691(c)(1) (1998)); (iii) the creation of a neutral or ombudsman office for confidential reporting; or (iv) some other means of encouraging reporting without fear of retribution?

PM Comment: Comment 3(k)(5) currently provides that the organization must have taken reasonable steps to achieve compliance with its standards, specifying as one example "by having in place and publicizing a reporting system whereby employees . . . could report criminal conduct by others within the organization without fear of retribution." PM believes that a mechanism allowing employees to report in good faith instances of misconduct or suspected misconduct without fear of retribution is an essential element of an effective compliance program. PM has long made this an element of its own compliance program. PM believes, however, that the existing language of Comment 3(k)(5) already encourages organizations to establish such reporting mechanisms, and we question whether it would necessarily be helpful for the Chapter Eight Guidelines to specify the types of mechanisms that should be adopted. This appears to be the type of implementing decision that is best made by an individual organization, based on its specific circumstances.

With respect to encouraging a privilege or policy for good faith self-assessment and corrective action, and the creation of a neutral/ombudsman office for confidential reporting, PM recognizes that offering these sorts of protections to employees could significantly

enhance the effectiveness of an organization's compliance program. There are, however, practical limits on an organization's ability to offer such protections.

For example, an employee cannot be afforded an absolute promise of confidentiality, so long as information on his or her report may be discoverable in litigation and/or sought by the Government as a condition of the organization's cooperation in a Government investigation or inquiry. Similarly, an employer can promise that good faith self-assessment and corrective action will not result in employment sanctions (at least as long as it feels that the Government will not penalize the employer itself for not sanctioning the employee), but it cannot promise an employee that good faith self-assessment and corrective action will not result in legal action by the Government or private plaintiffs. The ability to offer employees these sorts of assurances would be valuable to an organization's compliance efforts, and PM encourages the Advisory Group to develop recommendations for addressing the underlying problems that currently prevent organizations from offering such assurances.

Question 1.g: Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?

PM Comment: PM believes that periodic auditing is a useful tool for identifying weaknesses in and potential improvements to an organization's compliance program. PM believes that the Sentencing Guidelines should encourage auditing as a basic element of an effective compliance program and should also note the importance of training for either inside or outside auditors who conduct compliance audits.

PM questions the wisdom, however, of requiring specific types of audits or specific methodologies for auditing the "effectiveness" of a compliance program. PM believes that any attempts at such specificity would detract from the flexibility now afforded by the Chapter Eight Guidelines' criteria for effective compliance programs, which allow for a range of audit activities. Such activities could include, for example, "process audits" (checking compliance programs against the Sentencing Guidelines criteria and evaluating systems and controls) and "substantive audits" (checking for and identifying specific instances of non-compliance). The latter, of course, implicates the privilege issues identified in question three. The Sentencing Guidelines could note these as illustrative of the types of audits that companies should consider within the context of their overall compliance programs.

PM further believes that the Guidelines should avoid prescribing any specific methodology for measuring the "effectiveness" of compliance programs at a time when definitive standards have not been defined, and the term is subject to broad interpretation.

Question 1.h: Should §8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, *e.g.*, should there be credit given to organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected in rewards and compensation?

PM Comment: PM believes that compliance responsibilities and satisfaction of compliance objectives, particularly on the part of supervisory employees, should be considered in employee performance evaluations. Here again, however, PM believes that individual companies should be afforded the flexibility to design job performance criteria that are tailored to the organization's structure

and culture, specific job functions, supervisory responsibilities, and other relevant factors.

Question 3: How can the Chapter Eight Guidelines encourage auditing, monitoring, and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?

PM Comment: One modest step that would help to address this problem is suggested by question five - - *i.e.*, whether the provision for "cooperation" at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, should clarify that the waiver of existing legal privileges is not required to qualify for a reduction in culpability score or as a predicate to a substantial assistance motion by the Government. The answer to this question is yes; both sections should clarify this point. An explicit statement that "cooperating" with the Government and providing "substantial assistance" to the Government do not require turning over privileged information would reduce (if not eliminate) the risk that voluntary self-policing could increase an organization's legal exposure, and would thereby reduce the disincentives that now exist for self-policing.

A second important step the Commission should consider taking is supporting – or, alternatively, facilitating a discussion of the need for – a self-evaluative privilege relating to compliance activities. As Question (3) implicitly recognizes, when companies undertake rigorous evaluations to understand how their compliance programs can be improved, there is no guarantee that the information generated will not be used against them in various legal proceedings, both criminal and civil. This, ironically, puts companies that do rigorously self-evaluate their programs at greater risk than companies that do not. The Commission's enabling statute (see, *e.g.*, 28 USC §

995(a)(12),(20),(21)) provides the Commission with various avenues to study the question and, if so desired, propose statutory changes to resolve it.

Of course, another way in which the Chapter Eight Guidelines could encourage auditing, monitoring, and self-reporting is simply to increase the credit for an effective compliance program in §8C2.5(f) (now three points). This obviously would not reduce the risks associated with compliance programs, but it could still encourage organizations to develop and maintain strong compliance programs by increasing the benefits.

Question 4.b: According to §8C2.5(f), if an individual within high-level personnel or with substantial authority "participated in, condoned, or was willfully ignorant" of the offense, there is a rebuttable presumption that the organization did not have an effective program to prevent and detect violations. Does the rebuttable presumption in §8C2.5(f), for practical purposes, exclude compliance programs in small and medium-sized organizations from receiving sentencing consideration? If so, is that result good policy and why?

PM Comment: In a large corporation, it is possible for employees at the top of the organization to engage in misconduct, which in turn affects and victimizes innocent employees, among other stakeholders. This is clearly demonstrated by recent corporate scandals where high-level personnel or individuals with substantial authority are charged with having participated in, condoned, or been willfully ignorant of the corporate malfeasance alleged.

Such conduct, which involves only a single or limited number of individuals, does not necessarily reflect the absence of an effective compliance program. Compliance programs can deter, but they cannot prevent all misconduct by determined individuals. Accordingly, PM does not believe that there should be a rebuttable presumption that the organization did not have an effective compliance program in place to