

a separate determination about the effectiveness of the organizational culture in promoting compliance with law. In contrast, they could determine the effectiveness of the organization's *ethics-compliance program* based on

- 1) the existence of a statement of ethical principles and the integrated ethics-compliance interventions taken by the organization to realize them (and, thus, achieve compliance with the letter *and* the spirit of the law) and/or
- 2) the resulting, tested/ observed changes in knowledge, attitudes/values/beliefs/norms, and short-term practices among employees and, consequently, the organization.

The latter is preferable, of course, because due diligence is only a tenth of the battle—the proof is in the pudding. Furthermore, prosecutors and judges would have to do no more than they are already doing with regard to evaluating an compliance programs. That is, they would simply

- 1) ask for documentation that explains the program,
- 2) compare the program against existing model standards, and
- 3) then assess the extent to which the organization has effectively implemented its program.

Each of these steps fits with current and proposed approaches to measuring compliance program effectiveness.

- ethics could be integrated into the Proposed Amendments *without breaking new ground* for the Sentencing Commission, thereby raising questions about its mission. That ground was broken with the original, 1991 guidelines when the Sentencing Commission shifted its attention from looking solely at the crime, its perpetrators, and the organization as a whole—to looking at ways to prevent the occurrence of crime. Compliance programs went part of the way (but, given the epidemic of corporate in the last several years, clearly not far enough); ethics goes the rest of the way. The integration of ethics into compliance programs only enhances those programs and increases their effectiveness.

The time is ripe for the Sentencing Commission to maintain its leadership in the prevention of corporate crime by giving ethics its rightful place in the Proposed Amendments.

Expansion of Ethics and Compliance Program's Purview

If we've learned anything in the last several years about prevention of corporate crime, it is that ethics and compliance programs need to drill deeper and climb higher in the organization.

When they do not, the result is often what Widen describes with respect to Enron:

The cultural problem revealed by Enron ultimately is not subject to correction by teaching lawyers more accounting, fine tuning rules governing the use of "gatekeepers" in corporate matters, or requiring and expecting more from independent directors, though all these measures would help in a small way. The problem is that corporate and legal culture has lost all sense of right and wrong. Norms and business behavior have evolved so that compliance with the positive law is the so-called standard of ethical conduct—a role for which positive law is ill-suited.^{iv}

For this reason, we have suggested changes to the Proposed Amendments that expand the ethics and compliance program into all levels and functions of the organization (total internal market penetration, if you will), particularly the decisions made by officers and directors.

For example, we recommend that

- the Ethics and Compliance Officer be a *real* officer of the corporation with full rights and responsibilities in all executive decisions.
- this individual have academic and/or certificated training in both ethics and law (though she need not have a PhD in ethics or a JD in law).
- the Sentencing Commission consider including language in the commentary to the proposed “auditing and monitoring amendment” that suggests an “ethical impact report” for all major strategy and financial decisions. Many an Enron could have been prevented if an ethical impact report would have laid bare *in a documented fashion* the potential violations of ethical principles and law *before* a decision was made to go forward.

Finally, the effectiveness of an ethics and compliance program is not only measured in terms of the channels and messages it uses for communicating with employees; it is also effective in terms of the ways and extent to which it institutionalizes itself. In fact, if the literature is right, the latter may be much more significant than the former. One way to institutionalize itself is the command-and-control structure that sets up the program, designs its policies and procedures, and communicates them to the organization. The other—and far more effective—is the participatory structure that seeks the participation of employees, managers, officers, and directors (and other stakeholders, as appropriate) in the design, implementation, and evaluation of the program. Models for this latter structure include The Conference Model, Future Search, and Whole System Change. Thus, if an ethics and compliance program is going to be truly effective, it will need to become simply the way the organization goes about its business.

Measurement of Program Effectiveness

- The Proposed Amendments fail to enunciate any real measures of program effectiveness. Instead, they add more due diligence criteria, which, in the final analysis, cannot distinguish between a “paper program” and a truly effective program (one that follows the letter of the law and one that captures its spirit). Even the highlighting of the Health Care Compliance Association’s criteria^v does little to advance the discussion since these criteria simply measure more refined aspects of due diligence. Knowing whether something occurred or how many of it occurred, however, is not the same as knowing the impact and outcome of that occurrence.
- The Proposed Amendments, then, ignore written and verbal testimony that delineated strategies for measuring impact, that is, changes in knowledge, attitudes/values/beliefs/norms, and short-term practices. At the very least, these might include pre- and post-testing of training sessions and periodic, self-reported surveys of all employees on key, organizational risk and protective factors for fraud, waste, and abuse. It would not be sufficient, for example, to know that a self-described attorney went to law school (or, to represent another common measure, liked it a lot); we’d want to know that she had passed both law school and the bar exam.
- There are methodologically sound ways, contrary to the opinions expressed in the document,^{vi} to measure the effectiveness of ethics-compliance intervention—and even to relate these impact measures to the desired outcomes, namely, the prevention of fraud, waste, and abuse. Program evaluators and behavioral scientists would prove very helpful in this endeavor. At the very least, they could identify proxy measures that are strongly correlated with the incidence of various types of corporate corruption. It is never enough to say that just because we provided compliance training to 3,000 employees that the training

[2-154]

had any impact on them—or achieved the organizational goals of preventing violations of law.

ⁱ Diana E. Murphy, “The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics,” *Iowa Law Review* 87 (2002): 716.

ⁱⁱ William H. Widen, “Enron at the Margin,” *The Business Lawyer* 58 (May 2003): *passim*.

ⁱⁱⁱ Advisory Group on Organizational Guidelines (AGOG), “Recommendations for Proposed Amendments for Federal Sentencing Guidelines for Organizations” (October 27, 2003): 54.

^{iv} Widen 962-3.

^v AGGO 76ff.

^{vi} AGOG 35ff.

[2-155]

January 28, 2004

The Honorable Judge Diana M. Murphy, Chair
U.S. Sentencing Commission
One Columbus Circle NE, Suite 2-500
Washington DC 20002-8002

Dear Judge Murphy,

We congratulate you, your, your fellow commissioners, and your staff for drafting the Proposed Amendments and making them available for public comment. We know that the process has involved considerable time and resources. The result, however, has been amendments to the Guidelines that will make them more relevant to the new millennium.

Yet we're concerned that they are not as germane and significant as they could be. Indeed, if the goal was to go "beyond compliance," they disappoint by not going as far as numerous other governmental bodies, such as the SEC and Congress, have done already. As they stand now, the Proposed Amendments:

- fail to support the integration of "ethics" into compliance programs,
- sidestep an opportunity to re-define "effectiveness" in a substantive way, and
- neglect to reconsider the purview of an ethics and compliance program in the current environment of corporate malfeasance.

In our opinion, the Proposed Amendments need to reflect the proposition that ethics is the heart of law

We respectfully offer our suggested changes to the Proposed Amendments with an accompanying justification (please see enclosures). It is our hope that you will consider them in the spirit in which they are offered—a mutual concern for enhancing the public good. We will also be contacting members of Congress in the same spirit. If there's anything we can do to assist the Commission in further understanding these suggested changes—or obtaining documents in support of them—please do not hesitate to contact us.

This process for amending the Federal Sentencing Guidelines for Organizations presents an exciting opportunity, one that will probably not come again for another ten years. We urge the Sentencing Commission to retain its *leadership role* in preventing corporate malfeasance by including the changes we've suggested in the final amendments.

Sincerely,

[signature on file]

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[2-156]

**PART B – REMEDYING HARM FROM CRIMINAL CONDUCT, AND
PREVENTING AND DETECTING VIOLATIONS OF THE LAW**

1. REMEDYING HARM FROM CRIMINAL CONDUCT

* * *

2. PREVENTING AND DETECTING VIOLATIONS OF LAW

§8B2.1 Effective Programs to Prevent and Detect Violations of Law

(a) To have an effective program to prevent and detect violations of law, for purposed of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation – Organizations), an organization shall—

- (1) Exercise due diligence to prevent and detect violations of law; and
- (2) otherwise promote and organizational culture that encourages a commitment to the ethical principles that inform compliance with law

Such program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting violations of law, as well as promoting an organizational culture committed to ethical principles, that is, one that demonstrates commitment to ethical principles and compliance with law. The failure to prevent or detect instant offense leading to sentencing does not necessarily mean that the program is not generally effective in preventing and detecting violations of law, as well as in promoting an organizational culture committed to ethical principles.

(b) Due diligence and the promotion of an organizational culture that encourages a commitment to compliance with law and the ethical principles that inform law within the meaning of subsection (a) minimally require the following steps:

- (1) The organization shall establish ethics and compliance standards and procedures to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles.
- (2) The organizational leadership shall be knowledgeable about the content, and operation, and effectiveness of the program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles.

[2-157]

The organization's governing authority shall be knowledgeable about the content, and operation, and effectiveness of the program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles, and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program to prevent and detect violations of the law, as well as to promote an organizational culture committed to ethical principles.

Specific individual(s) within high executive-level personnel of the organization shall be assigned direct, full-time overall responsibility to ensure implementation and effectiveness of the program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles. Such individual(s) shall be given adequate resources and authority to carry out such responsibility, including full participation in all major executive decisions, and shall report on the implementation and effectiveness of the program to prevent and detect violations of law, as well as in promoting an organizational culture committed to ethical principles, directly to the governing authority or an appropriate subgroup of the governing authority.

(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through exercise of due diligence, has a history of engaging in violations of law or other conduct inconsistent with an effective program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles.

(4)(A) The organization shall take reasonable steps to institutionalize its ethics and compliance program by

(i) using model practices in organizational and systems change and

(ii) communicating communicate in a practical manner its ethics and compliance standards and procedures, and other aspects of the program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles, to the individuals referred to in subdivision (B) by conducting effective training programs that include but are not limited to subjects such as ethical and legal decision making, and otherwise disseminating information, appropriate to such individual's respective roles and responsibilities, with special emphasis on the organization's executive team.

[2-158]

(B) The individuals referred to in subdivision (A) are the members of the governing authority, the organizational leadership, the organization's employees, and, as appropriate, the organization's agents.

(5) The organization shall take reasonable steps—

(A) to ensure that the organization's program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles, is followed, including use of monitoring and auditing systems that

(i) are designed to prevent and detect violations of law and ethical principles that inform law, and;

(ii) function at all levels and in all functions of the organization, including, but not limited to, the executive and governing authority level;

(B) to evaluate at least annually periodically the effectiveness of the organization's program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles; and

(C) to have a system whereby the organization's employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms to allow for anonymous reporting.

(6) The organization's program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles, shall be promoted and enforced consistently through appropriate incentives, such as including compliance with law and commitment to ethical principles as a major component in performance reviews, to perform in accordance with such program and disciplinary measures for engaging in violations of law and for failing to take reasonable steps to prevent or detect violations of law, as well as to promote an organizational culture committed to ethical principles.

(7) After a violation of law or ethical principles that inform law has been detected, the organization shall take reasonable steps to respond appropriately to the violation of law or ethical principles that inform law and to prevent further similar violations of law or ethical principles that inform law, including making any necessary modifications to the organization's program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles, and to the organization's business practices, as necessary.

[2-159]

- (a) In implementing subsection (b), the organization shall conduct at least annually ongoing risk assessment and take appropriate steps to design, implement, or modify each step set for the in subsection (b) to reduce violations of law or ethical principles that inform law identified by the risk assessment.

Commentary

Application Notes:

1. Definitions. For purposes of this guideline:

"Ethics and Compliance standards and procedures" means standards of conduct, such as a code of ethics or statement of values, and internal control systems that are reasonably capable of reducing the likelihood of violations of law and ethical principles that inform law.

"Governing authority" means (A) the Board of Directors, or (B) if the organization does not have a Board of Directors, the highest level governing body of the organization.

"Organizational leadership" means (A) executive high-level personnel of the organization; (B) executive high-level personnel of a unit of the organization; and (C) substantial authority personnel. The terms "executive high-level personnel of the organization" and "substantial authority personnel" have the meaning given those terms in the Commentary to §8A1.2 (Application Instructions – Organizations). The term "executive executive-level personnel of a unit of the organization" has the meaning given that term in the Commentary to §8C2.5 (Culpability Score).

"Effective" means not only the count resulting from specific program activities, but also (A) the impact (measured changes in knowledge, attitudes/values/beliefs, and/or short-term practice) of those activities and (B) the outcome of those activities (actual reductions in violations of law or ethical principles that inform law—or well-documented proxies for those violations).

Except as provided in Application Note 4(A), "violations of law" means violations of any law, criminal or noncriminal (including a regulation), for which the organization is, or would be, liable.

2. Factors to Consider in Meeting Requirements of Subsections (a) and (b).—

(A) In General.—Each of the requirements set forth in subsections (a) and (b) shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, the organization shall consider factors that include (i) the size of the organization, (ii) applicable government regulations,

[2-160]

and (iii) any ethics and compliance practices and procedures that are well documented generally accepted as standard or model practices for businesses similar to the organization.

(B) The Size of the Organization.—

- (i) In General.—The formality and scope of actions that an organization shall take to meet the requirements of subsections (a) and (b), including the necessary features of the organization's ethics and compliance standards and procedures, depend on the size of the organization. A larger organization generally shall devote more formal operations and greater resources in meeting such requirements than shall a smaller organization.
- (ii) Small Organizations.—In meeting the requirements set forth in subsections (a) and (b), small organizations shall demonstrate the same degree of commitment to compliance with the law and commitment to ethical principles that inform law, as larger organizations, although generally with less formality and fewer resources than would be expected of larger organizations.

1. Application of Subsection (b)(2).—

- (A) Governing Authority.—The responsibility of the governing authority under subsection (b)(2) is to exercise reasonable oversight of the organization's efforts to ensure compliance with the law and ethical principles that inform law. In large organizations, the governing authority likely will discharge this responsibility through oversight, whereas in some organizations, particularly small ones, it may be more appropriate for the governing authority to discharge this responsibility by directly managing the organization's ethics and compliance efforts.
- (B) Executive High-Level Personnel.—The organization has discretion to delineate the activities and roles of the specific individual(s) within executive high-level personnel of the organization assigned overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles; however, the individual(s) must be able to carry out their overall and direct responsibility consistent with subsection (b)(2), including the ability to report on the effectiveness and operation of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, to the governing authority, or to an appropriate subgroup of the governing authority.

In addition to receiving reports from the foregoing individual(s), the governing authority or an appropriate subgroup thereof typically should receive at least

annually/periodically information on the implementation and effectiveness of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, from the individual(s) with day-to-day operational responsibility for the program.

(C) Organizational Leadership.—Although the overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, is assigned to specific individuals within executive/high-level personnel of the organization, it is incumbent upon all individuals within the organizational leadership to be knowledgeable about the content, and operation, and effectiveness of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, pursuant to subsection (b)(2), and to perform their assigned duties consistent with the exercise of due diligence, and the promotion of an organizational culture that encourages a commitment to ethical principles that inform the compliance with the law, under subsection (a).

1. Application of Subsection (b)(3).—

(A) Violations of Law.—Notwithstanding Application Note 1, “violations of law,” for purposes of subsection (b)(3), means any official determination of a violation or violations of any law, whether criminal or noncriminal (including a regulation).

(B) Consistency with Other Law.—Nothing in subsection (b)(3) is intended to require conduct inconsistent with any Federal, State, or local law, including any law governing employment or hiring practices.

(C) Implementation.—In implementing subsection (b)(3), the organization shall hire and promote individuals consistent with Application Note 3(C) so as to ensure that all individuals with the organizational leadership will perform their assigned duties with the exercise of due diligence; and the promotion of an organizational culture that encourages a commitment to ethical principles that inform law compliance with the law, under subsection (a). With respect to the hiring or promotion of any specific individual within the substantial authority personnel of the organization, an organization shall consider factors such as: (i) the individual’s combined academic and certificated training in ethics and/or law, as well as training in organizational change strategies and behavioral training methodologies; (ii) the recency of the individual’s violations of law and other misconduct (i.e., the individual’s other conduct inconsistent with an effective program to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles); (iii) the relatedness of the individual’s violations of law and other misconduct to the specific responsibilities the individual is anticipated to be assigned as part of the substantial authority personnel of the organization; and (iii) whether the individual has engaged in a pattern of such violations of law and other misconduct.

1. Risk Assessments under Subsection(c).—Risk assessments required under subsection (c) shall include the following:

(A) Assessing periodically the risk that violations of law or commitment to ethical principles that inform law will occur, including an assessment of the following:

(i) The nature and seriousness of such violations of law.

(ii) The likelihood that certain violations of law or commitment to ethical principles that inform law may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of violations of law or ethical principles that inform law may occur, the organization shall take reasonable steps to prevent and detect those types of violations of law or ethical principles that inform law. For example, an organization that, due to the nature of its business, handles toxic substances shall establish ethics and compliance standards and procedures designed to ensure that those substances are always handled properly. An organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish ethics and compliance standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its business, employs sales personnel who have the flexibility to represent the material characteristics of a product shall establish ethics and compliance standards and procedures designed to prevent fraud. Furthermore, an organization shall establish ethics and compliance standards and procedures designed to prevent corporate malfeasance that may result from the decisions of executive management and governing authority.

(iii) The prior history of an organization. The prior history of an organization may indicate types of violations of law or ethical principles that inform law that it shall take actions to prevent and detect. Recurrence of similar violations of law or ethical principles that inform law creates doubt regarding whether the organization took reasonable steps to prevent and detect violations of law or ethical principles that inform the law.

(B) Prioritizing, periodically as appropriate, the actions taken under each step set forth in subsection (b), in order to focus on preventing and detecting the violations of law or ethical principles that inform law identified under subdivision (A) as most likely to occur and most serious.

(C) Modifying, as appropriate, the actions taken under any step set forth in subsection (b) to reduce the risk of violations of law or ethical principles that inform law identified in the risk assessment.

[2-163]

(D) *Assessing at least annually one or more of these characteristics of organizational culture: executive decision making process, impact and/or outcome of this process through use of an "ethics impact report," level of organizational trust, public image, relative disparity in employee compensation, bottom-line mentality and others that are well-documented in the literature.*

Background: This section sets forth the requirements for an effective program to prevent and detect violations of law. This section responds to section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002, Public Law 107-204, which directed the Commission to review and amend, as appropriate, the guidelines and related policy statements to ensure that the guidelines that apply to organizations in this Chapter "are sufficient to deter and punish organizational criminal misconduct."

The requirements set forth in this guideline are intended to achieve reasonable prevention and detection of violations of law, both criminal and noncriminal, for which the organization would be vicariously liable, as well as to promote an organizational culture committed to ethical principles. The prior diligence of an organization in seeking to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, has a direct bearing on the appropriate penalties and probation for the organization if it is convicted and sentenced for a criminal offense.

* * *

[2-164]

JUSTIFICATION for Suggested Changes to Proposed Amendments to FSGO

*It is questionable whether a compliance program can be truly effective
if it does not have an ethics component.*

--- Diana E. Murphy^y

The changes we have suggested to the Proposed Amendments to the FSGO can be divided into three general categories: Omission of Ethics, Expansion of Ethics and Compliance Program Purview, and Measurement of Program Effectiveness. For each of these categories, we will provide a justification for the suggested changes.

Omission of Ethics

There is no mention of “ethics” in the Proposed Amendments *even though*

- ethics was discussed extensively in the Advisory Group’s Recommendations for Proposed Amendments, primarily in relation to the new developments in the arenas of compliance, ethics, and corporate governance with which the Advisory Group was trying to “synchronize” its recommendations (though *not* in the amendments and commentary it actually recommended);
- ethics figures largely in the “new developments” mentioned by the Advisory Group. For example, the SEC, Sarbanes-Oxley Act of 2002, and the NYSE all encourage or require their constituents to move beyond a compliance-based program to an ethics/values/integrity-based program for the prevention of fraud, waste, and abuse. In addition, the FASB has recently proposed a rule that would change its approach from rule-based to principle-based. All of these “new developments,” although they preceded the Proposed Amendments, are bolder, more innovative, and consistent with best practices, than the Proposed Amendments;
- ethics is the real tenor of “organizational culture” as enunciated in the Proposed Amendments. The concept of “organizational culture” that is apparently substituted for “ethics” simply begs the question of how an organization gets “beyond compliance” and how it measures whether its culture “promotes compliance with law.” An organization can strengthen its compliance program by enforcing more compliance with law ever more rigorously (and penalties for noncompliance), but in doing so it risks turning itself into a police state. Alternatively, it can situate compliance in ethics inasmuch as the laws that are the object of compliance are already grounded in ethical principles. To do otherwise only reinforces what William Widen in a recent article in *The Business Lawyer* refers to as “technical compliance”ⁱ—or the Office of the Inspector General calls a “paper program”;
- ethics is no more “fuzzy” than the law. Both require interpretation, ethics within the organization as business decisions are made, and law in the judicial system by attorneys (and at much greater cost to the organization and public). Furthermore, the reluctance to refer to ethics in the Proposed Amendments seems to be based, in part, on the mistaken notion that by doing so they obviate the need for “...prosecutors to litigate and judges to determine whether an organization has a ‘good set of values’ or ‘appropriate ethical standards.’”ⁱ This is simply not the case. Prosecutors and judges would still have to make a separate determination about the effectiveness of the organizational culture in

[2-165]