UNITED STATES SENTENCING COMMISSION

WRITTEN TESTIMONY

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To: Judge Murphy

From: Frances Cook

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The attached testimony from Nov. 14 also may be useful. See pages 10-13 of Dr. Gilman's testimony, page 3 of Steve Priest's testimony, two letters from Bob Olson, and pages 2-3 of EOA's submission for the public hearing. ~~The~~ Marilyn mentioned that Todd sent the rough draft of the hearing transcript to you - these four individuals may have elaborated on the ethics/compliance issue in their oral remarks at the hearing. I also could look at Paula's copy of the rough transcript, if that would be helpful.

Dr. Stuart C. Gilman's Testimony to the Advisory Group on Federal Sentencing Guidelines for Organizations November 14, 2002

Introductory Remarks

Distinguished members of the Advisory Group panel, ladies and gentlemen in the audience:

It is a great honor for me to be here today, and I thank you for the invitation to address some of the important issues before you as you seek to revise the Federal Sentencing Guidelines for Organizations. As mentioned in my introduction, my name is Stuart Gilman, and I am the president of the Ethics Resource Center, a non-profit organization located here in Washington DC.

It is quite true that where a person stands on any given issue depends on where he or she sits. For that reason, I believe it is important to frame my remarks with some information about the Ethics Resource Center and the perspective we bring.

The ERC is one of the oldest nonprofits in the Untied States addressing the issue of ethics. Founded in 1922 as American Viewpoint, what is now the Ethics Resource Center was an educational corporation dedicated to helping immigrants become productive members of American society by teaching them about the values of our country. In the 1970s, with the upswing of concern for the ethical practices of business organizations, the Center's focus shifted to organizational ethics in business, government and non-profit entities.

In the Center's changed role, we drafted, published and distributed the first U.S. Code of Ethics for Government Service in 1980. In 1985, we provided consulting services to General Dynamics that resulted in the formation of the first comprehensive organizational ethics office in the United States. The same year we advised the President's Blue Ribbon Commission on Defense Management that led to the formation of the Defense Industry Initiative and served that body as its first independent reporting agency. Much of what the ERC helped create in concert with General Dynamics and in the DII was instrumental in formulating the model of "an effective program to prevent and detect violations" as later defined in US Federal Sentencing Guidelines for Organizations (FSGO).

Since then, the ERC has engaged in extensive applied research through its advisory services to organizations, and analytical research through such efforts as our National Business Ethics Surveys and projects undertaken by our Fellows Program. We have examined many of the issues under consideration by your group, including the role of leadership in the implementation of ethics programs, the sources of pressure to commit misconduct faced by employees, and the impact of an ethics program on the creation of an organizational culture.

Today the ERC has been asked to comment on three issues concerning proposed changes to Chapter Eight of the U.S. Federal Sentencing Guidelines for Organization. Specifically we have been asked to address the:

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Today the ERC has been asked to comment on three issues concerning proposed changes to Chapter Eight of the U.S. Federal Sentencing Guidelines for Organization. Specifically we have been asked to address the:

- Role of the leader in establishing and maintaining an ethical culture within an organization - including the positioning of the ethics office and ethics officer;

- Role of the Board of Directors in providing oversight and establishment of an ethical culture; and
- Creation of an ethical culture within an organization, and the extent to which the culture of an organization can be regulated by the Federal Sentencing Guidelines for Organizations.

I'd like to use the remainder of my time before you to address each of these important areas, in turn. The first is the role of the leader within an organization.

The Role of the Leader Within an Organization

Much of the recent conversation regarding organizational leadership has centered on business scandals and the most appropriate way to avoid similar circumstances in the future. As you already know, this response is most evident in the Sarbanes-Oxley Act of 2002. This legislation requires executive leadership to attest to the integrity of their organizations' financial reporting and overall operations. Such an outcome presumes an effective system of monitoring and oversight of the business conduct of the organization (as prescribed in Chapter Eight of the Federal Sentencing Guidelines for Organizations' reference to effective programs to prevent and detect violations). Attesting to fiscal integrity is only possible if monitoring and oversight are integrated into the systems and practices at all levels of the organization - this includes formal systems, the informal operating norms and the culture as understood by all employees.

To do that requires leadership. An executive can comply with Sarbanes-Oxley and attest to the integrity of his or her organization only to the extent that he or she has set a tone for organizational integrity at the top.

One of the most important ways this can be accomplished by a leader is by serving as a role model. A leader's behavior has the ability to shape employees' perceptions of what constitutes acceptable ethical behavior, as well as employees' views of the leader him or herself. In other words, leadership translates from the "top-down," the conduct of the superiors influencing the actions of the subordinates.

If ethical behavior is to be integrated throughout an entire organization, no matter the size, those who are seen as leaders must proactively encourage ethical behavior and facilitate (legitimize) ethical dialogue. When they do, their actions help shape and maintain an ethical culture.

Recent research from the ERC Fellows Program[1] supports the notion that being perceived as an ethical role model requires more than simply being an ethical person. Leaders must make visible the ethical challenges they face and the ethical standards they apply to any given situation. To illustrate, consider downsizing. Most CEOs freely describe the ethical challenges of downsizing in private conversations. Off the record, most executives will openly discuss the struggles, the dilemmas and the ethical reasoning that led to their decisions. But, these same leaders, when making public statements about downsizing, never mention ethics. Their decisions are often supported with statements about operating efficiencies, streamlining, increased productivity and cost controls - messages designed to impress stock analysts. Employees and other stakeholders naturally assume that these CEOs never considered the ethics of their choices. That is how ethical leaders can fail in the role of being an ethical role model - simply by failing to make the ethical issues explicit.[2]

This brings us to the question of who, in an organization, is a leader. While it is

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This brings us to the question of who, in an organization, is a leader. While it is

clear that high-level personnel such as the CEO, CFO, members of the Audit Committee of the Board, and other highly visible personnel are key leaders within an organization, it may be less intuitively apparent how much the behavior of employees down the "chain of command" affects the ethical culture because they too are leaders themselves. The key is not the "title" of the executive, but the role of the individual. Leaders must be understood in terms of impact on other individuals-senior leadership must be understood in terms of their impact on supervisors, who in turn impact on employees. According to an Office of Government Ethics survey conducted in 2000, "...supervisory attention to ethics has strong relationships with program outcomes. Simply put, when employees believe that their direct supervisors are genuinely concerned with maintaining an ethical environment and supporting ethical performance, their positive perceptions of the organizational culture and other employees' behavior also increases. Second, an unanticipated finding of the study is that supervisors...tend to have a more positive perception of cultural factors and outcomes than do non-supervisors."[3] Thus, leadership changes culture, but individual employee behavior is most directly impacted by the employee's immediate supervisor.

ERC Fellows Program research[4] provides supporting evidence that one's immediate supervisor(s) and peers exercise the most influence over one's perceptions of the standards for ethical business conduct in organizations. While lower level employees might not be recognized as "formal" leaders in the organizational hierarchy, it is clear that people at all levels of organizations can serve as "opinion leaders."

Despite the widespread nature of leadership in an organization, it is indeed true that in nearly every case the leader with the most impact over the entire culture of the

organization is the CEO. We cannot safely conclude that any one individual can effectively discern the needs of the entire organization when it comes to setting ethical standards, and for that reason we are especially concerned about the observed reality that ethics office staffs and ethics officers themselves seem to be "migrating" further down into the organizational hierarchy. In short, ethics officers in many companies are becoming increasingly removed from the CEO and the ethics committee of the Board. Ethics officers provide a critical linkage between senior executives' cultural values and supervisors' direction of behavior. Good ethics officers serve as a transmission link between supervisors and managers. If they are buried in the organization, ethics officers will become ineffective as advisors to and communicators for senior executives. And because of this, ethics officers are playing less of a role in communicating the values of the organizational culture to supervisors, who in fact have the greatest impact on the behavior of employees.

One reason for this migration downward of the ethics officer is the failure of the current language of Chapter Eight to specify to whom the ethics officer should report. Although the guidelines state that there should be high-level personnel responsible for an effective program, the ERC believes this language is too vague. It is our position that the ethics officer must have direct and unfettered access to the highest authorities within an organization, including the CEO, COO, CFO and appropriate members and/or committees of the Board.

One way to characterize this level of access is to see the ethics officer as a direct report of both the CEO and the Board. In contrast, when ethics officers are several levels away from the CEO/CFO/Audit Committee, it becomes very difficult for them to impact

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an ethical culture or contribute substantively to the ethical integrity of an organization.

The Role of the Board

Related to the idea of leadership and the integrity of an organization is the role and direction of the Board of Directors. The current business landscape makes it vital that Boards take an active role in shaping the ethical culture of the organizations they oversee. The Board of Directors sets the tone for the company as a whole. Since the Board is ultimately accountable for the consequences of an organization's actions, it has the responsibility of holding the CEO and other high-level employees liable for their decisions and actions. To exercise this responsibility effectively, the Board must be actively involved in ensuring that key aspects of ethics and compliance are addressed. The Board must oversee the design of the ethics program itself and accept accountability for its eventual success.

At a minimum, the Board needs to understand its responsibilities in determining the scope of the ethics program in several areas. In particular, the Board should have a role in determining:

1. The form and content of the information required of the ethics officer. Examples include: help line activity numbers, patterns in issues raised, disciplinary actions taken, actions to protect those reporting observed misconduct, training activity, internal assessments of employee perceptions of ethics program effectiveness, general employee attitudes, and evidence of adherence to or violations of the organization's compliance and ethics standards.

2. The focus of the ethics and compliance efforts, whether strictly compliance-based, more broadly values-based or reaching beyond the corporate boundaries to address broader social issues.
3. The role and organizational positioning of the Ethics Officer. We believe it is essential for Boards to recognize the urgency of expanding compliance programs (and simultaneously ethics officer roles) beyond satisfying legal and regulatory minimums.

It is our opinion that the FSGO should encourage Boards to go past simple benchmarking of current industry standards and compliance with current law and regulation. As the ultimate custodians of corporate ethics, Boards are responsible for meeting their fiduciary obligations to employees, shareholders, and ultimately society as a whole. In this way the FSGO will be empowering the judiciary to address society's demands that organizations meet the ethical standards of honesty, integrity, fairness and transparency-so evidently absent based on our recent experience.

Since a Board of Directors has ultimate authority over the scope of ethics programs within an organization, it naturally has jurisdiction over the search and selection criteria for CEOs. In order to ensure that the ethical goals of their organization are met, the Board is obliged to establish objectives for the ethical conduct of CEOs. Ideally, the Board would articulate selection criteria that reflect those characteristics that allow the organization to fulfill its ethical obligations.

Furthermore, the Board must design a performance review and compensation system for the CEO and other high-level personnel to ensure that the ethical culture of the organization is maintained. One example of such a system can be found in Royal

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Dutch Shell. In this company, 168 country chairpersons are required to submit a detailed annual accounting of such issues as: the ethical challenges they have addressed; steps they have taken to prepare staff to address those challenges; the impact of ethics and compliance on joint-ventures, local economies and local politics; how they have measured their ethics and compliance success/progress; specific measurable goals they would set for the coming year and more. These accounts must be submitted in a standardized format provided by Shell's International Directorate - an arm of the Committee of Managing Directors. All these letters are then gathered, summarized and analyzed for the Committee of Managing Directors.

To further lend legitimacy to the process, each country chair has a face-to-face meeting with his/her Managing Director to discuss the letter and amend the future plans. This meeting has direct feedback into the compensation decisions for that year. As the Shell example suggests, in essence, the Board's role in the framing of the ethical culture in a company gives it tremendous authority over the course of development for all of its employees.

A major challenge that every Board of Directors must face is the potential for conflicts of interest among high-level personnel and the Board. Conflicts may appear in decisions such as the selection of future Board members, executive selections, evaluations, compensation, and when to recuse oneself from the decision-making process. Some measures, however, may be taken to minimize the opportunity for such conflicts.

To reduce the potential for conflicts, the ERC believes that the involvement of a truly independent third party is necessary. At minimum, each Board should regularly

subject itself to an independent review of its major actions and decisions. That review should concentrate on the Board's oversight of the executive management team and its own freedom from conflicts of interest. Without such a platform of integrity coming from the highest level, the future of the organization will always be uncertain.

Ethical Culture

All of these actions ultimately result in the creation of a culture for an organization. In the final portion of my time this morning, I'd like to address the need for an ethical culture within an organization, and more importantly, the extent to which culture can be regulated by the Federal Sentencing Guidelines for Organizations.

The ERC believes that Chapter Eight of the Sentencing Guidelines should encourage organizations to foster ethical cultures, to ensure focus on the intent of legal and regulatory requirements as opposed to mere technical compliance that can potentially circumvent the intent or spirit of the law or regulation. We agree that the FSGO should require organizations to make systemic and sustained efforts to create a culture that fosters ethical business practices and ethical employee behavior. Those behaviors are, in part, based on perceived organizational expectations and observation of those actions that are modeled, punished and/or rewarded. Frequently, what we see modeled, rewarded and punished influences our beliefs of what is truly valued by the organization. These beliefs set a standard of ethical business conduct and such conduct becomes the presumptive choice of most employees.

The organization's efforts to create an ethical business culture should be observable, measurable and open to audit. There should be a demonstrated alignment of

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The organization's efforts to create an ethical business 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 and transparency of those systems and processes as a foundational element.

A thorough independent, third party 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 be a regular element of the organization's governance systems and will reveal the degrees of consistency with legal requirements, stated organizational values and ethical business practice.

A natural question arises from this observation involving how guidelines can effectively mandate ethical cultures. A first step is to regularly assess the effectiveness of the organization's leadership - at all levels - in applying the stated organizational values in strategic and tactical decisions and actions. Organizations should be able to identify the steps they have taken to assure that employee behavior is consistent with the values and codes of that organization. Outcomes can be evaluated including those evidenced in hiring practices, previous audits, violations of policy, recruiting and marketing practices, and rewards and disciplinary actions. Initial assessments evaluate the current ethical performance and provide baseline data for defining future objectives and assessing future progress.

For many organizations, an essential element of an effective ethics and compliance program is the creation of systems to encourage employees to report observed misconduct and to appropriately raise and voice their ethics concerns. It is well documented that employees are often unwilling to take such actions. Research on whistle

blowing suggests that the top two reasons employees fail to raise ethics concerns and/or report misconduct are: (1) a belief that nothing will be done and (2) fear of retaliation. These reasons have as much to do with organizational culture as with formal mechanisms such as anonymous reporting lines. A greater emphasis on ethical culture may help to encourage reporting by ensuring that such reports are valued, acted upon and result in appropriate responses. That includes positive consequences for the employee making the report.

Another way to understand the concept of an ethical work culture is to consider what we know about social interaction. Humans derive at least some norms of conduct from our peers, leaders, and environment. As strong as the moral compasses of individual employees may be, ethical dilemmas and uncertainties in the workplace will at some point lead them to seek confirmation of their views with others in the work environment. As a result, it is not uncommon for employees to align their actions to address the beliefs and expectations of the organization and/or their peers. If organizations impact on employees' moral development, they have an obligation to help employees refine their ability to recognize the ethical components of the situation with which they are dealing. They must show their employees how to apply ethical reasoning to the challenges that they face on a day-to-day process.

A commitment to intentional, positive moral development is more than just good public relations. When organizations effectively communicate why they want their employees "to do the right thing" it becomes easier for employees to conceptualize and put those values and expectations into action.

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checking a box on ethics and compliance (e.g. checking if there were no reportable violations) there is increased positive reinforcement that is essential in developing an ethical culture. The ERC believes that moral development does not stop as the child leaves the household, or the student leaves college, but rather continues for life. This makes it imperative that organizations take a direct hand in the moral development of their employees so that the positive, ethical values of that organization will be reflected in the actions and decisions of their employees.

Summary

In summary, my comments today reflect our commitment to a core principle - that legal compliance is a minimum standard. The FSGO should encourage organizations to reach higher, evolving towards the highest standards, not seeking the minimum which society will tolerate. We are experiencing a crisis of trust and confidence today. In part we attribute that crisis to the belief that many hold regarding the value of the ethical minimum - skating on the fine line of legal defensibility and turning one's back on the higher ethical principles. Public confidence in our institutions is too dear a price to pay for ethical minimalism. The bar must be raised and the suggestions and recommendations we have presented here today seek to urge you to do just that.

Thank you for the honor of allowing me to testify here today. I'll be happy to take any questions you have.

Statement of Steven J. Priest
President, Ethical Leadership Group
To the Ad Hoc Advisory Group on Organizational Sentencing Guidelines
United States Sentencing Commission

Thank you for inviting me to be with you today. I am gratified to know that this group of esteemed individuals will be making decisions to improve the existing-and already highly effective-Organizational Sentencing Guidelines. I am doubly gratified to remember that the Chair of the USSC, Judge Murphy, and indeed the entire USSC, had the foresight to create this Advisory Group and implement this process many months before the recent spate of corporate scandals came to light. The need for increased public trust in our business organizations was great when this process began; it is of course greater now than at any other time in recent history.

The views expressed here today are based on ten years of experience consulting on ethics and compliance issues. Most of our clients have been large, publicly traded corporations-including over 10% of the Fortune 200. Our clients come from the fields of insurance, financial services, energy, consumer products, retail, transportation, telecommunications, health care, pharmaceuticals, defense and technology. Through numerous benchmarking projects, surveys and program assessments, we have developed a fairly solid understanding of the characteristics of "an effective program to prevent and detect violations of the law." In reality, not on paper.

In my opinion the current Guidelines relating to effective compliance programs are very successful in offering guidance and incentives to organizations. At the same time, they remain sufficiently broad to allow for the incredible variety of organizations across the United States. So we have only a few modest suggestions for improvement.

1. Clarify that the Guidelines apply to "violations of the law," and not, more narrowly, "criminal conduct." Advisory group members know better than I do the public dismay in the U.S. over illegal actions of executives and organizations, both criminal and civil. Over the past four months I have spent almost half my time in Europe, Asia and Latin America, meeting with executives and many others. Concern over American business practices is very high, and threatens both our economic and our political stature. Nothing positive is gained by focusing solely on criminal conduct in the Organizational Guidelines; and indeed much is lost.

2. **In the portion of the Guidelines requiring "due diligence in seeking to prevent and detect violations of the law," add language explicitly indicating that such due diligence must include a periodic assessment of a program's effectiveness.** (Question 1g of request for additional public comments.) In the current Guidelines, it is arguable whether "assessment" is included or implied in §8A1.2, comment 3(k)(5) or comment 3 (k)(7). And while it is common sense that an organization must assess the effectiveness of its ethics/compliance program, in order to determine whether it is living up to the

Organizational Guidelines, in practice assessments are very often not done. Some organizations fear what they might find; others fear what plaintiffs' attorneys or regulators or attorneys general may discover.

These fears impede progress and effectiveness. Organizations that assess their programs have better programs than those that don't. Companies that benchmark their own practices vs. others in their industry almost always discover practices that they can improve. Organizations that conduct internal evaluations-through surveys, focus groups or other means-almost always discover opportunities for improvement. And something more: American organizations-even nonprofits-are motivated by competition and guided by metrics.

We know a company that was disappointed by the results of its first, baseline measurement of employee perceptions of its ethics/compliance program and culture. This spurred the management team to action, and improvements to the program were implemented. Follow-up surveys indicated significant progress for most divisions: more employees knew about the Code and had training in it; employees felt more comfortable in reporting issues; more employees understood the company's commitment; fewer employees reported concerns about unethical or illegal conduct. Overall, management was quite pleased by the results; they felt as if their efforts had accomplished something. The few divisions in which significant progress had not been made, however, were not so gratified by the results. Management in these divisions was held accountable and immediate improvements in their implementation of the compliance program were required. The marked improvement of this company's ethics and compliance program, an improvement that was inspired by the results of an assessment, provides a striking example of the benefits of such a review.

I have gone on at some length about the importance of adding language about assessments because we believe that such an addition will encourage continued innovation and improvement without imposing undue burdens. Note that we do not recommend using the word "audit," which has connotations we don't believe are appropriate for the Guidelines. Audit is a financial term of art that, for example, implies check-lists and outside auditors. We do not recommend mentioning the use of outside auditors, lawyers or consultants in this process, unless it is to specifically state that they are not required to conduct or take part in the assessment. Nor do we believe that an enumeration of the elements of the assessment is necessary or desirable. The Guidelines' governing emphasis on flexibility, which has proven to be such a successful approach, should apply here. Let the organizations decide for themselves what form the assessment should take. The simple and common sense guideline that organizations should periodically assess the effectiveness of their programs will be a sufficient driver of improved effectiveness.

3. Require compliance officers to report to the Chief Executive Officer and, where a Board of Directors exists, to an independent committee of the Board. (Question 1a, b and c)

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CEO and an independent committee of the organization's Board of Directors. (For many companies this has historically been the audit committee, but with the increased workload faced by members of this committee and the increased amount of governance, compliance and corporate responsibility issues faced by boards, a number of companies are looking to spread the burden.)

Reporting to the CEO and an independent committee accomplishes several key objectives. It sends a message to all employees in the company that law abiding behavior is important, indeed, a top priority. It gives the Compliance Officer credibility, and important resources to draw upon when necessary. It firms up the governance links between the Board, the CEO, and compliance. And it provides the Compliance Officer with a "Fail-safe" option in the case of a crisis involving top management of the company.

We do not believe it is necessary to add further definition to the roles of the CEO, CFO, other executives, or the Board. The reporting structure recommended here, especially combined with assessments outlined in recommendation #2, will drive appropriate oversight relationships within the company.

4. We do not advocate specifically including language about culture in the Guidelines. (Question 6 of your additional request for public comment.) A company culture that fosters ethical behavior (and punishes unethical or illegal conduct) is the most important element in determining whether "an effective program" exists. As a result, a fundamental precept of our organization is that we are committed to help companies strengthen cultures through their ethics and compliance programs. However, defining an "ethical culture" with precision is not a task that seems appropriate for the judicial branch of our government. Instead, we believe that requiring an assessment for program effectiveness (recommendation #2) will lead organizations on their own to emphasize the importance of cultures that do not tolerate illegal conduct.

The current Organizational Guidelines strike an excellent balance between specificity and flexibility. The three modest changes suggested here continue on this successful path.

1. Cover "violations of the law," not simply criminal conduct.
2. Include "assessment of the program's effectiveness" as a necessary component of due diligence.
3. Recommend a defined reporting relationship between the Ethics/Compliance Officer and the CEO, and an independent committee of the Board of Directors where applicable.

I am delighted to answer any questions you may have.

Alliance for Health Care Integrity

A Health Care Industry Initiative to
Integrate Compliance, Ethics, and Corporate Responsibility

Board of Directors

Mark Aulisio, PhD
Center for Biomedical Ethics
Case Western Reserve University

Louis Feuerstein
Ernst & Young LLP

Robert Olson, PhD, MPH, Chair

Andy Thurman, JD
West Penn Allegheny Health System

Patricia Werhane, PhD
The Darden School of Business
University of Virginia

Supporters and Sponsors

Myra Christopher
Midwest Bioethics Center

Tim C. Mazur, MBA
Ethics Advisory Services

Brian Schrag, PhD
Association for Practical and Professional Ethics

Paul Schyve, MD
Joint Commission on Accreditation of Healthcare Organizations

David C. Smith, PhD
Council for Ethics in Economics

Affiliations listed for identification purposes

Staff

Robert Olson, PhD, MPH
Executive Director

October 25, 2002

Office of Public Affairs
U.S. Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle
Washington DC 20002

ATTN: The Advisory Group on Organizational Guidelines

We would like to provide testimony at the public hearing on November 14, 2002. Here is a summary of our proposed testimony. Since we have already submitted more extensive remarks (see our letters dated February 21, 2001; November 1, 2001; and May 15, 2002), as well as met with Sentencing Commission staff in April 2001, we will limit our testimony.

- We commend the Advisory Group for taking this third step in updating and enhancing the Organizational Guidelines. They have served industry, government, and the public well, but, as experience and research will attest, they can be further strengthened to achieve their goal of preventing corporate crime—and promoting ethical corporate cultures.
- The questions that the Advisory Group put to the public for a response by October 5, 2002, laid the groundwork for updating the guidelines. However, with the exception of question #6, they represent efforts only to tweak existing compliance measures. We believe these legalistic modifications will bring only marginal returns while, unfortunately, adding to the already heavy regulatory burden on corporations. What is needed is a paradigm shift, one that addresses the root causes of corporate malfeasance instead of just its symptoms.
- Our answer to question #6 is a resounding "Yes." The guidelines should encourage organizations to "foster ethical cultures" that support the spirit of the law, not just its letter. As research has documented, an emphasis on the former brings a stronger return on investment that the latter, while at the same time reducing regulatory burden and enhancing employee commitment to the organization's core values.
- The commitment of an organization to its core values—which in most cases are consistent with the core values that underlie governmental regulation—can be measured in a variety of ways. Head-counting the number of employees receiving booklets or being trained is the weakest. A stronger measure addresses the impact of booklets received or training attended. That is, it investigates changes in knowledge, attitude/values/beliefs, and short-term behavior of the employees—and compares them to established standards. The strongest measure relates these changes to outcomes desired by the organization—and the government—specifically, reductions in fraud, waste, and abuse. Impact and outcome evaluation, then,

operationalizes the organization's commitment to its core values, quantifying them according to standards it has established by itself or ones consistent with the broader industry.

- Because these standards are generally consistent with the core values that already underlie governmental regulation, "fostering [an] ethical culture" leverages the impact and outcome of compliance interventions. By integrating ethics and compliance, then, both organizations and the public get a much greater return on their investment.

We strongly endorse the Advisory Group's interest in moving the Organizational Guidelines to the next level, achieving the type of breakthrough that is made possible only by embracing a shift in paradigm. Guidelines that encourage organizations to foster ethical cultures will harness the power that results from commitment to the intent of regulation, rather than mere compliance with its technical details.

Sincerely,

Robert Olson

Robert Olson, PhD, MPH
Executive Director

1035 Winthrop Drive, Corona CA 92882-6178
(714) 307-6400 bobolsonatahci@earthlink.net

operationalizes the organization's commitment to its core values, quantifying them according to standards it has established by itself or ones consistent with the broader industry.

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Executive Director

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Alliance for Health Care Integrity

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Board of Directors

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Center for Biomedical Ethics
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Association for Practical
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Paul Schyve, MD
Joint Commission on
Accreditation of Healthcare Organizations

David C. Smith, PhD
Council for Ethics in Economics

Affiliations listed for identification purposes

Staff

Robert Olson, PhD, MPH
Executive Director

May 15, 2002

Office of Public Affairs
U.S. Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle
Washington DC 20002

ATTN: The Advisory Group on Organizational Guidelines

We commend the Advisory Group on taking this first step in updating and enhancing the Organizational Guidelines. They have served industry, government, and the public well, but, as experience and research will attest, they can be further strengthened to achieve their goal of preventing corporate crime.

I'll limit my comments to three since I have already submitted more extensive remarks (see our letters dated February 21, 2001 and November 1, 2001), as well as met with Sentencing Commission staff in April 2001.

First, we recommend that the Guidelines be revised to integrate compliance and organizational ethics. Compliance represents a minimum standard of business practice, whereas ethics represents an optimal one. If compliance focuses on the tip of the iceberg, ethics focuses on the rest of it. By integrating compliance and ethics, one gains access to the core values—some would say the heart—of the organization and the individuals who comprise it.

Second, we recommend that the revised Guidelines strongly emphasize integrated compliance-ethics performance measures that have been designed by—and are verified by—all major stakeholders, *not just* corporate representatives, their advocates, and their professional and trade associations. These measures would surpass the typical nose-counting that occurs today by addressing changes in knowledge, attitudes/beliefs/values, and behaviors at individual and organizational levels over time—and relate them to the outcomes expected by the corporation and, more broadly, the industry.

Third, we recommend that Advisory Group consider the value of an independent, multi-stakeholder body that can certify the results of our first and second recommendations. At present, industry does not trust the regulatory and enforcement authority of government; government does not trust the self-assessment measures of industry; and the public doesn't trust either industry or government very much. It is our belief that a certifying body could build—and sustain—trust among all three groups, thereby delivering the best strategy for preventing corporate crime.

Thank you for this opportunity to share our recommendations with you.

Sincerely,

Robert Olson, PhD, MPH
Executive Director

1035 Winthrop Drive, Corona CA 92882-6178
(714) 307-6400 bobolsonatahci@earthlink.net

ETHICS OFFICER ASSOCIATION

Dedicated to promoting ethical business practices

Board of Directors

CHAIR, Nancy Thomas-Moore
Weyerhaeuser Company

VICE CHAIR, Gretchen A. Winter
Baxter International Inc.

Charles E. Abbott
Textron, Inc.

T. Michael Andrews
Stewart & Stevenson Services, Inc.

Frank Z. Ashen
New York Stock Exchange

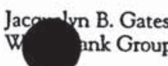
Jesse Battino
Sequa Corporation

James D. Berg
International Paper Company

Francis J. Daly
Northrop Grumman Corp.

Patricia J. Ellis
Raytheon Company

Jac[illegible]lyn B. Gates
W[illegible]nk Group



Patrick J. Gnazzo
United Technologies Corporation

Jerry D. Guthrie
BellSouth Corporation

Nancy McCready Higgins
Lockheed Martin Corporation

Robert Holmes, Jr.
Alabama Power

Barbara H. Kipp
PricewaterhouseCoopers

Thomas C. Mayer
Caterpillar Inc.

John H. O'Byrne
New York Life Insurance Co.

Edward S. Petry
Ethics Officer Association

Eric Pressler
PG&E Corporation

Alan R. Yuspeh
HCA

October 30, 2002

Todd Jones, Chairman
Advisory Group on Organizational Guidelines
c/o Office of Public Affairs
United States Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle, NE
Washington, D.C. 20002

Dear Mr. Jones:

The Board of Directors of the Ethics Officer Association (EOA) thanks you for the opportunity to present our views and recommendations regarding possible enhancements to the Organizational Sentencing Guidelines.

The EOA Board recognizes the immense impact the Organizational Sentencing Guidelines have had in shaping the activities of organizations that are working to prevent criminal and unethical activity. The Organizational Guidelines provide both a framework for effective compliance management and substantive incentives that encourage organizations to implement effective compliance and ethics programs. They have helped redefine corporate responsibility and to a great extent, have helped create the profession of ethics and compliance officers.

Although the Organizational Guidelines have had a substantial impact on organizational practices and culture, it is apparent from recent corporate compliance and ethics failures that the need to focus organizations on compliance, business conduct and ethics has never been more critical. Recent ethical failures by corporations, and the resulting crisis in public and investor confidence, have had significant detrimental effects on our economy, our institutions and our society. In response, the government, with implementation of the Sarbanes-Oxley Act, and the New York Stock Exchange (NYSE), with proposals to revise listing standards, are strengthening corporate governance and are requiring specific codes of conduct and ethics. As the Organizational Guidelines are revised, these other efforts should be examined so that common standards and direction are provided to organizations.

Background on the EOA

The Ethics Officer Association is a national organization of professionals that have come together to facilitate the exchange of ideas and information regarding compliance management, business conduct standards and business ethics. The EOA currently has over 800 members, including representatives from every major industry in the U.S.

30 Church Street • Suite 331 • Belmont • Massachusetts • 02478 • *phone:* (617) 484-9400 • *fax:* (617) 484-8330 • *website:* www.eoa.org

The EOA Board is composed of individuals representing twenty-one organizations that are EOA members. A list of current Directors and the organizations that they represent is included as Exhibit 1. The comments presented in this document are those of the EOA Board as an entity and may not represent the views of all EOA member companies. In addition, some individual Directors are also independently providing testimony for their organizations to the Advisory Group on Organizational Guidelines.

Recommendations

The EOA Board recommends that the Advisory Group maintain the flexible, non-prescriptive nature of the Organizational Guidelines as suggested changes to the Organizational Guidelines are considered.

The EOA Board offers recommendations in response to three questions posed by the Advisory Group, including:

1. Ethical Cultures. (Question 6). Should the Organizational Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes?
2. Neutral Office or Ombudsman (Question 1,f, iii). Should the Organizational Guidelines encourage the creation of a neutral or ombudsman office for confidential reporting?
3. Whistleblower Protections (Question 1,f, I). Should the Organizational Guidelines be more specific to encourage whistleblower protections?

Ethical Cultures

Effective prevention of criminal activity necessitates the development of an organizational culture that is supportive of full compliance and ethical business conduct. It is the view of the EOA Board that organizations should foster a compliant and ethical culture through conduct expectations and organizational values. By identifying conduct expectations and values that must be universally applied, employees are provided with a basis for business decisions when complex legal requirements may be unclear or when the law fails to specifically address behavior that may be in conflict with the interests of employees, investors and society. A commitment to ethics strengthens an organization's compliance program.

The need to address business conduct and corporate culture is recognized in the Sarbanes-Oxley Act and in the Securities and Exchange Commission proposed rules that were issued earlier this month to implement this Act. The SEC rules specifically address the need for a "Code of Ethics", which is defined as "a codification of standards that is reasonably necessary to deter wrongdoing and to promote":

- Honest and ethical conduct
- Avoidance of conflict of Interest
- Full, fair, accurate, timely and understandable disclosure
- Compliance with applicable governmental laws, rules and regulations
- Prompt internal reporting of code violations
- Accountability for adherence to the code.

The Corporate Accountability and Listing Standards Committee of the NYSE also proposed a requirement that "companies must adopt and disclose a code of conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive

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The Corporate Accountability and Listing Standards Committee of the NYSE also proposed a requirement that "companies must adopt and disclose a code of conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive

officers". As stated in the NYSE proposal, the code of conduct and ethics will "focus the board and management on ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide the mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability." The NYSE proposal also mandates that the code of conduct and ethics for each organization specifically require organizations to "proactively promote compliance with law, rules and regulations".

The EOA Board recommends that the Organizational Guidelines be revised to focus more directly on the need to communicate conduct expectations and organizational values. This change would be consistent with the Sarbanes-Oxley Act and with the NYSE listing standards recommendation. The EOA Board believes that this change would enhance the effectiveness of compliance management efforts and contribute to the prevention of unethical business activities.

The EOA Board recommends adding the following note to section to §8A1.2(k) of the Organizational Guidelines.

"The organization must have established and communicated conduct expectations and organizational values through a code of conduct and ethics or other mechanism appropriate to the organization. These conduct expectations and organizational values must include the requirement for full compliance with applicable laws and regulations and must be periodically and effectively communicated with employees".

Neutral Office or Ombudsman

In *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, the Honorable Diana E. Murphy, Chair, United States Sentencing Commission, stated "Not unlike the United States Constitution, the organizational guidelines contain simple statements of general principle that permit its application to varied and changing circumstances". The EOA Board agrees that one of the greatest strengths of the Organizational Guidelines is that they provide a general framework for compliance management without becoming overly prescriptive in directing organizations on the specific implementation of each of the seven program requirements. In taking this non-prescriptive approach, organizations have the flexibility to design compliance efforts in a fashion that best meets their organizational culture and individual assessment of compliance risk.

Since the EOA Board believes that maintaining maximum flexibility in the Organizational Guidelines should be a priority, we do not support a proposal to specifically encourage a neutral or ombudsman office. There are many different potential approaches that organizations may elect to implement to effectively meet the reporting system requirement. Implementation of a neutral or ombudsman office is only one of many possible approaches, and should not be specifically encouraged or required over other alternatives.

The EOA Board recommends that §8.1.2(k) 5 remain non-specific as to the required methodology of providing a reporting system. However, this section could be expanded to give examples of reporting systems, including ethics offices, compliance offices, ombudsman offices, hotlines and helplines.

Whistleblowing Protections

The Organizational Guidelines require organizations to provide a reporting system that employees and agents may use without fear of retribution. The effectiveness of a reporting system is dependent on individual participation by employees and on individual employees overcoming fears that they may have regarding the use of the system. It is our experience that fears are typically related to the potential for harassment or retribution based on a breach of confidentiality regarding the identity of the employee using the reporting system.

The EOA Board recommends that §8A1.2(k) 5 of the Organizational Guidelines should be modified to specifically address: 1) the need for confidentiality, and 2) the need to provide employees with the opportunity to anonymously use reporting systems. The EOA Board proposes the following language for this section:

"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 and by having in place and publicizing a reporting system that is confidential to the extent practical and which permits anonymous reporting, whereby employees and other agents could report violations of conduct expectations and values as well as criminal conduct by others within the organization without fear of retribution".

The EOA Board thanks you for the opportunity to provide comments regarding enhancements to the Organizational Guidelines.

Nancy Thomas-Moore
Chair
EOA Board of Directors

Gretchen A. Winter
Vice-Chair
EOA Board of Directors

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Nancy Thomas Moore

Nancy Thomas-Moore
Chair
EOA Board of Directors

Gretchen A. Winter

Gretchen A. Winter
Vice-Chair
EOA Board of Directors

PUBLIC HEARING OF THE AD HOC ADVISORY GROUP ON ORGANIZATIONAL GUIDELINES

Thurgood Marshall Federal Judiciary Building, Concourse Level, One Columbus Circle, N.E., Washington, D.C. 20002

November 14, 2002

AGENDA

WELCOME AND OVERVIEW 8:30 a.m. – 8:45 a.m.

B. Todd Jones
Chair, Ad Hoc Advisory Group on Organizational Guidelines

PLENARY SESSION PANEL I 8:45 a.m. – 10:15 a.m.

James W. Conrad, Jr.
Sidley Austin Brown & Wood LLP
Washington, D.C.
(Representing American Chemistry Council)

James Cowdery
Cowdery, Ecker & Murphy, LLC
Hartford, CT

Stuart Gilman, President
Ethics Resource Center
Washington, D.C.

Lynn Sharp Paine
Harvard Business School
Cambridge, MA

Steven Priest
Ethical Leadership Group
Wilmette, IL

PLENARY SESSION PANEL II 10:30 a.m. – 12:00 p.m.

James Comey
United States Attorney
Southern District of New York
New York, NY

Joshua Hochberg
Chief, Fraud Section
Criminal Division, U.S. Department of Justice
Washington D.C.

William B. Lytton
Executive Senior Vice President and General Counsel
Tyco International
New York, NY

Debra Yang
United States Attorney
Central District of California
Los Angeles, CA

Alan R. Yuspeh
Senior Vice President,
Ethics, Compliance, and Corporate Responsibility
HCA
Nashville, TN

12:00 p.m. – 1:30 p.m. LUNCH BREAK

1:30 p.m. – 4:00 p.m. CONCURRENT SESSIONS

SESSION I: LEADERSHIP, ACCOUNTABILITY, CORPORATE GOVERNANCE
Moderator: Ron James

James W. Conrad, Jr.
Sidley Austin Brown & Wood LLP
Washington, D.C.
(Representing American Chemistry Council)

Francis J. Daly
Corporate Director, Ethics & Business Conduct
Northrup Grumman Corporation
Los Angeles, CA

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

Joshua Hochberg
Chief, Fraud Section
Criminal Division, U.S. Department of Justice
Washington, D.C.

Robert Olson
Executive Director
Alliance for Health Care Integrity
Corona, CA

(See opposite side)

Gretchen A. Winter
Vice President and Counsel, Business Practices
Baxter International, Inc.
Deerfield, IL

Session II: Administration and Implementation of Compliance Programs
Moderator: Greg Wallance

Gale C. Andrews
Vice President, Ethics & Business Conduct
Boeing Company
Chicago, IL

Scott Avelino
KPMG
Washington, D.C.

Carole Basri
Executive Director
American Corporate Counsel Association of Greater NY
New York, NY

Nancy M. Higgins
Vice President, Ethics and Business Conduct
Lockheed Martin Corporation
Bethesda, MD

Barbara H. Kipp
PricewaterhouseCoopers, LLP
Boston, MA

Donald Langevoort
Georgetown University School of Law
Washington, D.C.

Eric Pressler
Director, Legal Compliance and Business Ethics
PG & E Corp.
San Francisco, CA

Deborah Yang
United States Attorney
Central District of California
Los Angeles, CA

E. Scott Gilbert,
Counsel, Litigation and Legal Policy
General Electric Company

Session III: Confidentiality, Internal Reporting, and Whistleblowing
Moderator: Win Swenson

Michael Goldsmith (former USSC Commissioner)
J. Reuben Clark Law School
Brigham Young University
Provo, UT

Patrick Gnazzo
Vice President, Business Practices
United Technologies Corporation
Hartford, CT

Charles Larson
United States Attorney
Northern District of Iowa
Cedar Rapids, IA
&
Chair, White Collar Crime Subcommittee of the Attorney General's Advisory Committee

Joseph E. Murphy
Compliance Systems Legal Group
Haddonfield, NY
(participating via teleconference)

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

Kenneth W. Johnson
Coordinator
Coalition for Ethics and Compliance Initiatives
Washington, D.C.

Session IV: Cooperation and Waiver of Privileges
Moderator: Gary Spratling

Mark Calloway
Alston & Bird LLP
Charlotte, SC

James Comey
United States Attorney
Southern District of New York
New York, NY

Earl J. Silbert
Piper Rudnick LLP
Washington, D.C.

James M. Griffin
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

PLENARY SESSION
PANEL I

SIDLEY AUSTIN BROWN & WOOD LLP

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WRITER'S DIRECT NUMBER
(202) 736-8118

WRITER'S E-MAIL ADDRESS
cbell@sidley.com

October 30, 2002

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

Re: November 14, 2002 Public Hearing

Dear Mr. Courlander:

Enclosed is testimony from the American Chemistry Council for the November 14, 2002 public hearing being held by the Ad Hoc Advisory Group on Organizational Guidelines to the U.S. Sentencing Commission. If you have any questions regarding this testimony, I can be reached at (202) 736-8118 or cbell@sidley.com.

Very truly yours,

Christopher L. Bell

cc: James Conrad
(American Chemistry Council)
David T. Buente

DC1 599140v1

STATEMENT OF JAMES W. CONRAD, JR., AMERICAN CHEMISTRY COUNCIL, TO THE ADVISORY GROUP ON ORGANIZATIONAL SENTENCING GUIDELINES TO THE UNITED STATES SENTENCING COMMISSION RELATED TO THE REVIEW OF CHAPTER EIGHT OF THE U.S. SENTENCING GUIDELINES

NOVEMBER 14, 2002

Good morning, my name is Jamie Conrad, and I am counsel with the American Chemistry Council. On behalf of the Council, I thank you for the opportunity to testify today before the Advisory Group on Organizational Guidelines to the United States Sentencing Commission.

The American Chemistry 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 business of chemistry is a $460 billion-a-year enterprise and a vital part 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.

The Council submitted written comments to the Advisory Group on May 16 and October 11 of this year. We have explained our views in some detail in these comments, including our responses to some of the specific questions posed by the Advisory Group. I would like to highlight some important principles for you today.

The Advisory Group has initiated the action called for by Congress in Sarbanes-Oxley.

In Section 805(a)(5) of the Sarbanes-Oxley Act of 2002, Congress directed the Commission to ensure that the *Guidelines* "are sufficient to deter and punish criminal misconduct." At least with respect to those elements of the Guidelines establishing the criteria for an effective compliance assurance program, the Advisory Group is already considering this question. Sarbanes-Oxley does not call for a separate or new review: you are simply ahead of schedule.

The *Guidelines* should continue to focus on criminal conduct in the context of criminal sentencing.

The Commission is charged with promulgating "detailed guidelines prescribing the appropriate sentences for offenders convicted of federal crimes." The courts use the *Guidelines* to sentence those convicted of crimes. The purpose of the *Guidelines*, therefore, is to "further the basic purposes of criminal punishment: deterrence, incapacitation, just punishment, and rehabilitation." The Commission should not stray from this mission. The *Guidelines* should not be expanded to address general issues of corporate social responsibility or ethics that are not governed by criminal laws or that are not directly relevant to criminal sentencing.

The Council's members strongly believe in ethical behavior and responsible social conduct. However, the Commission is tasked to address criminal conduct, not promulgate a code of ethics. Any suggested changes to the *Guidelines* must be evaluated in the very serious criminal sentencing context in which the *Guidelines* are used.

The *Guidelines* should not be used to encourage or force organizations 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 focus of the *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.

Any changes to the *Guidelines* should be based on objective evidence and a demonstrable need for change.

Any suggested changes to the *Guidelines* should be based on facts, not theory. Thousands of organizations have invested significant resources implementing compliance systems based on the *Guidelines*. Yet, we are unaware of any actual data or other evidence in the public record showing deficiencies in the *Guidelines* that need correcting. On the contrary, as the Commission has noted, the "organizational guidelines have had a tremendous impact on the implementation of compliance and business ethics programs over the past ten years." The Advisory Group should follow the adage: "If it ain't broke, don't fix it." Material changes should only be considered <u>after</u> finding the *Guidelines* are flawed and that the user community is demanding changes.

Some may say that something must be done because of the alleged criminal activities and corporate governance scandals that currently are high-visibility issues. However, the mere existence of alleged illegal or unethical conduct in some organizations does not mean that the *Guidelines* were at fault or that changing the *Guidelines* would have produced a different result. Changes to the *Guidelines* should be based on objective evidence that the *Guidelines* have not established adequate criteria for effective compliance systems, not on general concerns about unethical conduct. Further, one should not assume, without supporting evidence, that "ethics programs" necessarily prevent criminal misconduct. Indeed, an evidentiary project for this Group might be to determine whether some of the companies currently charged with illegal conduct had ethics programs and, if so, why those programs were ineffective in preventing the misconduct that occurred.

The *Guidelines* must remain flexible, practical and generally applicable to all organizations in all sectors.

The *Guidelines* currently offer the flexibility needed to allow organizations of all sizes and types to implement effective compliance programs. Any proposed changes to the *Guidelines* should take into account the small and medium-sized organizations that are the vast majority of U.S. businesses. This is not a theoretical concern. The Commission's statistics reveal that in FY 2000, some 87% of organizations sentenced under Chapter 8 had fewer than 200 employees, and that approximately 65% of all sentenced organizations had fewer than 50. Whatever obstacles small and medium-sized businesses face will not be lessened by increasing the level of detail or complexity in the *Guidelines*. Further, attempting to create unique provisions in the *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.

The "best practices" developed by sophisticated companies, consulting firms or academia should not become the model for what all organizations must undertake. While smaller organizations should follow the *Guidelines*, they should not be potentially subject to greater criminal penalties if they cannot implement the "best practices" of large enterprises.

The *Guidelines* already provide sufficient guidance on designing, implementing or auditing compliance systems.

Some commenters have suggested that the *Guidelines* should include more detailed guidance on designing, implementing or auditing compliance systems. These suggestions, however well-intentioned, are misplaced. The *Guidelines* should remain generic and applicable to all organizations.

There is no evidence of a "market need" for the Commission to provide detailed implementation guidance. There has been a proliferation of sector-specific, public, private, national and international guidance documents and standards on compliance assurance, many of which we surveyed in our May 16 comments. This vast literature is already available to the user community. It is not the function of the Commission to provide such general educational assistance through the *Guidelines*, since the failure of an organization to conform to the *Guidelines* can have direct implications in the criminal sentencing context.

Moreover, if the Commission were inclined to provide more detail on compliance programs, the practical impact of that effort must be carefully weighed. The available specific guidance on compliance programs continues to be refined and tailored to the needs of specific areas of regulation. For example, several Federal agencies have already developed sector-specific guidance or even regulations on compliance management systems. Adding detail to the *Organizational Guidelines* could create conflicts with these other efforts, leading to practical implementation problems.

The Guidelines do not need to provide more detail on "corporate governance."

It is no secret that corporate governance is a significant topic of public interest, and that there are several major legislative and regulatory initiatives that are making significant changes to corporate governance. Not the least of these are the new requirements just created by Congress in the Sarbanes-Oxley Act of 2002 and that are being implemented by various regulatory and self-regulatory bodies such as the Securities & Exchange Commission, the New York Stock Exchange and the National Association of Securities Dealers.

Adding specific corporate governance responsibilities in the *Guidelines* at this time could create conflicts with the flood of new requirements already being generated. For example, the *Guidelines* should not provide detail on the responsibilities of boards of directors or equivalent governance bodies in overseeing compliance programs. Not all organizations, particularly smaller ones, have such governance bodies, and the *Guidelines* already embody the principle that compliance programs should be supervised by "high level" personnel. Further, specifying the responsibilities of particular functions associated with corporate governance (e.g., CEO or CFO), expanding the definitions of "high level per-

sonnel," 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 *Guidelines*. These are all issues that are already topics of considerable federal legislative, regulatory and self-regulatory attention.

To provide one last example, more specificity on whistleblower protection is not necessary. We agree that whistleblowers must be completely protected from acts of retribution. However, the *Guidelines* already clearly state that internal reporting should be without fear of retribution. Further, many Federal and State statutes already provide specific whistleblower protections. Adding more specific whistleblower provisions in the *Guidelines* might either create conflicts with existing substantive laws or be duplicative, or even create loopholes that might result in less protection.

It is not the function of the Sentencing Commission to create new corporate governance rules. That is properly the province of Congress and the numerous regulatory bodies that have been delegated the authority to promulgate and enforce regulations on this topic. The remarkable extent of recent legislative and regulatory activity on this topic – in an otherwise stalemated political environment – demonstrates that there is not a "gap" that the Commission must fill. As the legal requirements on corporate governance are revised and expanded, organizations that implement compliance assurance systems that conform to the criteria in the *Guidelines* will necessarily have to include those new requirements in their systems. Therefore, without any modification to the Guidelines themselves, any new corporate governance requirements will become elements of an effective compliance assurance system.

Thank you again for the opportunity to speak today. I would be happy to answer any questions you may have, and look forward to participating in this afternoon's sessions.

JAMES T. COWDERY

James T. Cowdery concentrates his practice in the areas of white collar criminal defense and commercial litigation involving claims of fraud. He represents small and large businesses, as well as their officers, directors, employees and agents, in criminal investigations and prosecutions in the District of Connecticut. Mr. Cowdery has defended organizations and individuals in a wide variety of white collar investigations and prosecutions, including environmental, tax, securities, money laundering, false claims, RICO, antitrust, health care, bank fraud, public corruption, export administration, criminal trademark infringement, and other allegations of fraud brought under the mail fraud, wire fraud and false statement statutes.

Mr. Cowdery currently is a member of the Standing Committee on the Criminal Justice Act Panel of the United States District Court for the District of Connecticut. He has served as the Chairman of the Committee on Criminal Rules and Practice of the U.S. District Court for the District of Connecticut and as a member of the Merit Review Panel for Appointment of United States Magistrate Judges in the District of Connecticut.

Mr. Cowdery is the former Chief of the Criminal Division of the United States Attorney's Office for the District of Connecticut and former Chief of the Organized Crime Drug Enforcement Task Force. While at the United States Attorney's Office, Mr. Cowdery successfully prosecuted what was one of the largest money laundering cases in the United States. In 1989, he received the Federal Bar Association Younger Lawyer Award for Distinguished Federal Service.

Mr. Cowdery is a former law clerk to the Honorable Thomas J. Meskill of the United States Court of Appeals for the Second Circuit. He graduated with high honors from the University of Connecticut School of Law, where he served as the Editor-in-Chief of the Connecticut Law Review and received the William F. Starr Prize Fellowship for Scholarship and Leadership. He is a Phi Beta Kappa graduate of Trinity College in Hartford, Connecticut.

November 4, 2002

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SUMMARY OF TESTIMONY

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

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

A. PRELIMINARY NOTE: PUTTING SIZE IN PERSPECTIVE

1. What Is A "Small" Organization?

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

organizations that have been sentenced since January 1991,[1] 39 of them were closely held companies, almost all had fewer than 200 employees and most had fewer than 50 employees. Only 4 of them were public corporations.

2. The Contrast With Large Organizations

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

B. UNIQUE CONCERNS AND OBSTACLES FACED BY SMALL BUSINESSES

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

1. Credit for Compliance Programs

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

First, in almost every case, "an individual within high-level personnel of the organization [an owner, director, president, or vice president in charge of a business line]" will have "participated in, condoned or [been] willfully ignorant

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

of the offense." § 8C2.5(f). In most small businesses, where management authority tends to be concentrated in a very small control group, an owner or a high-level executive will have participated in, condoned or turned a blind eye toward the alleged violation. That results in a "rebuttable presumption that the organization did not have an effective program to prevent and detect violations of law."

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

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

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

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

ask how effective the program could have been in light of the violations that took place.

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

2. Credit for Cooperation

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

C. ALLOWANCES FOR SMALL BUSINESSES

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

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

to influence corporate behavior, might unintentionally create a system in which the sentences imposed on small businesses (which cannot access the carrots) become unduly harsh.

1. Statutory Factors

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

2. Three Chapter 8 Provisions Important To Small Businesses.

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

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

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

In the last 10 years, I have seen a growing trend among courts to order full restitution under 18 U.S.C. § 3663 regardless of ability to pay - even though the statute mandated consideration of ability to pay. More recently, courts have imposed restitution under 18 U.S.C. § 3663A, which requires full restitution regardless of the defendant's ability to pay. I am concerned that, in this environment, courts are becoming

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

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

3. Collateral Consequences on Small Businesses.

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

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

and in many cases causing it to fail.

Similarly, many regulated industries provide for substantial civil money penalties for violations. These civil money penalties are assessed on a per-violation basis in addition to the amount of the loss, and quickly pile up to astronomical levels. Moreover, the False Claims Act provides a bounty system in which whistleblowers can commence qui tam suits to recover for false claims to the government.

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

D. CONCLUSION

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

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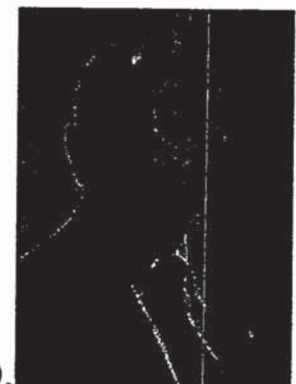
[5] Policy Statement § 8C4.9 does allow the court to depart downward if the organization's "remedial costs" greatly exceed its gain, but this may not apply to civil money penalties and, in any event, this relief may not be available to a small business because of the involvement of "substantial authority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



Stuart C. Gilman, Ph.D.
President

On February 25, 2002, Stuart C. Gilman, Ph.D. assumed the presidency of the Ethics Resource Center (ERC). The ERC is a nonprofit, nonpartisan, educational organization whose vision is an ethical world. Its mission is to be a leader and a catalyst in fostering ethical practices in individuals and institutions. The ERC fulfills its vision and mission through its groundbreaking ethics work in four core leadership areas: **Institution & Coalition Development, Research & Knowledge Building, Education & Advocacy and Consulting & Technical Assistance.**

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Stuart C. Gilman, Ph.D. assumed the position of the ERC president on February 25, 2002 after a 17 year career in the federal government. Prior to joining the ERC, Dr. Gilman served as the director of strategic development at the Office of the United States Treasury Inspector General for Tax Administration.

As the director of strategic development, Dr. Gilman was responsible for coordinating and directing initiatives to enhance efficiency and eliminate waste, fraud and abuse in the Internal Revenue Service. Between 1988 and 2001, he was a senior official at the United States Office of Government Ethics (OGE), where he served in several capacities, including associate director for education, special assistant to the director of OGE and associate director for integrity programs.

Dr. Gilman has served in a variety of liaison capacities with various government and private-sector anticorruption communities, including the President's Council on Integrity and Efficiency. He is an internationally recognized expert on government management and has consulted with and spoken to: the Organization for Economic Co-operation and Development (OECD), Council of Europe, the World Bank, the International Development Bank, the Organization for Security and Co-operation in Europe and the Rio Group.

In addition, Dr. Gilman has worked with many local, state and foreign governments. In the latter area, he was a member of the American delegation that negotiated the Organization of American States' Inter-American Convention Against Corruption. He

has chaired research groups for the OECD on several public management projects. He was a part of the planning groups that designed Global Anticorruption Forum I (in Washington, D.C.) and Global Forum II (in the Hague). At the request of the respective governments, Dr. Gilman has traveled to and acted as a consultant to the Administrative Control Authority in Egypt, the Parliament and the Public Service Commission of the Republic of South Africa, the National Office of Public Ethics in Argentina and the Ministry of Supervision in China.

Dr. Gilman has had a distinguished government and academic career including faculty appointments at the University of Richmond and Saint Louis University. He also served as professor of Public Policy and American Institutions at the Federal Executive Institute where he held a joint appointment with the University of Virginia's Institute of Government. He has taught or served as a visiting faculty member at Georgetown University, George Washington University, the University of Southern California and the University of Gottingen (Germany).

Dr. Gilman is widely published in the areas of policy and public management including several books, articles and journals. He serves on the editorial boards of *Public Integrity* and *The Journal of Public In*quiry, as well as the editorial board of Public Administration Review. In addition, for almost a decade, he was the "Integrity in Government Series" editor for the *Public Manager*. Dr. Gilman has been a member of the Fulbright Committee in public administration and was a founding member of the American Society for Public Administration's (ASPA) Center for Accountability and Performance. He is the immediate past-chairman and a founding member of ASPA's Ethics Section.

Dr. Gilman earned his bachelor's degree from the University of New Orleans, followed by a master's and Ph.D. in political science from Miami University. He has been a post-doctoral fellow at the Center for Advanced Study in the Behavioral Sciences at Stanford University and a N.E.H. Fellow at the University of Virginia. He is a graduate of the Senior Managers in Government Program at the John F. Kennedy School of Government at Harvard University. And, he has been a guest speaker for universities, private-sector companies and public agencies in the United States and throughout the world.

LYNN SHARP PAINE
Professor
Harvard Business School

Lynn Sharp Paine is a John G. McLean Professor at the Harvard Business School, where she is a member and former chair of the General Management unit. Currently head of the interest group on Ethics, Law & Leadership, she is also course head for the required MBA ethics module Leadership, Values, and Decision Making. In addition, her teaching assignments have included the required General Management course for MBAs and elective courses on ethics in both the MBA and Executive Programs. She is currently developing a new second-year course on Managing Across Cultures.

Ms. Paine's research focuses on management and organizational values. Author of numerous articles and nearly 150 case studies, she has just completed a book on the changing values of corporations titled Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance, (McGraw-Hill, October 2002). Her publications have appeared in a variety of books and scholarly journals including the Harvard Business Review, California Management Review, Journal of Business Ethics, Philosophy and Public Affairs, and the Wisconsin Law Review. She is also the author of Leadership, Ethics, and Organizational Integrity, a text and casebook published by Richard D. Irwin, Inc., in 1997. A Japanese edition of her casebook was published in 2000 and a Chinese edition in 2001.

A member of Phi Beta Kappa and a summa cum laude graduate of Smith College, Ms. Paine holds a doctorate in moral philosophy from Oxford University and a law degree from the Harvard Law School. A member of the Massachusetts bar, she practiced law with the Boston firm of Hill & Barlow after graduating from law school. She has also been involved in consulting, executive education, and organizational development activities for numerous companies and industry groups. In 1990-1991 Ms. Paine was a Fellow in Harvard's Program in Ethics and the Professions. Since 1991, she has served as a Faculty Associate of the Program. She also serves on the Advisory Board of Leadership Forum International (LFI) and on the Academic Council of the Fund for the Study of Crime and Corruption. Since its formation in June 2002, she has been a member of The Conference Board's Blue-Ribbon Commission on Public Trust and Private Enterprise, whose focus is restoring confidence in American capital markets.

Before joining the Harvard faculty, Ms. Paine was an assistant professor at Georgetown University's Business School. She has also served on the faculties of the University of Virginia's Darden School as well as National Cheng Chi University in Taiwan, where she was a Luce Scholar in 1976-77. Since 1987, she has been a permanent member of the Luce Scholar Selection Panel. She and her husband, Tom Paine, have three children and live in Wellesley, Massachusetts.

HARVARD | BUSINESS | SCHOOL

LYNN SHARP PAINE |
JOHN G. MCLEAN PROFESSOR OF BUSINESS ADMINISTRATION

November 1, 2002

Attn: Paula Desio
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By Fax: 202-502-4699
Original by U.S. Mail

Dear Mr. Jones:

I am pleased to accept your invitation to appear at the Advisory Group's November 14, 2002, hearing beginning at the Thurgood Marshall Federal Judicial Building in Washington, D.C. Unfortunately, however, I can attend only the morning session as my presence is required here at the School for at an important faculty meeting that same afternoon. It looks as though I will need to leave the hearing shortly after noon to catch the 1.30 p.m. shuttle back to Boston.

Having spoken with Ron James and Win Swenson, I plan to address three issues in my remarks: (1) the origins of corporate misconduct; (2) how best to build law-abiding companies; and (3) how this analysis relates to the Sentencing Guidelines. Of course, I will not attempt to treat these issues comprehensively, but only to highlight what I believe to be a few key points based on my research and experience.

I appreciate your invitation to contribute to the Advisory Group's important work and look forward to the hearing on November 14. I will submit a summary of my testimony at that time.

Sincerely,

Lynn Paine

Lynn Sharp Paine
LP/trb

P.S. Please let me know if there is any problem with submitting written testimony on November 14. Unfortunately, as I explained to Michael Courlander when I spoke with him just a moment ago, I am short of time to prepare the written materials before the week of November 11.

cc: Ron James, 651-962-4042 ; Win Swenson, 781-407-9218

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November 13, 2002

B. Todd Jones, Chairman
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Washington, D.C. 20002

Dear Mr. Jones:

Thank you for inviting me to testify at the November 14, 2002 public hearing of the Ad Hoc Advisory Group on Organizational Guidelines. My research has focused on strategies for building responsible companies-companies that conduct their business responsibly in relation to their core constituencies and the broader community-rather than ethics and compliance programs *per se*. So my work is not directly responsive to the questions posed by the Advisory Group. Still, my comments may be of some relevance to the Advisory Group's inquiry given the overall philosophy of the guidelines which, as I understand it, is to encourage and reward responsible corporate behavior-at least insofar as it involves behavior required by law.

In passing, I note that this philosophy appears to rest on two rationales. One has to do with moral culpability and just deserts: companies that have made a serious, good faith, and reasonably-likely-to-succeed effort to fulfill their responsibilities under the law (even though convicted of wrongdoing) deserve to be punished less severely than those that have not. The other rationale is pragmatic: by rewarding companies that have made such efforts, the guidelines will encourage more companies to do so and thereby increase the overall level of legal compliance among corporations subject to U.S. laws.

One issue I have explored through a number of case studies is the origin of misconduct in large companies. In selecting these studies, my focus has been principally on corporate misconduct-that is, misconduct undertaken in the company's name or on its behalf rather than misconduct against the company. And I have looked principally at companies that are well-regarded-at least prior to the misconduct. Virtually all of these cases have involved an untidy mixture of "unlawful," "arguably unlawful," and "questionable but lawful" acts and activities (as analyzed after the fact)-and thus defy the neat separation of law and ethics favored by some.

A theme that runs through these cases is the potency of the performance goals and targets set by management (and ultimately by the board of

directors). Often backed by strong financial incentives, these goals are powerful drivers of behavior and, by tradition, have not included legal compliance, code of conduct, or other ethics-related components. As a result, and particularly when short-term financial opportunities or pressures are strong, concerns about legality, ethics, and values naturally recede into the background if they are viewed as important at all. Individuals who achieve their targets are often handsomely rewarded with little or no inquiry into the legitimacy of the methods used, while those who raise questions about dubious tactics are shunted to the sidelines or worse. Most of these cases involve a mix of factors that, in summary, amount to (1) opportunities for goal-enhancing misconduct (though it is rarely characterized as such by its proponents); (2) strong reasons and incentives to pursue these opportunities; and (3) comparatively weak reasons and incentives to forego or avoid them. As this analysis suggests, the problem at its root is a skewed sense of priorities fostered by a too-narrow conception of performance that is typically reinforced by the company's formal and informal systems.

Based on these case studies as well as studies of companies that have sought to conduct themselves responsibly, I have concluded that responsible corporate behavior is the result of multiple factors falling under three broad headings:

1. <u>The company's leadership</u>: e.g., whether the leaders have the requisite skills and capabilities; whether they set appropriate goals and targets; whether they exemplify the standards and values they espouse for the organization
2. <u>The company's design:</u> e.g., whether appropriate considerations are woven into the company's core systems for planning, execution, and performance assessment; whether the requisite attitudes, skills, and capabilities are developed through the company's systems for hiring, training, and advancement; whether appropriate accountabilities are assigned and included in the company's performance evaluation and reward systems
3. <u>The company's decision making</u>: e.g., whether the company's decision processes incorporate an appropriate set of considerations; the nature of the analytic frameworks used and whether they include the requisite types of analysis and reasoning

In the schema I suggest, which likens society to a civic association, companies may choose their level of responsibility or ethical commitment: they may elect to be "dues payers" that comply with the law and avoid gross wrongdoing; they may elect to be "sustaining members" that adhere to generally accepted ethical standards and practice an ethic of mutuality; or they may choose to be "sponsoring members" that, in addition to complying with law and generally accepted ethical standards, also practice an ethic of contribution. (Each level encompasses the prior levels.)

Whatever level of responsibility companies choose, however, must be matched with the requisite leadership qualities, organizational attributes, and decision making skills needed for that level. In the end, management must create a context in which individuals and groups have the opportunity, ability, and desire to act responsibly as defined by the chosen standard.

These general observations, which are more fully developed elsewhere, lead to several suggestions regarding the issues before the Advisory Group:

- The temptation to offer ever more detailed specifications for acceptable compliance programs should be resisted. There is no "one right way" to build a responsible, law-abiding company. While general features can be outlined, the design details are best worked out in the context of an organization's specific legal and other responsibilities. Moreover, many factors interact with one another in shaping the behavior of a company and its employees. Equally or perhaps even more important than the ethics or compliance program *per se* are the quality of the company's leadership, the design of its performance management and compensation systems, and the quality of its decision making processes.

- At the level of general features, a striking omission from the hallmarks of an "effective program" is evidence of effectiveness. Given that flexibility in program design is necessary and desirable, it would seem appropriate to require companies to develop their own tools and measures of their program's effectiveness and to present evidence of effectiveness as part of their application for benefits under the guidelines. A significant unknown is the extent to which compliance and ethics programs actually do contribute to reducing crime and promoting law-abiding behavior. To my knowledge, there is no currently available, tested, and widely accepted tool or method for assessing a company's level of legal compliance or ethical performance more generally. By requiring companies to develop their own assessment methods, the Sentencing Commission would not only give substance to the requirement of an "effective program," but it would also stimulate innovation in this important area.

- In addition, and at the level of general features, the Commission should consider requiring a board-level committee to oversee the company's compliance and ethics efforts. To the extent that program officers may lack the clout necessary to address misconduct occurring at more senior levels of the organization and given the importance of leadership quality for corporate responsibility, board-level oversight would appear to be crucial. Moreover, in the absence of good measures of program effectiveness, board-level oversight would help assure the vitality and seriousness of corporate responsibility efforts, especially those related to ethics, legal compliance, and other areas not covered by traditional conceptions of financial responsibility.

- Finally, the centrality of performance assessment and compensation to the effective functioning of any organization suggests that ethics and compliance-related criteria should be included among the criteria used to evaluate and reward individual, business unit, and corporate performance.

I hope these comments are helpful to the Advisory Group and look forward to answering any questions at the hearing on November 14.

Sincerely,

Lynn Sharp Paine
LSP/trb

Steve Priest
Summary Biography

Steve Priest was described by the Wall Street Journal as "one of the most sought consultants to keep companies on the straight and narrow." For the last nine years Steve has been President of the Ethical Leadership Group, a Wilmette, Illinois consulting firm that specializes in ethics, values and compliance.

Steve has conducted seminars on business ethics in 16 countries. He speaks before organizations like the Conference Board, Institute of Internal Auditors, Young Presidents Organization and the Ethics Officer Association. He's raised awareness of the importance of ethical behavior on television, radio, newspaper and magazines.

Most of Steve's work, however, is with corporate clients. Priest has consulted with over 10% of the Fortune 200. The Codes of Conduct he has written are required reading for over one million employees around the world. His client list is filled with blue chip companies, including Honda of America, Abbott Laboratories, McDonald's, Marathon Oil and Sara Lee.

Prior to founding the Ethical Leadership Group in 1993, Steve Priest was for three years executive director of the Center for Ethics and Corporate Policy, a Chicago-based ethics think tank. Priest received his ethics training both in the real world of business and inside the ivy covered walls at Harvard University's Divinity School, where he received a Master of Theological Studies degree. He has his MBA and BA from the University of Chicago, and studied international organizational development in the Graduate Business School at the Katholieke University of Leuven in Belgium.

Steve Priest has founded, nurtured and sold two businesses. He also served as international marketing manager for a $50M manufacturer of consumer products.

In addition to consulting and speaking, Steve is Program Director of the Conference Board's Ethics Conference, and a member of the Board of Directors of DePaul's Institute for Business and Professional Ethics. He's the father of three children, who believe that good ethics and good leadership are pretty simple. In theory they are right. Putting theory into practical action for the real world of business is where Priest and the Ethical Leadership Group excel.

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Wilmette, Illinois 60091
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email ethical@aol.com

PROFESSIONAL EXPERIENCE

ETHICAL LEADERSHIP GROUP
WILMETTE, ILLINOIS
1993 to present.
President of consulting firm dedicated to encouraging ethical leadership at all levels within client companies. Primary focus on Fortune 500 firms; have served over 10% of the Fortune 200. Design and integrate ethics management systems that support client vision, values, and objectives. Assess areas of organizational strength and weakness. Effectively and evocatively communicate client policies and standards through ethics codes, articles, speeches and training.

CENTER FOR ETHICS AND CORPORATE POLICY
CHICAGO, ILLINOIS
1990 to 1993.
Executive Director of nonprofit organization dedicated to encouraging ethical leadership. Consulted with corporations, congregations, and nonprofits on ethics, values, quality, customer affection, and performance issues. Organized and publicized 12 major events featuring prominent CEOs. Gave over 50 speeches and media interviews, and wrote 10 published articles, raising the Center's public profile and image. Developed innovative programs, including "Encouraging the Moral Imagination." Increased corporate sponsorship by 40%. Strengthened staff and Board of Directors.

STEVEN PRIEST ASSOCIATES
YORK, MAINE
1986 to 1990.
Independent Sales Representative for manufacturers of seasonal merchandise and giftware. Increased sales from $260,000 to $1,300,000 in three years. Increased customer base from 250 to 800. Initiated direct mail, lead customer, and showroom strategies to boost sales. Top salesperson in country for three years.

ENCHANTMENTS
SPRINGFIELD, ILLINOIS
1986 to 1990.
Founder and Owner of unique Christmas and gift shop. Experimental model for an ethical, profitable business. 10% of profits donated to charity of customers' choice. Grossed over $175,000 in 1989, in only 900 square feet. Used concept of business responsibility to the community as a vehicle for extensive media coverage. Negotiated sale of business in 1990.

SILVESTRI CORPORATION
CHICAGO, ILLINOIS
1984 to 1986.
Marketing Manager - Hired and inspired staff of 12 to higher levels of creativity, production and personal growth. Responsible for overall strategic marketing direction, advertising, product development, and inventory management for leading $35 million gift company. Expanded market share, moving from #3 to #1 position in the industry. 70% of revenues from products introduced in previous two years.

Buyer and Divisional Merchandise Manager - Worked with corporate and outside designers and sales force to develop 150 new products per year. Successfully negotiated pricing, quality, and delivery of $10 million in annual business with manufacturers throughout Asia, Europe, and Mexico. Developed new manufacturing sources overseas.

Assistant to the President - Conducted market and competitive research in order to formulate and implement strategic plans and acquisitions, resulting in the creation of two new product divisions and one major line expansion.

EDUCATION

DIVINITY SCHOOL
HARVARD UNIVERSITY
Master of Theological Studies (MTS) June, 1988. Concentrated studies in philosophical and theological ethics applied to economics and business. Founded *Religion and Business Breakfast Club.*

GRADUATE SCHOOL OF BUSINESS
UNIVERSITY OF CHICAGO
MBA in finance and international business, December 1983. Research assistant for accounting professor. Assistant Resident Head and Counselor in undergraduate residence hall. Awarded full scholarship and stipend by the GSB to attend Katholieke Universiteit Leuven.

KATHOLIEKE UNIVERSITEIT LEUVEN
LEUVEN, BELGIUM
Concentrated studies in international business and organizational behavior at Graduate School of Business.

UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
BA with honors in highly selective interdisciplinary program: "Politics, economics, rhetoric, and law," June 1982. Active in campus ministry and student government.

OTHER PROFESSIONAL/COMMUNITY ACTIVITIES

Board of Directors, DePaul Univ. Institute of Business and Professional Ethics
Program Director, The Conference Board's Business Ethics Conference
Business Integrity Committee, Marathon Oil/Marathon Ashland Petroleum LLP

PLENARY SESSION
PANEL II

JAMES B. COMEY
PROFESSIONAL BIOGRAPHY

On January 7, 2002, Jim Comey was appointed United States Attorney for the Southern District of New York. Prior to assuming that position, he served from 1996 through 2001 as Managing Assistant U.S. Attorney in charge of the Richmond Division of the United States Attorney's office for the Eastern District of Virginia.

Mr. Comey was educated at College of William & Mary (B.S. with Honors 1982, Chemistry and Religion majors) and University of Chicago Law School (J.D. 1985). After law school, he served as a law clerk for then-United States District Judge John M. Walker, Jr. in Manhattan, and worked for Gibson, Dunn & Crutcher in their New York Office. He next joined the U.S. Attorney's Office for the Southern District of New York, where he worked from 1987 to 1993, eventually serving as Deputy Chief of the Criminal Division.

As a federal prosecutor, he has investigated and prosecuted a wide variety of cases, including firearms, narcotics, major frauds, violent crime, public corruption, terrorism, and organized crime. In the Southern District of New York, he served as lead prosecutor in United States v. John Gambino et al., a six-month mafia racketeering and murder trial. In the Eastern District of Virginia, he handled the Khobar Towers terrorist bombing case, arising out of the June 1996 attack on a U.S. military facility in Saudi Arabia in which 19 Airmen were killed.

In Richmond, Mr. Comey also served as an Adjunct Professor of law at the University of Richmond. Prior to joining the U.S. Attorney's office in Richmond in 1996, he was a partner at McGuireWoods, LLP specializing in criminal defense and commercial litigation.

Mr. Comey is married and has five children.

Joshua Hochberg

Joshua Hochberg has been the Chief of the Fraud Section of the Department of Justice in the Criminal Division since 1998. The Fraud Section implements and coordinates white collar crime enforcement policy and handles many cases of national significance. Mr. Hochberg is the Acting United States Attorney for Enron-related matters. In addition to securities fraud, Fraud Section investigations often involve health care fraud, violations of the Foreign Corrupt Practices Act, and a wide variety of advance fee and investment schemes. Mr. Hochberg was the Deputy Chief for Litigation in the Public Integrity Section from 1995 to 1998, and a Trial Attorney and Senior Litigation Counsel in the Fraud Section from 1986 to 1995. Prior to joining the Justice Department, Mr. Hochberg was an Assistant Attorney General in the New York State Medicaid Fraud Control Unit from 1975 to 1986. He is a graduate of New York University Law School.

The Effective Answer to Corporate Misconduct:

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William B. Lytton and Winthrop M. Swenson, "The Effective Answer to Corporate Misconduct: Public Sector Encouragement of Private Sector Compliance Programs," *ACCA Docket* 20, no. 10 (2002): 42–57.

Public Sector Encouragement of Private Sector Compliance Programs

By William B. Lytton and Winthrop M. Swenson

Twelve years ago, we (and others) collaborated on the development of a groundbreaking government initiative, an initiative that we believe still offers a promising model for tackling the kind of corporate scandals that have rattled the country in recent months. The government initiative was a somewhat obscure, but very important, set of laws called the Federal Sentencing Guidelines for Organizations ("FSGO"). These laws determine what penalties apply when corporations are convicted of federal crimes.[1]

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William B. Lytton recently left as senior vice president and general counsel at International Paper Company in Stamford, CT, to become the new executive senior vice president and general counsel at Tyco International, New York. He is also the immediate past chair, ACCA/GCCA's board of directors. He is available at wlytton@tyco.com.

Winthrop M. Swenson is a partner in Compliance Systems Legal Group in Washington DC, and a principal in Integrity Interactive Inc. in Dedham, MA. He is available at wswenson@cslg.com.

Back then, one of us (Lytton) was general counsel of a large subsidiary of a Fortune Ten company. The other (Swenson) chaired the task force at the U.S. Sentencing Commission ("Commission") responsible for drafting the FSGO. Our paths crossed because Swenson's task force, in an effort to craft a sensible approach to corporate sentencing guidelines, sought out private sector input and Lytton's company at the time, GE Aerospace, had been part of an innovative, industry-wide initiative to develop sound self-policing practices in the defense industry.[2]

With the benefit of this input, the Commission settled on an approach to the FSGO that remains instructive today: to be effective, government should do more than just focus on regulating and punishing corporate conduct. Rather, it should find ways to promote efforts by companies themselves to develop strong, internal compliance programs.

Let us be clear from the beginning: rewarding companies that implement effective internal compliance programs should supplement, but not replace, imposing criminal and civil penalties on companies that fail to implement such programs and break the law. When the carrot of rewarding companies that make it a priority to create an ethical and compliant culture is combined with the stick of penalizing those that do not, experience shows that the best results are achieved.

As this article will show, the Commission's approach, that of fostering good corporate citizenship in the form of effective compliance programs, has yielded tremendous dividends over the last decade. And yet despite the cacophonous cries that have echoed from Main Street to Wall Street to Capitol Hill to do something about corporate crime, few have focused on this compelling approach.

We believe that the legislators, regulators, prosecutors, and courts, collectively known as our government, are at a crossroads when it comes to corporate misconduct. Although the FSGO have spurred the development of strong and effective corporate compliance programs, there are limits to what one policy can do. Moreover, other laws and public policies actually create disincentives to effective compliance. Thus, we are faced with a clear policy choice that challenges us to decide between form on the one hand and substance on the other.

WHEN THE CARROT OF REWARDING COMPANIES THAT MAKE IT A PRIORITY TO CREATE AN ETHICAL AND COMPLIANT CULTURE IS COMBINED WITH THE STICK OF PENALIZING THOSE THAT DO NOT, EXPERIENCE SHOWS THAT THE BEST RESULTS ARE ACHIEVED.

Government can choose attention grabbing tactics that produce great stories but limited success, or it can focus on a highly effective approach that results in fewer headlines. "Dog Does Not Bite Man" stories rarely appear but actually bring us closer to achieving what should be our common goal: corporations that honor and obey both the letter and the spirit of the law. The first approach is a good recipe for generating the occasional caught-another-one headline. The second, we believe, is a recipe for actually making a sustained and sustainable difference.

THE THINKING BEHIND THE FSGO

When the Sentencing Commission started working on the FSGO in 1988, it began by looking at what the courts had been doing in corporate criminal cases historically. The Commission found curious results: criminal penalties ranged from

requiring one company to donate three executives' time to charity,[3] to a case in which a corporation was sentenced to a term of "imprisonment."[4] Some penalties for wrongdoing were steep, but others were so low as to be meaningless.[5]

Astonishingly, the review of hundreds of corporate sentencing cases revealed virtually no cases in which a court had tried to assess what would seem to be a rather fundamental question: Had the offending company tried to prevent and detect the misconduct in the first place through such activities as a code of conduct, policies, training, auditing—in short, a compliance program? This consideration simply did not seem to be on the courts' minds.

This fundamental question is where the

THE TRADITIONAL APPROACH TO ENFORCING CORPORATE CRIME LAWS WAS LIKENED TO THE WAY THAT STATE POLICE DEPARTMENTS ENFORCE SPEEDING LAWS ON INTERSTATES: BY DOTTING THE OCCASIONAL PATROL CAR ALONG MILLIONS OF MILES OF HIGHWAY.

Commission broke ground. Under the FSGO, courts sentencing convicted corporations must consider whether the company had a compliance program. If the company had such a program and otherwise acted as a good corporate citizen at the time of the offense, the fine is vastly lower than would otherwise be the case.[6] Compliance programs, in other words, are at the heart of the FSGO's carrot-and-stick penalty structure.

In arriving at this compliance-centered policy, the Sentencing Commission made three observations that are as true today as they were in 1991 when the FSGO were promulgated. First, the Commission saw that there were decided limits to what prosecutors, investigators, or other after-the-fact enforcement officials—no matter what their numbers—could do to stem corporate crime. Of course, vigorous enforcement is a critically important tool in the fight against corporate crime, but the Commission saw a realistic recognition of the limits of what the enforcement community could do on its own.

The traditional approach to enforcing corporate crime laws was likened to the way that state police departments enforce speeding laws on interstates: by dotting the occasional patrol car along millions of miles of highway.[7] You catch some offenders that way, and traffic generally does slow down when the patrol cars are spotted, but realistically, the process is hit or miss at best, and where enforcement is not directly visible, experience shows that some will be tempted to flout the rules. The Commission reasoned, therefore, that to effectively prevent and detect corporate wrongdoing, companies themselves needed to be made part of the solution. Companies could work at the problem in a way that enforcement personnel could not: from the inside—like governors on cars that limit how fast the vehicle can travel.

The second observation on which the Commission hung its procompliance policy related to the broadly sweeping nature of the American legal doctrine of vicarious corporate liability.[8] The Commission recognized that under this doctrine companies could be convicted of corporate crimes rather easily, even when they had policies specifically directing their employees to comply with the law that had been violated.[9] All that a conviction really required was that a single employee out of perhaps tens of thousands of fellow workers broke the law during the course of employment.

Given the breadth of this doctrine, the Commission saw that very different kinds of companies could be convicted of crimes. On one end of the spectrum of potentially liable companies were those that had done everything reasonably possible to prevent violations and perhaps had even voluntarily disclosed the misconduct involved, but nevertheless had seen what amounted to a rogue employee break the rules.

On the other end of the spectrum were companies whose senior management actually participated in the misconduct. Both kinds of companies could be criminally liable for the acts of their employees, but the two categories of companies could not be more different. The Commission wanted the penalties dictated by the FSGO to reflect these starkly different kinds of companies.

The third observation that the Commission made—at the time, really more a hypothesis than an observation—was that putting in place a sentencing scheme that greatly varied penalties according to whether the company in question had a strong compliance program or not would, in turn, create incen-

tives for companies to adopt compliance programs. Such a policy would credibly and powerfully say that compliance programs counted.

These three ideas served as the rationale for the FSGO's procompliance policy. To make the formula work, however, the Commission had to define the kind of compliance program that would receive credit. Here, the Commission made another important decision. Building on self-policing principles instituted by the defense industry in the wake of the "Ill Wind" scandals in the late 1980s,[10] the Commission resisted the bureaucratic temptation to prescribe a highly detailed model for a qualifying compliance program. Rather, the FSGO definition of an effective program to prevent and detect violations of law outlines broad categories of activities, each of which is deemed critical to make compliance programs work.

These categories include conducting a realistic assessment of the company's actual risks, having high-level oversight of the program, communicating, training, and auditing with respect to compliance risks, and enforcing the program through discipline.[11] Companies are expected to determine the specific means to execute the prescribed categories of activity based on such matters as their size, the nature of their business, and their past history.[12]

The FSGO contain one additional, overarching criterion, however. The program must be "designed, implemented and enforced so that it generally will be effective."[13] With this requirement as the guiding principle and a carrot-and-stick formula that means that compliance really counts, the Commission expected that companies would, over time, develop compliance best practices.[14] The Commission itself conceded that its procompliance policy was an experiment.[15]

THE EFFECTS OF THE FSGO

Work remains, but the experiment has been a resounding success. Before 1991, when the FSGO were promulgated, no professional association of compliance and ethics officers existed, there was very little literature on the practicalities of managing compliance programs, few conferences focused on the topic, and, truth be told, too few companies outside the defense industry had sophisticated compliance programs. Most companies had policies, but the kind of comprehensive model for effective compliance prevention and detection outlined in the FSGO had yet to be widely adopted.

After 1991, this situation changed. The Ethics Officer Association ("EOA") was formed in 1992 with 12 members and, as a direct response to the FSGO, has ballooned to more than 800 in 2002. EOA's members regularly meet to share best practice information on how to implement and sustain compliance programs that meet the FSGO standards. Members include in-house compliance and

INSTEAD OF LABELING THESE INTERNAL REPORTING RESOURCES AS HOTLINES, WHICH TOO OFTEN CARRIED A STIGMA OF BEING "RATFINK" LINES, COMPANIES CALLED THEM COMPLIANCE ADVICE OR HELPLINES AND PUBLICIZED THEIR USE AS A BROAD RESOURCE FOR RAISING CONCERNS AND GETTING ANSWERS ABOUT HOW TO DEAL WITH PARTICULAR SITUATIONS BEFORE THEY BECOME PROBLEMS.

ethics officers from about half of the Fortune 500.[16] Other compliance associations specific to various industries, such as telecommunications and pharmaceutical, and compliance associations specific regions, such as New England Ethics Forum, Northwest Ethics Network, and Bay Area Compliance Association, also have sprung up to share best practices information.

The Practising Law Institute and the Conference Board began running annual conferences on corporate compliance in the 1990s, and the Sentencing Commission itself joined with EOA to run excellent regional programs on compliance.[17] Periodicals focusing exclusively on compliance programs have sprung into existence,[18] and treatises on compliance have been written.[19]

All of this activity coincided with a rapid growth in the number of companies with compliance programs. And as more companies developed and shared compliance experiences, the sophistication

of programs grew, as well. Companies learned that user friendly, values-based codes of conduct were more effective than unreadable, legalistic ones. Hotlines were implemented to encourage good faith reporting by employees of compliance issues when normal channels were unavailable, but best practice experience eventually led to a refinement. Instead of labeling these internal reporting resources as hotlines, which too often carried a stigma of being "ratfink" lines, companies called them compliance advice or helplines and publicized their use as a broad resource for raising concerns and getting answers about how to deal with particular situations before they become problems. Companies also have developed a variety of ways to better build compliance into everyday decisionmaking, ranging from having compliance reflected in performance evaluations to having compliance officers directly involved in setting business strategy.

WHAT IS HIGHLY SIGNIFICANT IS THAT, BY AND LARGE, COMPANIES WITH STRONG COMPLIANCE PROGRAMS HAVE EXCELLENT TRACK RECORDS ON COMPLIANCE. IN SHORT, THE EVIDENCE IS THAT COMPLIANCE PROGRAMS WORK.

More and more companies are today using technology to promote compliance, too. Compliance intranet sites with policy links and resources are common, and web-based training on compliance risk areas, such as antitrust, insider trading, and conflicts of interest, is becoming the norm. Companies are learning that web-based training does not obviate the need for all in-person training, but that it does create an effective baseline for teaching employees about compliance risks—wherever they are around the world. And by taking the lion's share of training off the shoulders of legal departments, lawyers are able to spend more time counseling in areas where in-person advice is most needed.

After the FSGO were promulgated, other enforcement policies and corporate liability case law, which up to that point had generally been oblivious to compliance programs, began following the FSGO rationale. This collection of policies and pronouncements further supported the trend within the business community of building more and better compliance programs.

The U.S Department of Health and Human Services developed "model compliance plans" explicitly based on FSGO compliance criteria that detail expectations for compliance programs in various health care subindustries.[20] Likewise, the U.S. Environmental Protection Agency adopted the FSGO compliance criteria in developing its policy, "Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations,"[21] which provides for reduced civil penalties and no criminal liability in some circumstances for companies with environmental compliance programs. Case law and policies in the equal employment opportunity ("EEO") area also now address the importance of compliance programs.[22]

Two of the most important developments were not tied to any specific compliance risk area but rather are general endorsements of compliance programs. First, in the 1996 case, *In re Caremark Derivative Litigation*,[23] the influential Delaware Chancery Court opined, in approving the settlement of a shareholder derivative suit, that compliance programs could make the difference in deciding whether directors and officers should be personally liable for the harm caused by employee misconduct.

Second, and perhaps most significantly, the Department of Justice weighed in on the importance of compliance programs in a seminal restatement of corporate criminal charging policy in 1999.[24] Known as the "Holder Memo" because it was first circulated under a cover memorandum by then Deputy Attorney General Eric H. Holder Jr., the policy is now part of the U.S. Attorneys Manual. It provides that—never mind about sentencing for the moment—evidence of a rigorous compliance program should be considered in determining whether criminal charges should be filed against a company at all. In other words, companies that have exemplary compliance programs may—for good policy reasons—escape criminal prosecution even though a legal basis for prosecution exists.

The success of these policies and particularly of the FSGO, which preceded and largely drove the creation of all of them, can be measured by one demonstrable fact: companies with rigorous compliance programs have generally avoided serious com-

pliance problems. Data maintained by the Sentencing Commission shows that these companies are almost never criminally charged.[25]

This observation is not to say that companies with compliance programs have perfect track records, but then again, perfection—while a laudable goal—would be an unreasonable standard. In large companies, just as is true in towns and cities of comparable size, some will flout the rules. Based upon the percentage of employees within an organization who typically commit fraud, it would not be unusual to find that government agencies have as much or more of a problem than most large corporations. The Department of Justice itself notes in its corporate charging policies that "the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation's employees . . . ."[26]

UNDER THE FSGO, A COMPANY CONVICTED OF A CRIME THAT HAD A GOOD COMPLIANCE PROGRAM AND VOLUNTARILY DISCLOSED THE MISCONDUCT IN QUESTION IS LIKELY TO FACE ONLY A NOMINAL FINE.

What is highly significant is that, by and large, companies with strong compliance programs have excellent track records on compliance. In short, the evidence is that compliance programs work.

NOW THE BAD NEWS

In the wake of headline cases that have captured the country's attention, policymakers have been busy demonstrating that they mean business. Some of their responses have followed the procompliance idea. Proposed listing requirements by the New York Stock Exchange, for example, require codes of conduct,[27] and recent federal corporate crime legislation, the Sarbanes-Oxley Act of 2002, promotes protection from retaliation for those who report compliance issues internally, an accepted principle of compliance best practices.[28]

But overall, it is probably fair to say that a great deal of recent policymaking activity has been focused more on high-profile "get tough" symbolism—new penalties for this, higher penalties for that, more hoops for companies to jump through—than less visible but even more effective measures. This trend is too bad because, although the FSGO and their progeny over the last decade have done tremendous good in terms of conscripting companies into the fight against corporate crime, as one prosecutor aptly put it,[29] the sad reality is that much more needs to be done.

MIXED MESSAGES

The risk is that these various new laws and policies that are bolted on to existing rules will send mixed messages to companies about the importance and effectiveness of internal compliance programs. Indeed, even in cases in which companies are fully committed, some of these laws and policies actually make achieving effective compliance programs more difficult. Here are some examples.

Damned If You Do, Damned If You Don't

Under the FSGO, a company convicted of a crime that had a good compliance program and voluntarily disclosed the misconduct in question is likely to face only a nominal fine. And under the Department of Justice's corporate charging policies, the same company would be a good candidate for not being criminally prosecuted at all. If the misconduct happens to have involved fraud against the government, however, the same company, the one that had had a strong compliance program and had disclosed the misconduct, would likely be charged under the civil portion of the False Claims Act and face a civil fine as high as the highest FSGO criminal fines typically ever imposed. The highest FSGO criminal fines are typically twice the loss from the fraud and are reserved for "bad actor" companies without compliance programs.[30]

This Is Our Policy, But Don't Quote Us on That

As discussed above, the Holder Memo, which outlines policy of the Department of Justice on charging corporations, indicates that prosecutors should weigh a company's compliance program in determining whether to charge the company. The statements by the Department of Justice about actual cases, however, raise doubts about whether

(continued on page 53)

From this point on . . .
Explore information related to this topic.

ONLINE:

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- John K. Villa, *In-House Counsel: What Are Your Ethical Obligations When Management Engages in Illegal or Improper Conduct?* CORPORATE COUNSEL GUIDELINES § 3.07 (West and ACCA 2001), available on ACCA Online℠ at www.acca.com/legres/enron/corporateladder.html.

ON PAPER

- BNA/ACCA COMPLIANCE MANUAL: PREVENTION OF CORPORATE LIABILITY.
- COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES (Kaplan, Murphy, and Swenson, eds.) (West 1993, annually supplemented).
- Commissioner Michael Goldsmith, "Commentary on Existing Law," in U.S. Sentencing Commission Symposium Proceedings, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation* 351–57 (September 7–8, 1995).
- Goldsmith & King, *Policing Corporate Crime: The Dilemma of Internal Corporate Compliance Programs*, 50 VAND. L. REV. 1 (1997).
- William B. Lytton, "The Case for Greater Governmental Coordination: Civil Sanctions and Third-Part Actions," in U.S. Sentencing Commission Symposium Proceedings, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation* 277–83 (September 7–8, 1995).
- Memorandum by Eric H. Holder, to Heads of Department Components and All United States Attorneys, "Bringing Criminal Charges against Corporations," June 16, 1999, and attachment, "Federal Prosecution of Corporations," now part of the United States Attorneys Manual.
- J. Murphy, *Compliance on Ice: How Litigation Chills Compliance Programs*, 2 CORPORATE CONDUCT Q. (now ETHIKOS) 36 (Winter 1992).
- J. Murphy, *Examining the Legal and Business Risks of Compliance Programs*, 13 ETHIKOS 1 (Jan./Feb. 2000).
- W. Swenson, "The Organizational Guidelines' 'Carrot and Stick' Philosophy, and Their Focus on 'Effective' Compliance" in U.S. Sentencing Commission Symposium Proceedings, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation* 30–31 (September 7–8, 1995).
- JOHN K. VILLA, CORPORATE COUNSEL GUIDELINES (West and ACCA 2001).
- R. Walker, *What We Can Learn about Effective Compliance Policies from Recent Employment Discrimination Cases*, 14 ETHIKOS 4 (July/Aug. 2000).

(continued from page 50)
the policy is really being implemented. Whenever the Department of Justice announces a decision to prosecute a big company, it or the local U.S. Attorney's office often issues a press release explaining why. These statements rarely indicate, even tangentially, that the company's compliance program has in fact been evaluated and virtually never what the results of any such evaluation were.

What better way to determine whether the acts of a relatively few lawbreakers really spoke for the entire firm than to see whether the firm had committed itself to instituting serious measures to prevent misconduct? Yet the Department typically says nothing about a corporate defendant's program or lack thereof in defending its decision to prosecute.

Perhaps the Holder Memo itself provides a clue as to why the Department of Justice says so little about compliance when it announces a charging decision. The Holder Memo candidly concedes, "The Department has no formal guidelines for [evaluating] corporate compliance programs."[31] This statement is revealing. Although compliance officials and law departments in the business community have been actively discussing best practices under the FSGO framework for the last 10 years or so, prosecutors have sat on the sidelines during these discussions.

Moreover, in developing the Holder Memo, which does, in fact, have some useful things to say about compliance programs, the Department of Justice apparently sought no input from compliance experts about what the compliance standards should be. Despite having an ex officio member on the Sentencing Commission, the Department of Justice declined to do the obvious, as other legal pronouncements and policies have,[32] and state that the FSGO compliance framework would be a touchstone for prosecutors in evaluating programs.

LAWS AND POLICIES THAT UNDERCUT EFFECTIVE COMPLIANCE

All in all, the procompliance principles of the Holder Memo are excellent in concept, but there are serious questions as to whether they can be meaningfully implemented. Absent standards, real-world experience, or training that would allow prosecutors to objectively and knowledgeably assess compliance programs, it is no wonder that the Department of Justice says nothing about such assessments when it brings corporate charges. Note the following problems.

No Good Deed Goes Unpunished

The FSGO's compliance standards call for "monitoring and auditing systems reasonably designed to detect criminal activity,"[33] and commenters have noted the benefits of additional evaluative techniques, ranging from employee surveys to focus groups, to determine how well a compliance program is working and how it might be strengthened.[34] More broadly, compliance experts have observed that programs can best be strengthened when compliance issues can be openly discussed.

ALL IN ALL, THE PROCOMPLIANCE PRINCIPLES OF THE HOLDER MEMO ARE EXCELLENT IN CONCEPT, BUT THERE ARE SERIOUS QUESTIONS AS TO WHETHER THEY CAN BE MEANINGFULLY IMPLEMENTED.

Although these activities can bolster compliance program effectiveness, as most lawyers know, however, they can also heighten litigation risks. What assurances do companies have that, if they critically audit and self-evaluate their compliance performance in order to improve it, the information that they unearth will not be used against them by the government or a third party?

The answer is none, and this lack of assurance understandably leads many companies to create programs without seriously evaluating their performance. The uncertainty can also push some companies to create formalistic and artificial means for communicating sensitive compliance issues to bring them under the attorney-client privilege. The effect, as one commenter has put it, is to put candid compliance communications, which promote program effectiveness, "on ice."[35] The EPA publicly opposed the adoption by many states of self-evaluative privilege statutes for environmental compliance programs in the 1990s, and despite a recognition

of the problem by members of the Sentencing Commission[36] and others, policymakers have kept their heads in the sand.[37]

Let's Pay Employees to End-run Their Company's Compliance Programs

The FSGO, EEO case law, and even the recent corporate crime legislation all recognize the importance to company compliance programs of providing a failsafe internal reporting mechanism, such as a helpline, that employees can use when they need to report compliance issues and normal channels are not realistic. This situation can happen, for example, when a supervisor in some distant location directs employees to bend rules to improve his department's performance. As long as there is such a thing as human nature, this kind of risk will continue to exist, and companies, through their compliance programs, work very hard to minimize it. Companies work especially hard at encouraging their employees to speak up when they become aware of such compliance problems because, frankly, it is also human nature for employees to be reticent about doing so without such encouragement.

MAYBE IT COMES DOWN TO THE IDEA THAT "DOG DOESN'T BITE MAN" STORIES RARELY GRAB HEADLINES, BUT ISN'T A WORLD WHERE HARM IS AVOIDED WHAT WE ARE REALLY AFTER?

Enter the federal government. Although Congress gave us the Sentencing Commission, the Equal Employment Opportunity Commission, and recent corporate crime legislation, each of which has a policy supporting internal employee reporting mechanisms, such as helplines, it has also given us the qui tam provision of the False Claims Act. This provision awards someone who brings an action alleging fraud against the government 30 percent of the ultimate recovery, which itself is up to three times the amount of the government's loss. Employees—and their profit-minded plaintiff's counsel—can walk away with millions of dollars in some cases, especially if they sit quietly by and watch the fraud mount.

Amazingly, there is no requirement that the employee ever make an effort to tell the company about the fraud first through the kind of internal reporting processes that the FSGO and other policies say is critical. Moreover, from the employee's point of view, doing so would likely kill his or her chance to hit the qui tam jackpot because, once the government knows about the fraud, the qui tam action is barred and most companies with rigorous compliance programs will immediately put a stop to the fraud and disclose it. Put simply, the qui tam law gives employees powerful monetary incentives to undercut their company's compliance program: they can profit handsomely if they contact a plaintiff's attorney rather than their company's compliance office.[38]

Other Issues

These examples are part of a much longer list of policies that are inconsistent with or actually obstruct corporate compliance efforts, including the following:

- An NLRB decision that says that a company that adopts a code of conduct without first having bargained with the union has engaged in an unfair labor practice.[39]
- Diverging and confusing voluntary disclosure programs among agencies and departments.
- Risk of defamation suits if an employee's former employer candidly describes noncompliant behavior to the employee's prospective employer.
- Even an agency interpretation of the Fair Credit Reporting Act that would say that, if an employee alleged that her manager had been sexually harassing her, the company would have to get the manager's permission before hiring an outside law firm to investigate.[40]

IS NO NEWS GOOD NEWS?

The picture is clearer than the hyperbole of pundits, prosecutors, and politicians has been making it out to be in recent months. Enforcement actions against bad actor companies is critical, but ultimately, corporate misconduct cannot be fixed from the outside by an army of enforcement personnel, no matter how big that army is. Companies have proven that strong compliance programs work.

These programs must be part of the solution. To optimize the benefits that corporate compliance programs offer, government should increase its focus on what it will take to improve the legal and policy environment in which corporate compliance programs operate. This increased focus means (1) sharpening the message, backed up by action, that compliance programs count in resolving allegations of misconduct against a corporation and (2) bringing rationality to an array of laws and policies that thwart effective compliance efforts.

Maybe it comes down to the idea that "Dog Doesn't Bite Man" stories rarely grab headlines, but isn't a world where harm is avoided what we are really after? Too often, corporate crime initiatives are like bunting on the Fourth of July, colorful, patriotic, but, in the end, mostly symbolic. Can the policymakers recognize that their greatest contribution in this area is not to generate more symbolism, but to build an environment in which effective corporate compliance programs can flourish?

Someone needs to make a policy decision as to what the mission is. Is it our goal to publicize miscreants, add up the fines and penalties, and declare victory? Or is it to search out effective new and not-so-new means of building ethical and law-compliant corporate cultures? Adopting means to achieve the former is not always consistent with the latter.

What we propose is not some probusiness scheme. Companies that do not take their ethical and legal obligations seriously should and do pay the penalty, both in the courthouse and in the marketplace. But any effective after-the-fact enforcement scheme needs to be supplemented by a proactive policy if we are to achieve our mission—our common goal as a people and a society—to respect the spirit, as well as the letter, of the law. ◘

NOTES

1. United States Sentencing Commission, GUIDELINES MANUAL (hereafter "USSG"), ch. 8.
2. The "Defense Industry Initiative on Business Ethics and Conduct" ("DII") was established in 1986 and continues today, at www.dii.org.
3. United States v. Mitsubishi Int'l Corp., 677 F.2d 785 (9th Cir. 1982).
4. United States v. Allegheny Bottling Co., 695 F.Supp. 856 (E.D. Va. 1988), *rev'd in relevant part*, 870 F.2d 656 (4thCir. 1989) (tbl.).
5. In this category were cases in which the Commission found that the penalty imposed was less than the cost of complying with the law that was violated. *See* W. Swenson, "The Organizational Guidelines' 'Carrot and Stick' Philosophy, and Their Focus on 'Effective' Compliance" in U.S. Sentencing Commission Symposium Proceedings, *Corporate Crime in America: Strengthening the "Good Citizen" Corporation* 30–31 (September 7–8, 1995) (hereafter "*USSC Symposium Proceedings*").
6. Compare the treatment of two hypothetical companies sentenced under the FSGO. Company A had a compliance program at the time of the offense, cooperated with authorities, and "accepted responsibility" (pleaded guilty) for the offense. Company B did not have a program, had senior management turn a blind eye toward the offense, and failed to accept responsibility or cooperate. Courts have some margin of discretion under the FSGO, but under these facts, Company A's fine would likely be nominal and could be as low as 1.3 percent of the fine that Company B would face. *See* USSG §§ 8C2.5–8C2.6.
7. *See* W. Swenson, *supra* note 5, at 31.
8. *See id.* at 33.
9. *See, e.g.*, United States v. Basic Construction Co., 711 F.2d 570 (4th Cir. 1983). The Sixth Circuit in Holland Furnace Co. v. U.S.,158 F.2d (6th Cir.1946), provided an early exception to this widely followed principle, holding that a policy directing compliance did insulate the company from liability, but the case has not been followed.
10. *See supra* note 2.
11. *See* USSG § 8A1.2, comment, n(3)(k).
12. *See* USSG § 8A1.2, comment, n(3)(k)(i–iii).
13. Emphasis added.
14. W. Wilkins Jr. (former Chairman, U.S. Sentencing Commission), foreword, COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES (Kaplan, Murphy, and Swenson, eds.) (West 1993, annually updated).
15. *See id.*
16. For further information, visit www.eoa.org or call 617.884.9400.
17. EOA/Sentencing Commission regional forums have been held in San Francisco, New York, Minneapolis, Atlanta, Houston, and Columbus, Ohio, over the last several years.
18. *See, e.g.*, ETHIKOS; BNA/ACCA COMPLIANCE MANUAL: PREVENTION OF CORPORATE LIABILITY.
19. *See, e.g.*, COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES, *supra* note 14; BNA/ACCA COMPLIANCE MANUAL: PREVENTION OF CORPORATE LIABILITY; GUIDE TO PROFESSIONAL DEVELOPMENT IN COMPLIANCE (Aspen 1999) (Heller, Murphy, and Meany, eds.).
20. *See* www.hhs.gov/oig/modcomp.
21. A final version of the policy was published in 65 *Fed. Reg.* 19618 (Apr. 2000).
22. *See* R. Walker, *What We Can Learn about Effective Compliance Policies from Recent Employment Discrimination Cases*, 14 ETHIKOS 4 (July/Aug. 2000).
23. 698 A.2d 959 (Del. Ch. 1996).

24. *See* Memorandum by Eric H. Holder, to Heads of Department Components and All United States Attorneys, "Bringing Criminal Charges against Corporations," June 16, 1999, and attachment, "Federal Prosecution of Corporations" (hereafter Holder Attachment).
25. For a compilation of organizational sentencing data, *see* the U.S. Sentencing Commission's website, at www.ussc.org.
26. Holder Attachment, *supra* note 24, at 9.
27. *See* www.nyse.com (Aug. 16, 2002, Corporate Governance Rule filing).
28. *See* Sarbanes-Oxley Act of 2002, § 1107.
29. O. Obermeier, *Drafting Companies to Fight Crime,* N.Y. TIMES, May 24, 1992, at 11 (Forum Section).
30. Holder Attachment, *supra* note 24, at 9–10.
31. *Id.*
32. *See supra* notes 19–20, and accompanying text.
33. USSG § 8A1.2, comment n(3)(k)(5).
34. *See* Swenson, Avelino, and Ben-Chorin, *Measuring the Effectiveness of Compliance and Ethics Programs* in COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES, *supra* note 14.
35. J. Murphy, *Compliance on Ice: How Litigation Chills Compliance Programs,* 2 CORPORATE CONDUCT Q. (now ETHIKOS) 36 (Winter 1992). *See also* J. Murphy, *Examining the Legal and Business Risks of Compliance Programs,* 13 ETHIKOS 1 (Jan./Feb. 2000).
36. *See* Commissioner Michael Goldsmith, "Commentary on Existing Law," in USSC Symposium Proceedings, *supra* note 5, at 351. *See also* Goldsmith & King, *Policing Corporate Crime: The Dilemma of Internal Corporate Compliance Programs,* 50 VAND. L. REV. 1 (1997).
37. For a detailed review of the debate and history of the self-evaluative privilege, *see* COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES, *supra* note 14, at §§ 5:36–5:46.
38. For further discussion, *see* Lytton, "The Case for Greater Governmental Coordination: Civil Sanctions and Third-Part Actions," in USSC Symposium Proceedings, *supra* note 5, at 277 (see also questions and answers following this presentation in which a senior Defense Department official agrees that the qui tam provision should be amended to require employees to avail themselves of internal reporting mechanisms before filing an action).
39. American Electric Power Co., 302 NLRB 161 (1991).
40. *See* Hartman v. Lisle Park Dist. (ND ILL 8/16/01) (discussing this FTC interpretation, but rejecting its application to outside counsel).

Debra W. Yang
United States Attorney
Central District of California

Debra W. Yang, United States Attorney, Central District of California. Judge Yang is the first Asian American woman in the United States to serve as a United States Attorney. She also has been selected to serve on President Bush's Corporate Fraud Task Force and to chair the Attorney General's Advisory Sub-Committee on Civil Rights. Prior to being appointed United States Attorney, Judge Yang was a California state judge. She was appointed to the Los Angeles Municipal Court in 1997 and became a member of the Los Angeles Superior Court bench in 2000. She was also an instructor at California's Judicial College, and she sat on the Criminal Law Advisory Committee and the Subcommittee on the Quality of Judicial Service for the Court's Judicial Council. Before becoming a judge, Judge Yang served as an Assistant United States Attorney specializing in the prosecution of violent crimes, white-collar crimes, international money laundering, mail fraud, arsons, and computer crimes. She also taught trial advocacy as an Adjunct Professor at the University of Southern California School of Law, and served as an instructor at the National Institute of Trial Advocacy at Loyola Law School. Outside of her practice, Judge Yang has also been President of The Chinese American Museum in Los Angeles. She has played an instrumental role in the creation of this ground breaking cultural, education, social and historical new landmark for Southern California intended to highlight the Chinese-American experience. Judge Yang was a founding member and officer of the first Asian-American Bar in the City of Chicago, Illinois. She has also been an officer and board member for the Southern California Chinese Lawyer Association. Ms. Yang received her J.D. in 1985 from Boston College.

Alan R. Yuspeh

Alan R. Yuspeh is Senior Vice President, Ethics, Compliance & Corporate Responsibility for Nashville, Tenn.-based HCA, the nation's largest provider of healthcare services.

Mr. Yuspeh began his career as a management consultant in the Washington, D.C. office of McKinsey & Company. From 1974 to 1978, he served as Chief of Staff and Senior Legislative Assistant for United States Senator J. Bennett Johnston of Louisiana. Mr. Yuspeh served as General Counsel to the Committee on Armed Services of the United States Senate from 1982 to 1985.

Mr. Yuspeh was engaged in the private practice of law for 15 years, most recently as a partner with Howrey & Simon in Washington, D.C. His practice focused on government contracts law and the development of ethics and compliance programs in large organizations. From 1987 to 1997, Mr. Yuspeh served as Coordinator of the Defense Industry Initiative on Business Ethics and Conduct (DII). The DII consisted of approximately 50 major defense contractors and was widely recognized for its role in creating some of the country's most sophisticated corporate ethics and compliance programs.

Mr. Yuspeh was honored as the Health Care Compliance Association's (HCCA) "Compliance Professional of the Year" in 1999. Currently, Mr. Yuspeh is a member of the board of directors of the Ethics Officer Association and of HCCA. Mr. Yuspeh is also vice president of HCCA and will assume the presidency of the organization on January 1, 2003.

Mr. Yuspeh received his bachelor's degree with honors in political science and economics from Yale University and graduated *magna cum laude* in 1971. He earned his master's degree in business administration with distinction from Harvard Business School in 1973. In 1978, he earned a law degree from Georgetown University, where he was an editor of *Law and Policy in International Business*, the school's international law journal.

STATEMENT OF ALAN R. YUSPEH

BEFORE THE AD HOC ADVISORY GROUP TO THE

UNITED STATES SENTENCING COMMISSION

November 14, 2002

Washington, D.C.

Thank you very much for the opportunity to appear before your panel today. I am flattered to have been asked to participate in this effort.

Though I know a number of the members of this panel, it may be useful to those I have not met to summarize very briefly my work in the area of ethics and compliance programs. This work began in 1987, when I was asked to serve as the Coordinator, or Executive Director, of the Defense Industry Initiative on Business Ethics and Conduct, known as the DII. The DII consisted of some 50 defense contractors, each of which became a signatory to certain principles pertaining to ethical and compliant business conduct. I worked with this group through 1997. In the course of that work, I also was asked to assist various organizations outside the defense industry with designing an ethics and compliance program. In October 1997, I was asked to serve as the Senior Vice President for Ethics, Compliance and Corporate Responsibility at the largest hospital company in the country, a company then known as Columbia/HCA Healthcare Corporation and now known as HCA, or Hospital Corporation of America. HCA owns some 180 hospitals. We have tried at HCA over the last five years to develop and implement a comprehensive and meaningful ethics and compliance program.

I should also include a disclaimer not unlike that we often hear government officials make when they speak in public. The views that I am going to express today are

my personal views on this matter. While HCA is of course aware of my participation in this session, these views do not represent any official position of HCA.

I would like to provide to your panel certain background information for the record of this proceeding. I have prior to today sent to your staff rather extensive materials about the HCA Ethics and Compliance Program. I have made available our Code of Conduct, an article for an academic journal explaining at some length our efforts, and two speeches that I have previously given which were published in *Vital Speeches of the Day*. I hope that this will be helpful background material. I should also note that HCA has placed virtually all relevant information about our Ethics and Compliance Program on our website. We believe that publicly held companies should be transparent about their efforts in this area. In our own case, because we are in an activity where there are many small stand-alone hospitals with far fewer resources than ours, we have also regarded it as a matter of our corporate social responsibility to make these materials available for other hospitals to adapt and use as they wish.

With this as background, I would like to offer only a few observations and then would be pleased to answer your questions. First, I believe that the Sentencing Commission should understand one basic fact. It is my belief that as to the subject of compliance programs, the Commission has enormous potential to promote enhanced corporate responsibility, business ethics, and compliance in this country. It can do this very simply by the way in which it defines an "effective program to prevent and detect violations of law" in its guidelines, provided, however, that the Commission is prepared to articulate this as a proper norm for organizations, particularly larger ones.

In doing this, however, the Commission must come to grips with something that I am reasonably certain is reality. Large corporations in this country are for the most part not going to take some management action with the thought in mind that they will reduce their criminal liability if they are sentenced. It is my belief that a large organization that believes itself to be well managed does not expect to be accused of committing a crime. Thus, the appeal to a CEO that he or she should do what the Commission guidelines imply is desirable in order for the corporation to be sentenced more leniently if convicted of a crime is not going to resonate. Such a set of events is too remote a possibility, even in today's environment.

What may resonate, however, is simply the Commission using the guidelines and its stature as a "bully pulpit." I am using this term as President Theodore Roosevelt used it, to mean a terrific platform from which to persuasively advocate an agenda. If the Sentencing Commission through its guidelines is in effect saying to large American organizations that these are the management practices you need to adopt, there is a much greater possibility that organizations will do that than if no governmental authority is making such recommendations. Particularly at a time when it appears that we are in the midst of a crisis of corporate responsibility and when investor confidence seems to be lagging in light of this, the Commission could easily claim a proper leadership role to advise well managed organizations as to how to approach these issues.

If the Commission is willing to do this, then I think a very few changes in the definition of "effective program to prevent and detect violations of law" are necessary. The first and most important change I would recommend is in Paragraph (2). I would recommend that a second sentence be added as follows: "For business organizations with

________ or more employees, an officer position must have been established as part of the senior management of the organization, with the primary responsibility of overseeing compliance with such standards and procedures, promoting sound business conduct, and ensuring overall organizational responsibility." The import of this recommendation is very simple. This Commission should mandate that business organizations of a certain size should have a position that is comparable in stature to other major functional leadership positions, such as the general counsel, or chief financial officer, or head of human resources, to oversee the organization's approach to compliance, business conduct, and corporate responsibility.

This single mandate more than any other the Commission could articulate has the potential to upgrade dramatically the level of attention to compliance and sound business conduct among large corporations in this country. No single element of an effective program to prevent and detect violations of law is so important as the proper placement in the organizational structure of the person charged with leading this effort. If a corporate officer has this as his or her primary duty, that person will have the ear of the CEO, access to the Board of Directors, influence with other leaders in the organization, and the availability of sufficient resources to do the job. To the extent that our efforts at HCA in the last five years to create a program like that mandated in the guidelines have been successful, the most important reason for this is that my position was created as a part of senior management. If this Commission by using its "bully pulpit" can influence large business organizations in this country to elevate the stature of these issues by creating officer-level ethics and compliance officers, you will have had an enormous impact on ensuring ethical and compliant conduct by our largest corporations.

As to the issue of the size of business organizations to which this mandate should apply, I would suggest that you define that in terms of employees. In order to avoid criticism that you are imposing additional overhead on organizations that cannot afford it, I would recommend that you consider a threshold that by any reasonable standard defines large corporations. The listing in *Fortune Magazine* of the largest 500 business organizations in this country indicates that the median number of employees for such organizations is about 25,000. I think no leader of an organization of that size could assert with any credibility that his or her organization lacked the financial resources to afford to have a corporate officer in charge of compliance, business conduct, and corporate responsibility. You might conclude that the employee threshold should be even lower.

My second proposal is that you incorporate within your definition of an "effective program to prevent and detect violations of law" a requirement for publicly held business organizations at the employee threshold for which a full-time compliance officer is needed the obligation to have a compliance committee of the board of directors. We have had such a committee for almost five years at HCA, and it has been enormously important in ensuring the success of our efforts in this area. Particularly after the Sarbanes-Oxley Act has been passed, audit committees will be extraordinarily busy focusing on the accuracy of financial statements. A separate group of the board should monitor overall compliance and business conduct.

I would make only one other suggestion. While I recognize that the statutory duty of the Commission inclines it to speak to "criminal conduct" as the focus in its guidelines, perhaps a broader formulation could be used. At a minimum, I would suggest

that the term of "violations of law" be considered as an alternative to criminal conduct in your compliance program definition. As we all know, there are many important laws that are not criminal, and certainly an effective compliance program seeks compliance with all of these. In addition, there may be conduct that is clearly improper but perhaps not illegal. I think even that could be covered by reference to improper conduct. Thus, I think the Commission should consider changing the definition of a compliance program to mean a "program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting violations of law and other improper conduct." If this were done, then conforming changes would have to be made elsewhere in the definition to use the broader term in lieu of "criminal conduct." I do not think this is an overreach for the Commission. The Commission can define an effective compliance program in whatever way it wishes, and encouraging programs to seek to address any violation of law or any improper conduct is to me more desirable than suggesting that such programs may properly focus only on the body of criminal law.

I would like to close with one final thought. In my view, it is regrettable that the business press and Congress have focused solely on the issue of correct financial reporting in the last year. I think that the highly visible failures of corporate responsibility in the last year offered a wonderful opportunity for a national conversation on the need for all large corporations to put into place formal, structured ethics and compliance programs. While Congress has not mandated these, the Sentencing Commission has a great opportunity to send the message to the business community that this is required and expected. I would encourage the Commission to use changes to its guidelines like those suggested as a means of doing this.

CONCURRENT
SESSIONS

Session I: Leadership,
Accountability,
Corporate Governance

Public Hearing of the Ad Hoc Advisory Group on Organizational Guidelines

Thurgood Marshall Federal Judiciary Building, Concourse Level, One Columbus Circle, N.E., Washington, D.C. 20002

November 14, 2002

Session I Agenda

Session I: Leadership, Accountability, Corporate Governance
Moderator: Ron James

James W. Conrad, Jr.
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Washington, D.C.
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October 30, 2002

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

Re: November 14, 2002 Public Hearing

Dear Mr. Courlander:

Enclosed is testimony from the American Chemistry Council for the November 14, 2002 public hearing being held by the Ad Hoc Advisory Group on Organizational Guidelines to the U.S. Sentencing Commission. If you have any questions regarding this testimony, I can be reached at (202) 736-8118 or cbell@sidley.com.

Very truly yours,

Christopher L. Bell

cc: James Conrad
(American Chemistry Council)
David T. Buente

DC1 599140v1

STATEMENT OF JAMES W. CONRAD, JR., AMERICAN CHEMISTRY COUNCIL, TO THE ADVISORY GROUP ON ORGANIZATIONAL SENTENCING GUIDELINES TO THE UNITED STATES SENTENCING COMMISSION RELATED TO THE REVIEW OF CHAPTER EIGHT OF THE U.S. SENTENCING GUIDELINES
NOVEMBER 14, 2002

Good morning, my name is Jamie Conrad, and I am counsel with the American Chemistry Council. On behalf of the Council, I thank you for the opportunity to testify today before the Advisory Group on Organizational Guidelines to the United States Sentencing Commission.

The American Chemistry 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 business of chemistry is a $460 billion-a-year enterprise and a vital part 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.

The Council submitted written comments to the Advisory Group on May 16 and October 11 of this year. We have explained our views in some detail in these comments, including our responses to some of the specific questions posed by the Advisory Group. I would like to highlight some important principles for you today.

The Advisory Group has initiated the action called for by Congress in Sarbanes-Oxley.

In Section 805(a)(5) of the Sarbanes-Oxley Act of 2002, Congress directed the Commission to ensure that the *Guidelines* "are sufficient to deter and punish criminal misconduct." At least with respect to those elements of the Guidelines establishing the criteria for an effective compliance assurance program, the Advisory Group is already considering this question. Sarbanes-Oxley does not call for a separate or new review: you are simply ahead of schedule.

The *Guidelines* should continue to focus on criminal conduct in the context of criminal sentencing.

The Commission is charged with promulgating "detailed guidelines prescribing the appropriate sentences for offenders convicted of federal crimes." The courts use the *Guidelines* to sentence those convicted of crimes. The purpose of the *Guidelines*, therefore, is to "further the basic purposes of criminal punishment: deterrence, incapacitation, just punishment, and rehabilitation." The Commission should not stray from this mission. The *Guidelines* should not be expanded to address general issues of corporate social responsibility or ethics that are not governed by criminal laws or that are not directly relevant to criminal sentencing.

The Council's members strongly believe in ethical behavior and responsible social conduct. However, the Commission is tasked to address criminal conduct, not promulgate a code of ethics. Any suggested changes to the *Guidelines* must be evaluated in the very serious criminal sentencing context in which the *Guidelines* are used.

The *Guidelines* should not be used to encourage or force organizations 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 focus of the *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.

Any changes to the *Guidelines* should be based on objective evidence and a demonstrable need for change.

Any suggested changes to the *Guidelines* should be based on facts, not theory. Thousands of organizations have invested significant resources implementing compliance systems based on the *Guidelines*. Yet, we are unaware of any actual data or other evidence in the public record showing deficiencies in the *Guidelines* that need correcting. On the contrary, as the Commission has noted, the "organizational guidelines have had a tremendous impact on the implementation of compliance and business ethics programs over the past ten years." The Advisory Group should follow the adage: "If it ain't broke, don't fix it." Material changes should only be considered after finding the *Guidelines* are flawed and that the user community is demanding changes.

Some may say that something must be done because of the alleged criminal activities and corporate governance scandals that currently are high-visibility issues. However, the mere existence of alleged illegal or unethical conduct in some organizations does not mean that the *Guidelines* were at fault or that changing the *Guidelines* would have produced a different result. Changes to the *Guidelines* should be based on objective evidence that the *Guidelines* have not established adequate criteria for effective compliance systems, not on general concerns about unethical conduct. Further, one should not assume, without supporting evidence, that "ethics programs" necessarily prevent criminal misconduct. Indeed, an evidentiary project for this Group might be to determine whether some of the companies currently charged with illegal conduct had ethics programs and, if so, why those programs were ineffective in preventing the misconduct that occurred.

The *Guidelines* must remain flexible, practical and generally applicable to all organizations in all sectors.

The *Guidelines* currently offer the flexibility needed to allow organizations of all sizes and types to implement effective compliance programs. Any proposed changes to the *Guidelines* should take into account the small and medium-sized organizations that are the vast majority of U.S. businesses. This is not a theoretical concern. The Commission's statistics reveal that in FY 2000, some 87% of organizations sentenced under Chapter 8 had fewer than 200 employees, and that approximately 65% of all sentenced organizations had fewer than 50. Whatever obstacles small and medium-sized businesses face will not be lessened by increasing the level of detail or complexity in the *Guidelines*. Further, attempting to create unique provisions in the *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.

The "best practices" developed by sophisticated companies, consulting firms or academia should not become the model for what all organizations must undertake. While smaller organizations should follow the *Guidelines*, they should not be potentially subject to greater criminal penalties if they cannot implement the "best practices" of large enterprises.

The *Guidelines* already provide sufficient guidance on designing, implementing or auditing compliance systems.

Some commenters have suggested that the *Guidelines* should include more detailed guidance on designing, implementing or auditing compliance systems. These suggestions, however well-intentioned, are misplaced. The *Guidelines* should remain generic and applicable to all organizations.

There is no evidence of a "market need" for the Commission to provide detailed implementation guidance. There has been a proliferation of sector-specific, public, private, national and international guidance documents and standards on compliance assurance, many of which we surveyed in our May 16 comments. This vast literature is already available to the user community. It is not the function of the Commission to provide such general educational assistance through the *Guidelines*, since the failure of an organization to conform to the *Guidelines* can have direct implications in the criminal sentencing context.

Moreover, if the Commission were inclined to provide more detail on compliance programs, the practical impact of that effort must be carefully weighed. The available specific guidance on compliance programs continues to be refined and tailored to the needs of specific areas of regulation. For example, several Federal agencies have already developed sector-specific guidance or even regulations on compliance management systems. Adding detail to the *Organizational Guidelines* could create conflicts with these other efforts, leading to practical implementation problems.

The Guidelines do not need to provide more detail on "corporate governance."

It is no secret that corporate governance is a significant topic of public interest, and that there are several major legislative and regulatory initiatives that are making significant changes to corporate governance. Not the least of these are the new requirements just created by Congress in the Sarbanes-Oxley Act of 2002 and that are being implemented by various regulatory and self-regulatory bodies such as the Securities & Exchange Commission, the New York Stock Exchange and the National Association of Securities Dealers.

Adding specific corporate governance responsibilities in the *Guidelines* at this time could create conflicts with the flood of new requirements already being generated. For example, the *Guidelines* should not provide detail on the responsibilities of boards of directors or equivalent governance bodies in overseeing compliance programs. Not all organizations, particularly smaller ones, have such governance bodies, and the *Guidelines* already embody the principle that compliance programs should be supervised by "high level" personnel. Further, specifying the responsibilities of particular functions associated with corporate governance (e.g., CEO or CFO), expanding the definitions of "high level per-

sonnel," 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 *Guidelines*. These are all issues that are already topics of considerable federal legislative, regulatory and self-regulatory attention.

To provide one last example, more specificity on whistleblower protection is not necessary. We agree that whistleblowers must be completely protected from acts of retribution. However, the *Guidelines* already clearly state that internal reporting should be without fear of retribution. Further, many Federal and State statutes already provide specific whistleblower protections. Adding more specific whistleblower provisions in the *Guidelines* might either create conflicts with existing substantive laws or be duplicative, or even create loopholes that might result in less protection.

It is not the function of the Sentencing Commission to create new corporate governance rules. That is properly the province of Congress and the numerous regulatory bodies that have been delegated the authority to promulgate and enforce regulations on this topic. The remarkable extent of recent legislative and regulatory activity on this topic – in an otherwise stalemated political environment -- demonstrates that there is not a "gap" that the Commission must fill. As the legal requirements on corporate governance are revised and expanded, organizations that implement compliance assurance systems that conform to the criteria in the *Guidelines* will necessarily have to include those new requirements in their systems. Therefore, without any modification to the Guidelines themselves, any new corporate governance requirements will become elements of an effective compliance assurance system.

Thank you again for the opportunity to speak today. I would be happy to answer any questions you may have, and look forward to participating in this afternoon's sessions.

NORTHROP GRUMMAN

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October 29, 2002

B. Todd Jones, Chair
Advisory Group on Organizational Guidelines
To The United States Sentencing Commission
c/o Office of Public Affairs
United States Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle, NE
Washington, D.C.20002-8002

Dear Mr. Jones:

I am writing in response to 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?" While my response is "yes", I would like to comment on the question itself without, I hope, parsing it too much.

The question sets "fostering ethical cultures" in opposition to "technical compliance." It isn't clear to me whether this is a literary device or, in fact an indicator of one of the unfortunate divisions that takes place when we turn to this subject. An ethics program or compliance effort that includes one to the exclusion of the other isn't complete.

RULES AND VALUES ARE ALLIES

Business ethics is often defined by a description of two main components, namely, values or the ethical environment on the one hand and compliance with laws and regulations on the other. The difference can be described in terms of that between rules-based and values-based programs. Discussion of the relationship between these two elements has focused largely on their differences and the suggestion that they are divergent dynamics. The problem of defining "rules" and "values" as divergent program approaches rather than necessary program components, means that embrace of one may be considered, of necessity, exclusion of the other. This dichotomy has consequences in implementation of the program.

A recent study of phone line systems that employees can use to contact their companies helps illustrate this. The title "Hotline" which implies a regulatory compliance emphasis resulted in less use by employees than "Helpline" which implies openness to inquiries, counseling of employees and an emphasis on a more open culture.

Recycled paper

Codes of Conduct are not legal documents although they may be documents that are useful in legal actions. While more detailed rules may be found in a company's policies and procedures, Codes of Conduct are communication documents. The danger is that some codes can be too legalistic for employees to read or on the other extreme not augmented by policies and procedures that specify the regulatory framework.

I'd like to suggest that the dichotomy between compliance and values oversimplifies the issue. Now that a number of programs have reached a level of maturity, it may be useful to step back and take a complete look at the elements that make up a good ethics program and how those elements relate to each other. The effort will, I believe, lead to a program that sees rules and values as allies.

WORKING ENVIRONMENT

Law, regulation and company policy do address some issues and questions clearly and decisively. It is equally true that some issues and questions reside in "gray areas" presenting challenges that rules do not address as clearly. Employees need guidance in making decisions where rules do not apply, where the application is not clear and especially where the employee may be unaware of the existence of an applicable rule. In those cases we need to provide two things. The first is communication to help develop ethical awareness and resources to get help. The second is a set of values that permeates the culture and enables an employee in such a quandary to say: "I better get help because I don't know what to do. But what I do know is: "That's not the way we do things around here."

I believe that the commission has shown more than informal interest in this approach. The commission has joined with the Ethics Officer Association, an organization that embraces this broader approach in presenting workshops around the country. Judge Richard Conaboy, the first Chairman of the Commission seemed to commit himself to this in a speech in September 1995. He said: "You must take on the obligation to lead this effort, to be in the forefront, not only by working to ensure that your company's employees follow the law but by embracing and placing at the very top or your company's priorities the basic good citizenship values that make law abidance possible." Judge Diana Murphy made a similar point in a speech to the Conference Board Meeting earlier this year when she asked the rhetorical question: "Can a compliance system work if it doesn't have ethics at its heart?" Our Chairman at Northrop Grumman, Kent Kresa embraces exactly the same sentiment in a statement in which he describes ethics thus. "It's about creating the kind of climate in which people are encouraged to make the right decisions in the first place."

RECOMMENDATION

I would conclude that the Guidelines should send the message that a legal compliance approach is necessary but not sufficient. Companies must encourage the good values the

overwhelming number of our employees bring to work. The need to develop and foster structures and a climate that reward employees for following those values at work is as essential to a healthy corporate ethos as respecting privacy and honoring freedom is to our national ethos.

All that having been said, the task of incorporating this into the guidelines which are essentially a legal scheme will be a challenge. The FAR might guide the way. In regulations on Anti-Kickback Procedures, it offers a number of "reasonable procedures" that a company or organization might have in place to indicate due diligence without mandating any one. This approach, in my view, accommodates the significant differences that companies and organizations have such as size, style of management, demographics etc.

Thus, it would seem to me that a statement that attention to whether or not a company has fostered an atmosphere that promotes ethical activity and gives priority to, in Judge Conaboy's words, the basic good citizenship values that make law abidance possible should be included. There are a number of "reasonable procedures" a company might have in place separately or together that could offer evidence that this has been done, for example :

- A Code of Conduct that communicates basic company values to all levels of employees.

- Periodic presentations by organization leaders of the importance of values and integrity to the business and to the way we do business.

- Regular sensing of the climate through surveys and audits to assess the ethical climate.

- A confidential company resource that enables employees to get advice, information and counseling as well as make reports.

I am reluctant to suggest that any of these steps should be a requirement or to suggest that any of them are in themselves fail safe but each one is an indicator of an effort to send important messages. Persons examining such evidence would have to exercise due diligence of their own to ensure that what you see is what you get.

Thank you for the opportunity to have this input. I look forward to testifying.

Sincerely,

Francis J. Daly

Francis J. Daly
Corporate Director, Ethics and Business Conduct
Northrop Grumman Corporation.

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October 11, 2002

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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.

<u>Question 3</u>: 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?

<u>PM Comment</u>: 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 <u>increase</u> 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 (<u>see</u>, *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

prevent and detect violations involving the organization's senior officials, unless it is shown that a significant number of individuals with substantial authority to act on behalf of the organization participated in the misconduct — in other words, that the conduct was pervasive. PM questions whether it is fair, absent such circumstances, to punish an entire organization and its various stakeholders.

Question 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?

PM Comment: This question is addressed as part of the response to question three 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?

PM Comment: PM believes that organizations should be encouraged to employ an ethics or a values-based approach in formulating their basic business conduct guidelines and compliance policies. PM prefers the term "values"-based to "ethics"-based, because it is a more neutral term. PM supports the view that in order for a compliance program to become part of a company's culture and embedded in its basic business processes, senior management must define a set of shared values and standards for business conduct with

the objective of improving employee decision-making across a broad range of practical business situations.

* * *

Philip Morris Companies Inc. appreciates the opportunity to present these comments to the Advisory Group. We hope that these comments will be useful to the Advisory Group as it prepares its report to the United States Sentencing Commission. We would be pleased to respond to any further questions you may have.

Sincerely,

David Greenberg

Joshua Hochberg

Joshua Hochberg has been the Chief of the Fraud Section of the Department of Justice in the Criminal Division since 1998. The Fraud Section implements and coordinates white collar crime enforcement policy and handles many cases of national significance. Mr. Hochberg is the Acting United States Attorney for Enron-related matters. In addition to securities fraud, Fraud Section investigations often involve health care fraud, violations of the Foreign Corrupt Practices Act, and a wide variety of advance fee and investment schemes. Mr. Hochberg was the Deputy Chief for Litigation in the Public Integrity Section from 1995 to 1998, and a Trial Attorney and Senior Litigation Counsel in the Fraud Section from 1986 to 1995. Prior to joining the Justice Department, Mr. Hochberg was an Assistant Attorney General in the New York State Medicaid Fraud Control Unit from 1975 to 1986. He is a graduate of New York University Law School.

Gretchen A. Winter

Ms. Winter is Vice President and Counsel, Business Practices, for Baxter International Inc. in Deerfield, Illinois. In that role, she is responsible for developing and communicating business practice standards as well as designing and supporting processes that ensure compliance with those standards and provide guidance to Baxter employees who see ethical dilemmas in their work. The business practice program is a featured part of the company's commitment to "sustainable development." Baxter's business practice program received the 2001 Business Ethics Award from DePaul University Institute for Business and Professional Ethics and the 1999 Chicago Business Ethics Award, and Baxter has been listed as one of *Business Ethics* magazine's "100 Best Corporate Citizens" for the last three years.

Winter is Vice Chair of the Ethics Officer Association Board of Directors and has spoken at EOA national and regional conferences. Winter also has been a speaker for a variety of ethics, corporate social responsibility, and legal programs within and outside of the United States. She recently completed two years as chair of the Conference Board's Global Council on Business Conduct, and she has served on ethics committees for the American Bar Association and DePaul University. She co-authored an article on "Breathing Life into Your Company's Code of Conduct" that appeared in the *ACCA Docket* and another on "International Business Standards: The Competitive Imperative" that appeared in the *Thunderbird International Business Review*.

While with Baxter, she has held positions as Director of Training and Development, Director of Field Human Resources, Employee Relations/Labor Counsel, and a member of the company's re-engineering team. She also participated in an Executive Exchange Program between Baxter and Evanston Hospital Corporation. Winter presently serves as a member of Baxter's political action committee board of trustees. Prior to joining Baxter, she worked as an attorney with the firm of Seyfarth, Shaw, Fairweather and Geraldson in Chicago.

Ms. Winter obtained her J.D. from the University of Chicago and her Bachelor's degree from the University of Illinois at Chicago. She is a member of the Illinois Student Assistance Commission and she serves on the boards of the Hispanic Lawyers Association of Illinois (HLAI) and the Board of Visitors for the University of Illinois at

Chicago College of Liberal Arts and Sciences. She is immediate past president of Leadership Greater Chicago and serves on advisory committees for Lutheran Child and Family Services of Illinois, Project LEAP (Legal Elections in All Precincts), the University of Chicago Law School, and Pegasus Players, a not-for-profit theater.

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Proven skills in designing and delivering private and public sector corporate initiatives, consultation and training, and leadership in compliance and ethics.

Unmatched experience in research, clinical, and organizational ethics, as well as in corporate responsibility and governance.

Track record of reducing business costs by redesigning processes, expediting change, implementing CQI, and listening to internal and external customers.

Impressive background in program management and performance-based metrics.

SIGNIFICANT ACCOMPLISHMENTS

CORPORATE INITIATIVES

- Delivered training on organizational ethics to senior managers responsible for compliance at corporate headquarters of **Fortune 500 insurance company**. Stressed values-based approach to regulations promulgated by SEC, NLRB, FASB, FTC, and NASD. Decreased ethical and legal exposure and increased trust and goodwill.
- Evaluated ethical and legal exposure at **Fortune 500 utilities company**, including potential violations of antitrust, campaign contributions, GAAP, conflict of interest, professional licensing, bribery, and kickback regulations. Decreased ethical risks.
- Designed and delivered seminar on organizational ethics to senior managers at major **Native American gaming enterprise** in northeastern U.S. Enhanced trust and communication between employees and management.
- Selected to serve on expert panel that revised the **Society of Management Accountants of Canada's** (Hamilton, Ontario) draft guidelines for "Implementing Corporate Ethics Strategies." Distribution of guidelines to 26,000 members.

CONSULTATION AND TRAINING

- Asked by **Anthem Blue Cross and Blue Shield** to speak at national conference of ethics and compliance staff on best practices and future directions in health care integrity. Presentation focused on integration of ethics and compliance, performance metrics, and organizational change strategies.
- Invited by **American Hospital Association** to discuss strategies for integrating compliance and ethics programs, as well as evaluating their performance, with fourteen member organizations on national conference call. Participants included COOs, compliance officers, ethics officers, HIPAA staff, and legal counsel.
- Assisted **American Medical Association's Ethical Force Program** in reviewing ethical performance measures for privacy and confidentiality, related to HIPAA, as

well as in recruiting health care organizations for field testing of these metrics.

- Appointed to serve on **County of Orange Health Care Agency's Corporate Compliance Committee**. Developed program from ground up, including design, code of conduct, training, HIPAA cross-overs, investigations, hotline, and evaluation. Consulting on integration of ethics and performance-based metrics into compliance program.
- Designed and delivered seminar on organizational ethics to ethics staff, clinical providers, and senior managers at **Walter Reed Army Medical Center** (Bethesda MD). Fostered integration of organizational ethics in existing clinical ethics program.
- Elected to serve on ethics committee at **National Institutes of Health's (NIH) Clinical Center** (Bethesda MD). Advised on issues related to clinical and organizational ethics.

LEADERSHIP

- Founded and direct **Alliance for Health Care Integrity**. As Executive Director, advocate for integration of compliance and ethics programs, as well as industry design of model standards, commitment as signatories to those standards, and independent verification of that commitment. Face-to-face and telephone meetings with organizations, such as **HHS/CMS, Jackson Hole Group, HHS/Office of Inspector General, Department of Justice, American Association of Health Plans, Healthcare Leadership Council, and National Association of Insurance Commissioners, as well as numerous provider organizations.**

EXPERIENCE

Executive Director, Alliance for Health Care Integrity, Corona, CA 2000-present

Founded and direct national, independent non-profit organization of major stakeholders dedicated to assuring the health care industry's commitment to integrity through the voluntary design, delivery, verification, and certification of model standards for integrated compliance-ethics programs. Board members include Louis Feuerstein (Ernst & Young) and Patricia Werhane (Darden School of Business). Active supporters include Myra Christopher (Midwest Bioethics Center) and Paul Schyve (JCAHO).

Program Manager, Orange County Health Care Agency, Santa Ana, CA 2000-present

Manage five programs at $2.3 million for Health Promotion division. Thirty-five (35) professional staff, including epidemiologists and researchers, and nurses, as well as education and training specialists. Member of Corporate Compliance Committee and Public Health Quality Management Advisory Council. Focus on strategic planning and organizational change.

Adjunct Instructor, University of Virginia, Charlottesville, VA 1997-1998

Design and deliver seminars in organizational ethics for physicians and administrators in Programs of Education & Training in Health Care Ethics.

Contract Consultant, Ethics Resource Center, Inc., Washington, DC 1995-1998

Conduct cultural analysis and deliver training to senior

management based on identified ethical/legal risks.

EDUCATION

Ph.D. in cultural studies *with emphasis on ethics (1995).* Syracuse University, Syracuse, New York

M.P.H. in program planning and evaluation, coalition building, and behavioral training (1976). California State University, Northridge, California

M.A. in English (1970). California State University, Fullerton, California

B.A. in philosophy (1968). University of Southern California, Los Angeles, California

Session II: Administration
& Implementation of
Compliance Programs

PUBLIC HEARING OF THE AD HOC ADVISORY GROUP ON ORGANIZATIONAL GUIDELINES

Thurgood Marshall Federal Judiciary Building, Concourse Level, One Columbus Circle, N.E., Washington, D.C. 20002

November 14, 2002

SESSION II AGENDA

SESSION II: ADMINISTRATION AND IMPLEMENTATION OF COMPLIANCE PROGRAMS

Moderator: Greg Wallance

Gale C. Andrews
Vice President, Ethics & Business Conduct
Boeing Company
Chicago, IL

Scott Avelino
KPMG
Washington, D.C.

Carole Basri
Executive Director
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Deborah Yang
United States Attorney
Central District of California
Los Angeles, CA

E. Scott Gilbert
Counsel, Litigation and Legal Policy
General Electric Company

Prepared Comments to the Advisory Group on Organizational Guidelines to the United States Sentencing Commission

Presented by:
Gale C. Andrews Vice President of Ethics and Business Conduct
The Boeing Company

Ladies and gentlemen of the Advisory Group,

First let me thank you for the opportunity to be heard on this issue. The Sentencing Guidelines are a major component of what forms ethics and compliance programs in industry, and your call for this public dialogue on the topic is to be applauded.

As I reviewed the specific questions you have asked me to comment on, I formed some general impressions on what we should be considering in the Guidelines as well as specific answers to your questions. At a general level, the Guidelines should be (and I contend are) written at a broad enough level to support a wide range of business types and sizes. That is, it is unrealistic to expect a small one thousand-person firm to implement the intentions of the Guidelines in the same manner that a two hundred thousand-person firm would. The level of formal control and resource allocation required would be dramatically different. Therefore, the Guidelines should focus on the desired results as opposed to specific implementation actions. It is, after all, the achievement of results that will change behaviors mitigate the risks.

On a more specific level, question 1e. regarding §8A1.2, comment 3(k)(4), is representative of the general observation. Is the type of training or communication the key issue, or is ensuring results from training and communications the point? I would contend that the Guidelines should focus on requiring training to occur and companies to demonstrate that employees have been trained. Training classes and company news communication channels will not impact behaviors unless there are appropriate monitoring of results. As to whether to require "training" or "communication" or both, I assert that they are one in the same with identical intentions.

Question 1f. regarding the need for a threat-free environment for individuals to report concerns again must be looked at from the standpoint of what is intended. Section 8A1.2, comment 3(k)(5), calls for "reasonable steps" to be taken to provide such an environment. At issue then are not the steps themselves, but the reasonableness of those steps. Reasonableness is very often in the eyes of the beholders, and therefore very difficult to quantify. I would suggest that a better position would be the requirement of an anti-retaliation policy and a demonstration that the policy is in effect. This could be accomplished via monitoring actions taken toward the reporting employee (raises, promotions, transfers, etc.) subsequent to any reporting event. Such a monitoring action would clearly demonstrate a companies commitment to an anti-retaliation environment, encouraging those who have concerns to come forward.

Regarding question 1g. on emphasizing monitoring, suffice to say that any control needs to be monitored and independently reviewed on a periodic basis to ensure its continued effectiveness and relevance. Most audit organizations currently have fraud related tests in their audit programs today, but articulating the need for such reviews in the Guidelines is probably still appropriate. Additionally, articulating a requirement for reviewing compliance programs on a periodic basis would support the continuance of a healthy program.

As to whether §81.2, comments 3(k)(6), should contain language giving "credit" for companies demonstrating positive actions towards supporting compliant behaviors, I would say yes. If we all subscribe to the theory of "what gets measured gets done," then it would make sense to have a measurement and reward system around compliance results. While I think that, in many cases today, companies do have measurement and consequence for non-compliance, it would appear that there is a less direct correlation between reward and compliance. The reason for this is probably lodged in the belief that compliance is just part of the total job and therefore doesn't require special attention. Placing verbiage in the Guidelines supporting efforts to bring special attention to positive compliance performance would provide leverage in changing the awareness in this area and ultimately changing behaviors. Again, whatever prescription is formulated for recognizing a company's efforts in rewarding compliant behavior must be sufficiently broad enough to accommodate the vast array of compensation systems. However, I believe this can be successfully developed, and the desired result can be achieved.

As to question 3 of your writing, to address it properly requires some frank and delicate conversation. Question 3 poses the issue of the natural tension between the "correctness" of self-disclosures and the threat of punishment for same. To examine this, I am inclined to look at the issue from two points of view. First of all from the point of view of companies, the Guidelines should not have to stress the importance of independent assessment and making appropriate corrective actions. Companies that do not undertake this kind of open evaluation on their own are destined to suffer unforeseen compliance failures that can be devastating. The hallmark of any credible audit or monitoring control is complete access to information and absolute independence. If a company does not subscribe to this already, no amount of urging from the Guidelines will change their view. But on the other side of this is the question of the environment the companies operate within. The importance of auditing, monitoring and self-reporting can be stressed ten fold from its current position, and nothing will change if the actions don't support the writings. To be more blunt, companies that energetically support and follow the Sentencing Guidelines must see specific benefit from their actions. Companies who are "on the fence" about supporting the Guidelines must also see tangible results for those who participate if we expect them to get off the fence. So this raises the question of what metrics should there be to support the desired behavior, and how should that be published? I know this is a very difficult question that will take more than the few minutes we have together to resolve. However, it is pivotal to attaining the level of trust and openness the Guidelines attempt to create, and therefore worth addressing in some manner.

This ends my prepared comments on the questions you had asked me to address. Again I would like to thank the Advisory Group for opportunity to speak on these topics, and compliment you on the effort and interest you are investing in this important work. I would be happy to answer any questions you might have at this time.

PROFESSIONAL BIOGRAPHY

SCOTT AVELINO
KPMG LLP

Scott serves as a director with KPMG's Forensic practice in Washington, D.C. where he is a national product leader on matters related to corporate governance and integrity.

Scott has helped many well-known companies assess their ethical and legal risks; establish programs to govern corporate conduct; measure compliance; and report externally on performance indicators related to corporate responsibility. He has counseled clients in numerous contexts, including crisis response; litigation and dispute resolution; M&A due diligence; compliance risk management; independent monitoring; and social auditing.

His research in the field of corporate integrity has been profiled in *The Wall Street Journal*, *The New York Times*, *The Financial Times*, *The Washington Post*, CNN and other major media outlets. His international experience has included assessments across North America, Latin America, Europe, the Middle East and Asia-Pacific. Prior to joining KPMG, Scott was on the management consulting team of the Ethics Resource Center, an influential non-profit organization that helped pioneer the field of business ethics in the United States and abroad.

Scott is the co-author of "Measuring the Effectiveness of Compliance and Ethics Programs," in *Compliance Programs and the Corporate Sentencing Guidelines*; contributing author of "Beyond the Numbers," KPMG's international position paper on non-financial assurance; and author of KPMG's national benchmarking study on corporate integrity.

Scott serves on the corporate sponsor board of Transparency International and is a faculty member of the Practising Law Institute on Corporate Compliance. He is also a contributor to The Conference Board's 2002 Roundtable Project "Post-Enron: A Blueprint for Best Corporate Governance Practices and Early Warning Systems." He received his B.A. in Political Science (International Relations) from the University of California, Santa Barbara and studied the University of California's Center for Public Policy in Washington, D.C.

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Carole Basri
Corporate Lawyering Group LLC
New York, NY

Carole Basri is a graduate of Bernard College, Columbia University and NYU School of Law, where she was a member of its National Moot Court Team. She was an assistant counsel on the Senate Antitrust and Monopoly Subcommittee, and was an attorney at the Federal Trade Commission (FTC). She was in house counsel at the advertising agency of NW Ayer, Inc. She left to become an associate at Baker & McKenzie and later at Hall, Dickler, Lawler, Kent and Friedman. Ms. Basri was in house counsel at Maidenform, Inc. She was a consultant to the Perrier Group, Inc. and from 1994 to 2002, she has been a consultant to Deloitte & Touche LLP. In addition, she continues her role as Executive Director of the Greater NY Chapter of the American Corporate Counsel Association. From 1999 to March 2001, she was General Counsel to China On Line, Inc. She has been an Adjunct Professor of Corporate Law at Benjamin N. Cardozo Law School and Director of the Corporate Lawyering Conference of the NYU School of Law. Presently, she is an Adjunct Professor of Corporate Law and the Grant Irey Committee Lecturer at the University of Pennsylvania School of Law. Also she is a co chair of the Practicing Law Institute's (PLI) Conferences on corporate compliance and on advanced corporate compliance; co-chair of the Corporate Counsel Committee of the International Law and Practice Section of the New York Bar Association; a Director of the International Advertising Association for the U.S. Chapter; a member of the PLI Corporate General Counsel Advisory Committee; co-chair of the International Employment Law Committee and the Mideast Committee of the International Law and Practice Section of the ABA; and an emeritus member of the Professional Ethics Committee of the Association of the Bar of the City of New York. She is co-author of Corporate Legal Departments (3rd edition) published by the PLI. She is the Corporate Law Columnist for the New York Law Journal. She is the President of the Corporate Lawyering Group LLC which sponsored the Corporate Lawyering accreditation program on May 12, 1999 at the Plaza, June 2,3 & 4th 1999 at the Penn Club, June 12, 2000 at the Plaza and September 10, 2001 at the Penn Club in cooperation with the U.S. Commerce Department, New York State Bar Association and the American Corporate Counsel Association.

October 30, 2002

Office of Public Affairs
U.S. Sentencing Committee
1 Columbus Circle, NE
Suite 2-500
Washington, D.C. 20002

Dear Members of the Advisory Group on Organizational Guidelines:

As an Adjunct Professor at the University of Pennsylvania School of Law teaching Corporate Lawyering, I believe that Chapter Eight Guidelines should 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 compliance with such programs. The Caremark Decision dicta on corporate compliance oversight by the board of directors should be incorporated. into the Chapter Eight Guidelines criteria. The connections between good corporate governance and an effective corporate compliance program is critical.

I feel such a strong connection between corporate governance and corporate compliance will instill a high level of interest and promote corporate citizenship among officers of the company. It would be an important lever in creating a culture of compliance.

As you are aware, the New York Stock Exchange proposed rules issued on August 16, 2002 recommend a majority of independent directors. With this in mind, specifically connecting Chapter Eight Guidelines to corporate governance and the board of directors' responsibility would further compliance efforts since I believe that independent directors will more readily take a leadership role in making sure that they have the appropriate tools to oversee compliance.

The board of directors will be more likely to request a high level compliance officer who has adequate time and resources so they have someone to rely on; a third party anonymous hotline that provides regular, audited reports on violations; sufficient training on risk areas; and reliable and frequent monitoring of the compliance program. These are the key areas of oversee that the board of directors could expect regular reporting on a quarterly or semi-annual basis to be available.

Sincerely,

Carole Basri

Carole Basri

Nancy McCready Higgins
Vice President, Ethics and Business Conduct
Lockheed Martin Corporation

Nancy Higgins is Vice President of Ethics and Business Conduct for Lockheed Martin Corporation, reporting to the Office of the Chief Executive and the Audit and Ethics Committee of the Board of Directors.

Prior to joining Lockheed Martin, she headed the Office of Ethics and Business Conduct for The Boeing Company where she launched Boeing's company-wide ethics and compliance oversight program. She also served in Boeing's Law Department where she managed complex corporate litigation and advised the Board on shareholder litigation issues. Prior to that, she practiced law at the Lane Powell firm in Seattle, Washington, and at Skadden, Arps, Slate, Meagher & Flom in New York City.

She is active in the leadership of the American Bar Association Litigation Section, having served as a council member, a member of several task forces, and as Co-Chair of the Committee on Corporate Counsel. Higgins has also served on the ABA Standing Committees on Professionalism and Legal Ethics and Professional Responsibility.

Higgins is the immediate past chair of the Working Group of the Defense Industry Initiative on Business Conduct and Ethics (DII), a consortium of defense contractors that subscribe to a set of principles for high standards of business ethics and conduct. Higgins is a member of the Board of Directors of the Ethics Officer Association (EOA), is a member of the Conference Board Global Council on Business Conduct, and is a Corporate Fellow and member of the Advisory Board of the Ethics Resource Center Fellows Program. She also serves on the Board of Trustees of BAPA's Imagination Stage, a theatre arts center for young people that celebrates innovation, diversity and inclusion.

Higgins earned her bachelor's degree in Russian History from Western Washington State University in Bellingham, Washington, and holds a law degree from the University of Washington in Seattle. She has completed the Advance Management Program at INSEAD, an international business school in Fontainebleau, France.

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Nancy McCready Higgins
Vice President, Ethics and Business Conduct

November 5, 2002

Todd Jones, Chairman
Advisory Group on Organizational Guidelines
c/o Office of Public Affairs
United States Sentencing Commission
Suite 2-500, South Lobby
One Columbus Circle, N.E.
Washington, D.C. 20002

Dear Mr. Jones:

Thank you for your invitation to testify at the November 14, 2002, public hearing. I am pleased to have this opportunity to share with the Advisory Group on Organizational Guidelines my perspective on the implementation and administration of effective compliance programs.

My perspective is based upon my experience in the development and implementation of corporate ethics and compliance programs for two major aerospace companies. Both of these companies, or their predecessors, were original signatories to the Defense Industry Initiative on Business Conduct and Ethics (DII), and thus already had formal ethics and compliance programs before the promulgation of the Sentencing Guidelines. However, the Sentencing Guidelines, with their seven minimum steps for an effective program to prevent and detect violations of the law, prompted DII signatory companies to take a fresh look at their self-governance programs and make them even stronger.

There is no question that the Sentencing Guidelines were the driving force in bringing these programs to the rest of corporate America ten years ago. In this time of increased scrutiny of corporate business conduct, it is appropriate that the United States Sentencing Commission is reviewing the effectiveness of the guidelines to determine whether further changes or enhancements are appropriate.

Comments and Recommendations

As a general matter, I recommend that the Commission not make major changes to the Guidelines or add much detail to the seven criteria. Companies have now had ten years of experience in dealing with the Guidelines and have built effective programs. The general, flexible nature of the Guidelines has fostered the development of programs that are suited to a particular company. Put simply, there are many "right" ways to structure a program and companies should have the flexibility of creating one that best suits their corporate cultures.

Training and Communication

I believe that §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, should not be changed to specifically require both training and other methods of communication. Although most programs involve both training sessions and distribution of printed materials, there may some situations where the dissemination of handbooks, guidelines, or other publications would be an effective method of communicating standards and procedures. The Sentencing Guidelines should not mandate a particular method.

Reporting Systems

I agree with the comments of the Ethics Officers Association with respect to the inadvisability of specifically encouraging a neutral or ombudsman office. Although this approach is best for some companies, there are many other good methods. The Guidelines should avoid promoting a specific methodology of providing a reporting system.

The Guidelines should encourage the availability of confidentiality and the ability for employees to remain anonymous when reporting suspected misconduct or other concerns. Currently, corporations cannot guarantee confidentiality or anonymity in the face of third-party litigation or government investigations. Ideally, the guidelines would encourage a privilege for good faith self-assessment, although that may be beyond the powers of the Sentencing Commission.

Ethical Cultures

The Guidelines should be amended to encourage companies to adopt a code of ethics and business conduct that identifies company values and expectations for appropriate conduct and behaviors. Compliance systems are more effective when accompanied by a clear statement of corporate commitment to a culture of ethical business conduct. However, in adopting such a requirement, the Commission should be careful to limit itself to a statement of general principles, rather than specific content requirements.

Most companies are now in the process of examining and revising their existing codes of conduct in light of Sarbanes-Oxley and the SEC proposed rules. If the revised Guidelines contain requirements for specific code provisions, companies that have just revised their codes may well have to do so again in order to assure that their codes meet the requirements of the Sentencing Guidelines. It is unlikely that such changes, which would need to be publicly disclosed pursuant to the SEC proposed rules, would truly enhance the effectiveness of the programs. Thus the Commission should attempt to insure that any specific requirements are compatible with the code of conduct requirements in the final SEC rules.

I am looking forward to meeting with the Advisory Group at the November 14, 2002 hearing.

Very truly yours,

Nancy M Higgins

Nancy McCready Higgins

BARBARA H. KIPP

Partner, PricewaterhouseCoopers
Global Leader, Ethics & Business Conduct

Barbara ("Bobby") Kipp is a partner and the Global Leader of Ethics & Business Conduct with PricewaterhouseCoopers. PricewaterhouseCoopers was the recipient of the 1998 American Business Ethics Award. Prior to assuming the role of Director of Ethics & Business Conduct in 1996, Barbara was an audit partner with the Firm.

Bobby received a Bachelor's degree in Business Administration, majoring in accounting, from the University of Massachusetts at Amherst in 1981. In 1997, Bobby was honored as the University of Massachusetts, Department of Accounting and Information Systems, Alumna of the Year.

Bobby's professional and community activities include the Board of Directors of the Ethics Officer Association; Board of Directors of the Ethics Resource Center; Bentley College Center for Business Ethics Executive Fellow; New England Ethics Forum; Boston Center for the Arts, Board of Directors and Treasurer; University of Massachusetts, Accounting Advisory Council; National Organization for Women Legal Defense and Education Fund, Women of the Year Planning Committee; National Association of Female Executives; Lane School Advisory Council; Bedford POMS (Patrons of Music Students) Executive Committee; and Bedford Youth Basketball, Soccer and Softball Coach.

In the past, Bobby has also served on the American Business Ethics Award Judging Panel; Greater Boston Chamber of Commerce, Small Business of the Year Award Committee; Board of Directors of the Metropolitan Wind Symphony, as a volunteer for the Business Volunteers for the Arts, on the Smaller Business Association of New England (SBANE) Associate Members' Committee; and The North Suburban Chamber of Commerce Economic Development Task Force, and Destination Imagination coach. She is a graduate of the FBI Citizens' Academy.

Bobby lives with her husband, Thomas, and three children, ages 12, 10, and 7, in Bedford, Massachusetts. She plays Oboe and English horn in local musical groups.

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October 29, 2002

Dear Mr. Jones:

Thank you for the invitation to offer commentary to the Advisory Group on Organizational Guidelines on November 14, 2002. I will be attending the hearing and look forward to providing additional information to the Advisory Group in relation to questions 1(e) through 1(h) and 3 of Attachment A that was enclosed with your letter of invitation.

Before providing specific commentary to the above noted questions, I would like to reiterate the basic premise of our position in relation to Chapter Eight of the Sentencing Guidelines.

Overall, we believe that the guidelines have contributed greatly to furthering an ethical climate in American business. We also believe that the guidelines, as they currently exist, provide an appropriate framework for the development of compliance programs. However, further specificity regarding the guidelines in relation to how the Commission applies the guidelines in evaluating the effectiveness of a compliance program would be of value. In suggesting further specificity, we recommend a "points of focus" approach rather than prescriptive rules. Prescriptive rules could lead to a dilution of one of the underlying tenets of the Guidelines themselves – that standards be tailored to the individual organization. Without the flexibility to tailor standards, communications, training, monitoring, etc., individual compliance programs are likely to become less, not more, effective. In addition, we believe that detailed prescriptions will limit the creativity in developing new practices, some of which may become best practices.

PRICEWATERHOUSECOOPERS

Questions:

1(e) – Communication/Training

We agree that the language should be clarified to make it clear that both training and other methods of communication are necessary components of "an effective" compliance program because training and communication each accomplish different goals. While communication is effective for such things as raising awareness of the compliance program and conveying resource availability to employees, our experience is that communication alone cannot address the complexities of the situations people encounter. Training can accomplish several goals that communication alone cannot, including: helping to ensure that employees know how to recognize compliance events and providing a safe environment to discuss ethical issues and practice ethical decision making.

We would also support replacing the term "disseminating publications" with more flexible language, such as the proposed "other forms of communications" to further clarify this section.

We would not support any notion to prescribe the types of training (i.e., one-on-one, web-based, video, etc.) that organizations should employ per the reasoning in our overall viewpoint noted above. For example, an approach mandating instructor-led, facilitated group training would have precluded the development of very effective computer-based training media. For many organizations, the ability to use technology for certain types of training enables them to reach their employees on a more timely and targeted basis than instructor-led training. By allowing for this flexibility, organizations can identify their specific training objectives and design appropriate learning activities to meet these objectives.

1(f)(i) – Whistleblowing protections

It is our position that the current guideline in §A1.2, comment 3(k)(5) regarding the implementation and publicizing of a reporting system that fosters reporting without fear of retribution could be enhanced by specifically noting that such a reporting system should allow for anonymous reporting. While our organization, and most that we are aware of with an established reporting mechanism, already have anonymous reporting capabilities, the addition of such a specific requirement would provide good guidance for those organizations that develop such reporting capabilities in the future.

1(f)(ii) -- Privilege or policy for good faith self-assessment and corrective action

Given that the Guidelines define an effective compliance program as one designed to "prevent and detect violations of the law," it is inherent within the definition that organizations need to perform due diligence and develop information within the organization to know best where to focus compliance risk management efforts. One such source is the information reported through the confidential reporting mechanism established by the organization. We believe that the absence of an effective and comprehensive self-evaluative privilege continues to be a barrier to full implementation of effective compliance programs. Without the protection of self-evaluative privilege, organizations could be hesitant to conduct expanded self-evaluations, reviews, investigations and auditing programs (of their confidential reporting mechanisms or other sources of information), fearing that the information uncovered may be used against them. With a self-evaluative privilege, it is our opinion that organizations would be encouraged to perform more proactive compliance auditing, leading to quicker discovery of compliance issues and swifter corrective action.

1(f)(iii) -- Creation of a neutral or ombudsman office for confidential reporting

We support the notion of a neutral resource for employees to go to for confidential reporting purposes. However, it is our position that specifying that the confidential resource needs to be an ombudsman is too prescriptive. Our Ethics & Business Conduct Office acts in the capacity of a confidential and neutral resource within our organization by being situated outside of our business units both from a reporting and funding perspective. This structure allows our Ethics & Business Conduct Office to be objective in the review and investigation of issues raised within our firm. We believe that, because this function is operated by individuals within our company that have a strong understanding of our businesses, organization and initiatives, they are in a better position to effectively engage appropriate people within PwC to investigate and resolve potential issues than a third party ombudsman is. We believe that the goal of prevention and early detection is, in our company's case, better met by an internal reporting/investigation/resolution approach. In other organizations, ombuds may be the most appropriate and effective confidential reporting vehicle, but not in all organizations.

Again, by being non-prescriptive on this issue, the Guidelines provide organizations with the flexibility to provide resources to their people in a manner that is consistent with tailoring compliance programs to the individual organization. We would not, however, object to expansion of the Guidelines to include examples of different methods organizations can employ to meet the requirement for a reporting system/process, including, ombuds, helplines, mail boxes or other mechanisms.

1(f)(iv) – Some other means of encouraging reporting without fear of retribution

As noted under question 1(f)(iii) above, we believe that the Guidelines could be reasonably expanded to provide examples of the types of reporting systems or other means to encourage reporting. In our experience, most organizations provide multiple avenues of upstream reporting, including a confidential/anonymous reporting vehicle. We believe that any kind of confidential and anonymous reporting system is beneficial, but that the reporting system needs to fit the organization. In addition, it is our opinion that the process that is followed in regard to reports of potential misconduct is more important than the form of the reporting mechanism.

1(g) – Auditing and monitoring of compliance program

While the Guidelines imply that organizations' monitoring activities include periodic assessments of the effectiveness of their overall compliance programs, we believe that the Guidelines would be strengthened by specifically mentioning the importance of this activity. However, while we believe that the Guidelines should recognize the importance of self-assessment through auditing and monitoring activities, since the effectiveness of ethics and compliance management activities is multi-faceted, it is dangerous to suggest that one or more quantitative measures is more important than others. Instead, we believe the Guidelines should provide examples of the types of monitoring and auditing activities that organizations should consider, such as periodic confirmations, review of statistics and trends related to reported incidents, periodic surveys or other assessments of organizational culture.

Greater clarity around these activities would allow organizations to more confidently deploy appropriate systems and processes for monitoring and auditing compliance. However, we do not think that the Guidelines should in any way be so prescriptive that there is a requirement for such things as third-party auditing and assessment of an organization's compliance program. Such a requirement would only drive up the cost of compliance programs and would likely act as a disincentive to the development of compliance programs.

1(h) – Disciplinary Consistency

As with our response to question 1(g), we believe that greater clarity around what the Commission and prosecutors expect in relation to consistent enforcement would allow organizations to more confidently deploy appropriate systems and processes for ensuring consistent enforcement. Also, we would support the notion raised in the question that credit should be given to organizations for the inclusion of compliance criteria in performance

evaluations. In addition, we believe that the Guidelines should give credit to organizations that recognize ethical behaviors in their performance assessment and management systems. Given the varied nature and relative importance of compliance requirements in different industries, the specific compliance requirements should not be prescribed in the guidelines, as to do so could have unintended effects. For example, while our industry requires many of our professionals to comply with auditor independence requirements, independence is not a compliance issue for every job function within our organization. Furthermore, while this compliance requirement is paramount to auditing firms, it does not apply in the same manner to other industries.

3 – Encouraging auditing, monitoring and self-reporting

We believe that the development of a comprehensive self-evaluative privilege [see 1(f)(ii)] would result in increased and deeper auditing, monitoring and self-reporting activities. Without such a privilege, as the question acknowledges, "the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting."

Thank you for the opportunity to offer my input into the review of the Chapter Eight Guidelines. I look forward to testifying before the Advisory Group.

Sincerely,

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Donald C. Langevoort is Professor of Law at Georgetown University Law Center, Washington, D.C. He joined the Georgetown faculty in 1999 after eighteen years at Vanderbilt University School of Law, where he had been the Lee S. & Charles A. Speir Professor. He has also been a visiting professor at the University of Michigan and Harvard Law School. Professor Langevoort graduated from the Harvard Law School in 1976, and immediately went into private practice with the law firm of Wilmer, Cutler & Pickering in Washington. In 1978, he joined the staff of the U.S. Securities & Exchange Commission as Special Counsel in the Office of the General Counsel. Since entering academia in 1981, Professor Langevoort has written a treatise on insider trading, co-authored a casebook on securities regulation, and produced numerous law review articles on topics such as insider trading, the impact of technology on securities regulation, investor behavior and the intersection between cognitive psychology and lawyers' professional responsibilities. He has also served on the Legal Advisory Committee of the New York Stock Exchange and the Legal Advisory Board of the National Association of Securities Dealers, and has testified several times before Congressional committees on matters relating to securities regulation and litigation. Currently, he is a member of the SEC's Advisory Committee on Market Information , chairing its subcommittee on alternative models for data consolidation. He is also a member of the American Law Institute.

Comments to the Advisory Group on Organizational Guidelines to the United States Sentencing Commission

Professor Donald C. Langevoort
Georgetown University Law Center

Submitted: October 29, 2002

I am pleased to participate in the Advisory Group's deliberations on the effectiveness of the criteria for an effective compliance program. My comments will be indirect to many of the issues you are considering, because my research does not deal specifically with criminal corporate liability or the use of sentencing as an incentive mechanism. Rather, my work - which is primarily in corporate and securities law - touches on issues of compliance monitoring generally, with special attention to financial services firms. Its methodology borrows from a mix of conventional and behavioral economics, the latter being a blending of psychology into the usual predictors of economic activity.

The focus my work has been to determine what social and cognitive psychology research - the stuff of contemporary behavioral law and economics - has to say about the task of compliance and the contest between hard and soft monitoring strategies. The psychological work touching on this subject is tentative, often contestable, and always highly context-dependent, making it difficult to articulate strong confident predictions. My aim, however, is slightly less ambitious. Most of the legal discourse on supervision and compliance today makes behavioral predictions while ignoring this body of research entirely. I am content to think about what conclusions might follow if it turns out that these psychological predictions are robust within firms. In other words what are the risks associated with ignoring these predictions?

The potential pay-off from this effort is two-fold. There is a strong consensus that the law must do something other than simply relying on its conventional strategy of strict vicarious corporate liability in order to induce good monitoring. As the Sentencing Guidelines recognize, firms must be sanctioned for having poor systems or be given some sort of bonus for having good ones. But that necessarily means that a fact-finder has to make a reasonableness determination with respect to any given system, which in turn implies some cost-benefit analysis. My main claim is that these evaluations are prone to unexpected error in two somewhat off-setting directions. First, evaluators are likely to overestimate the extent to which a firm can rely on line supervisor monitoring to detect

possible illegality. Which such supervision will catch some misconduct, a host of forces thwart its effectiveness overall. Here, the bias is toward tolerating sub-optimal monitoring. Secondly, there is also a likelihood of underestimating the costs associated with the most obvious cure for line supervisor bias: third-party compliance audits. This likely error biases the legal response towards insisting on too much auditing, forcing unnecessarily costly compliance initiatives.

I cannot quantify the net impact of these kinds of errors, which limits the precise policy lessons we can draw from the analysis. But if these unexpected or immeasurable costs of monitoring turn out to be high enough, it might mean that *any* affirmative regulatory insistence on high-powered monitoring will be inefficient. The problem is less severe if these costs turn out to be less, but it still does not go away. My point for now is simply that judges are likely to do a poor job of estimating the costs associated with specific compliance initiatives in a given firm, creating at least the risk that the legal regime will be an inefficient one.

These errors may also create disincentives for firms to experiment with so-called integrity-based systems, which have some promise even if they can be expected to fail rather dramatically on occasion. There is an inverse relationship between high-powered monitoring and trust-based systems, and any effort to encourage them must necessarily step down the intensity of command and control-style supervision.

To be sure, all I am doing is pointing out a risk of inefficiency in the process of evaluating compliance, with a bias in the direction of forcing excessive monitoring. This does not automatically translate into a reason for the law to become less aggressive. It may be that the social costs of the particular illegality in question are sufficiently large or immeasurable that this bias is a risk worth tolerating. My sense is that my analysis has the greatest normative bite in settings where (1) the harms in question are economic and (2) large externalities do not result from the conduct. In other words, we should worry most about this problem where the costs of over-precaution are most readily passed on to the class of persons who are the beneficiaries of the regulation. Here, at least, my sense is that the risk of inefficiency via insistence on too much monitoring is sufficiently strong that the law presumptively ought to take a fairly moderate position with respect to firm-level obligations. Some carrots and sticks are desirable with respect to compliance: vicarious liability is necessary, but not sufficient, for optimal organizational compliance. However, I would normally set the bar at medium height. Two steps seem wise along these lines. One is limiting our insistence on compliance to that which is already a best practice within the relevant industry (as opposed to trying to force steps to significantly on these standards, *de novo*). The other is shifting the emphasis to individual supervisory liability when supervisors actually ignore the red flags waving in their faces.

I will be happy to elaborate on these points to the extent that you would find helpful in your deliberations.

Eric Pressler

Eric Pressler has been the Director of Legal Compliance and Business Ethics for PG&E Corporation since 1996. PG&E Corporation is one of the largest utility and energy services companies in the United States, with over 23,000 employees and annual revenues of over $15 billion. His department is responsible for the PG&E Corporation program to assess legal and regulatory compliance requirements and manage those requirements in accordance with the Organizational Sentencing Guidelines. His department is also responsible for the corporate code of conduct, annual compliance and ethics training, on-line compliance training and the compliance and ethics Helpline.

Mr. Pressler is currently a member of the Ethics Officer Association Board of Directors and in 2000/2001 served as the Chairperson of the Bay Area Compliance Association. He has also presented at numerous professional conferences and seminars on topics related to compliance and ethics management.

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October 29, 2002

Mr. Todd Jones, Chairman
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Washington, D.C. 20002

Dear Mr. Jones:

Thank you for the invitation to comment on possible enhancements to Chapter Eight of the Organizational Sentencing Guidelines. I plan to attend the hearing of the Advisory Group on Organizational Guidelines scheduled for November 14, 2002.

The Organizational Guidelines have had an immense cross-industry impact on the prevention of criminal activity. They have helped organizations focus on their obligation to prevent violations and have implemented meaningful incentives and standards in support of effective compliance management. In response to these incentives and standards, many corporations have established legal compliance and business ethics functions to design, implement, and manage programs to prevent violations. Virtually all of these programs are modeled on the Organizational Guidelines.

One of the greatest strengths of the Organizational Guidelines is that they provide a framework for compliance management and identify key elements of effective compliance management programs without dictating exactly how organizations must implement each program element. In this way, organizations can tailor their compliance efforts based on the risks they face, their corporate culture, and the resources available for compliance management activities. As the Advisory Group considers changes to the Organizational Guidelines, I suggest maintaining this non-prescriptive approach.

Summary of Testimony

In the invitation to testify, I was asked to comment on questions 1(e) through 1(h) and 3. My observations and recommendations are summarized in the following paragraphs.

Question 1(e) - Communication. This question asks if the language of §8A1.2(k)(4) should be clarified to establish that both training and other methods of communication are necessary components of an effective program. It also asks if the phrase "disseminating publications" should be replaced with more flexible language, such as "other forms of communications." I believe that most organizations already understand the flexibility provided by the Organizational Guidelines, since a wide variety of training and communication techniques are currently in use. However, replacing "disseminating publications" with broader language, such as "other forms of communications", would add clarity to the section.

Question 1(f)(i) - Whistleblowing Protections. Section A1.2(k)(5) of the Organizational Guidelines requires that organizations provide "a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution". Most organizations have clear policies prohibiting retribution against those who use reporting systems. However, "fear of retribution" also depends on the ability of an organization to protect the confidentiality of individuals using their reporting system. Although organizations can implement procedures to safeguard the identity of callers and to secure information collected during investigations, they cannot promise absolute confidentiality because records may have to be disclosed in subsequent litigation or in response to a government inquiry.

Many organizations address the need for confidentiality by making it possible for employees to use their reporting systems anonymously. Over the past six years, at my company, approximately 20 to 30 percent of employees have chosen to remain anonymous when making allegations through our Compliance and Ethics Helpline. In 2001, 56 corporations participated in a benchmarking study of reporting systems conducted by the Ethical Leadership Group. This study found that 38 percent of allegations submitted through reporting systems were submitted anonymously.

I recommend modifying §A1.2(k)(5) to be more specific in addressing the need for confidentiality and anonymous reporting. Included below is possible revised language for this section.

"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 and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution. Such a reporting system must permit anonymous reporting, and reports must be kept confidential to the extent practical".

Question 1(f)(iii) - Encouraging a Neutral or Ombudsman Office for Reporting. Organizations take many different approaches in meeting the reporting system requirement of the Organizational Guidelines, e.g., a compliance hotline, a compliance and ethics helpline, an ethics office, a compliance office, or an ombudsman office. The Organizational Guidelines currently are non-prescriptive in this area, allowing organizations maximum flexibility to meet the requirement through whatever mechanism best fits their corporate culture and compliance management needs. A neutral or ombudsman office may be the best approach for some organizations to provide a reporting system, but adding a statement to specifically encourage establishment of a neutral or ombudsman office would be inconsistent with the non-prescriptive approach taken throughout the Organizational Guidelines. Instead, the Advisory Group may wish to consider offering examples of reporting systems, including ombudsman offices, ethics offices, compliance offices, helplines, and hotlines.

Question 1(g) - Periodic Auditing of Compliance Programs for Effectiveness. This question asks if greater importance should be given to auditing and monitoring, including a new requirement for periodic auditing of an organization's compliance program for effectiveness. I think that it would be difficult to implement a requirement for periodic auditing of compliance programs for effectiveness because of the non-prescriptive nature of the Organizational Guidelines. They provide a framework for an effective program, but they do not define "effectiveness" in terms of specific outcomes or standards that could be audited. One of the distinctions between auditing and consulting is the existence of specific and widely understood standards that lend themselves to an audit process.

Question 1(h) - Disciplinary Mechanisms. This question focuses on the need to expand §A1.2(k)(6) to address performance evaluations, rewards, and compensation. From my perspective, the primary purpose of §A1.2(k)(6) is to require organizations to make compliance important to individual employees. One

approach to doing this is through disciplinary systems, but the importance of compliance also can be enhanced through performance evaluations, compensation systems, and other internal programs. Included below is possible revised language for §A1.2(k)(6).

"The organization must have taken reasonable steps to reinforce the importance of compliance through the use of mechanisms such as disciplinary action, performance evaluations, compensation systems, and other forms of incentives. Adequate discipline, reinforced by other incentives, must be consistently applied to those responsible for violations, and as appropriate, to individuals responsible for the failure to detect an offense."

Question 3 - Encouraging Auditing, Monitoring, and Self-Reporting. This question asks how the Organizational Guidelines could encourage auditing, monitoring, and self-reporting. Currently, implementation of a compliance program that follows the requirements in the Organizational Guidelines for monitoring, auditing, and self-reporting could result in an organization identifying and disclosing information that could be used against it in a lawsuit or subsequent government investigation. This is a significant disincentive to organizations that contemplate establishing a compliance program based on the Organizational Guidelines. In the absence of an effective privilege for self-evaluation or a guarantee of reduced penalties, organizations may be penalized for voluntarily taking steps outlined in Organizational Guidelines to prevent criminal conduct.

Again, thank you for the opportunity to comment on possible enhancements to the Organizational Guidelines.

Sincerely,

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Debra W. Yang
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Debra W. Yang, United States Attorney, Central District of California. Judge Yang is the first Asian American woman in the United States to serve as a United States Attorney. She also has been selected to serve on President Bush's Corporate Fraud Task Force and to chair the Attorney General's Advisory Sub-Committee on Civil Rights. Prior to being appointed United States Attorney, Judge Yang was a California state judge. She was appointed to the Los Angeles Municipal Court in 1997 and became a member of the Los Angeles Superior Court bench in 2000. She was also an instructor at California's Judicial College, and she sat on the Criminal Law Advisory Committee and the Subcommittee on the Quality of Judicial Service for the Court's Judicial Council. Before becoming a judge, Judge Yang served as an Assistant United States Attorney specializing in the prosecution of violent crimes, white-collar crimes, international money laundering, mail fraud, arsons, and computer crimes. She also taught trial advocacy as an Adjunct Professor at the University of Southern California School of Law, and served as an instructor at the National Institute of Trial Advocacy at Loyola Law School. Outside of her practice, Judge Yang has also been President of The Chinese American Museum in Los Angeles. She has played an instrumental role in the creation of this ground breaking cultural, education, social and historical new landmark for Southern California intended to highlight the Chinese-American experience. Judge Yang was a founding member and officer of the first Asian-American Bar in the City of Chicago, Illinois. She has also been an officer and board member for the Southern California Chinese Lawyer Association. Ms. Yang received her J.D. in 1985 from Boston College.

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Scott Gilbert is Counsel, Litigation and Legal Policy for the General Electric Company, based in the company's headquarters in Fairfield, Connecticut. His responsibilities include litigation management, internal investigations, and preventive law. He is the co-chairman of GE's compliance leaders group. He joined GE in 1992 after serving as an Assistant United States Attorney in the Southern District of New York. He served as law clerk to United States District Judge Vincent L. Broderick in the Southern District of New York from 1980 to 1981. Scott is a graduate of Harvard College (1976) and Harvard Law School (1980).

Session III: Confidentiality,
Internal Reporting,
Whistleblowing

Public Hearing of the Ad Hoc Advisory Group on Organizational Guidelines

Thurgood Marshall Federal Judiciary Building, Concourse Level, One Columbus Circle, N.E., Washington, D.C. 20002

November 14, 2002

Session III Agenda

Session III: Confidentiality, Internal Reporting, and Whistleblowing
Moderator: Win Swenson

Michael Goldsmith (former USSC Commissioner)
J. Reuben Clark Law School
Brigham Young University
Provo, UT

Patrick Gnazzo
Vice President, Business Practices
United Technologies Corporation
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Charles Larson
United States Attorney
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Cedar Rapids, IA
&
Chair, White Collar Crime Subcommittee of the Attorney General's Advisory Committee

Joseph E. Murphy
Compliance Systems Legal Group
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(participating via teleconference)

A. Terry Van Houten
Assistant General Counsel
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Kenneth W. Johnson
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MICHAEL GOLDSMITH
BIOGRAPHICAL STATEMENT

Michael Goldsmith is a professor of law at Brigham Young University, where he teaches courses on criminal procedure, evidence, RICO, trial advocacy and complex criminal investigations. In 1994, President Clinton appointed Professor Goldsmith to the U.S. Sentencing Commission. In 1996-1997, Professor Goldsmith served as Vice-Chairman of the Commission.

Professor Goldsmith is a former Assistant United States Attorney, and has also served as Counsel to the New York State Organized Crime Task Force. He has written extensively on RICO, asset forfeiture, and electronic surveillance, and previously served as Vice-chairman of the ABA Criminal Justice Section, RICO Committee. His work has been cited in numerous judicial decisions, and he has testified before the United States Congress on several occasions. Professor Goldsmith lectures on these issues throughout the country, and has served as a consultant to many law firms and law enforcement agencies. Finally, Professor Goldsmith has been an expert witness in international RICO litigation, and has also served on the faculty of numerous state and federal judicial training programs.

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Education

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Law Teaching Experience

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Other Legal Experience

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1976-77: Deputy State's Attorney, Chittenden County P.O. Box 27, Burlington, VT 05401.

1975-76: Law Clerk to Albert W. Coffrin, United States District Judge Burlington, VT 05401.

Legal Scholarship

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Selected Consulting and Lecturing Experience

The 1997-1998 Fortunoff Criminal Justice Colloquium, New York University School of Law.

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Procedure.

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ABA Criminal Justice Section, RICO Committee (Vice-chairman), White Collar Crime Committee (1987-1994).

Complex Criminal Investigations (1987-1994; training programs delivered throughout the country).

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Cornell Institute on Organized Crime (1980).

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Patrick J. Gnazzo has been Vice President, Business Practices at United Technologies Corporation since 1993. He is responsible for the corporation's compliance and ethics program, which includes managing more than 188 Business Practice Officers worldwide. These officers are responsible for supporting management's implementation of the company's ethics/compliance programs for all its 150,000 employees in more than 200 countries.

In addition, Mr. Gnazzo is responsible for directing and coordinating UTC's contracts and government property programs.

Mr. Gnazzo previously was Vice President, Government Contracts and Compliance, a post he held from January 1991. He joined UTC in 1981 as Assistant General Counsel at the Corporate Office and was named Associate General Counsel in 1982 and Vice President - Contracts and Deputy Counsel at Pratt & Whitney in 1983. Three years later he was appointed Counsel for UTC's Washington, DC office, and the following year he was named UTC Vice President - Government Liaison. In 1987, he was appointed President of United Technologies International Corporation and, in 1989, Vice President and Litigation Counsel.

Prior to joining UTC, Mr. Gnazzo was the US Navy's chief trial lawyer and director of its litigation division, and an associate general counsel of the Navy Department.

Mr. Gnazzo holds an undergraduate degree in political science and philosophy from John Carroll University and a law degree from Cleveland State University.

Mr. Gnazzo is a member of the Board of Directors of the Ethics Officers Association, Chairman of the Defense Industry Initiative Working Group and a member of the Board of Advisors of the National Contract Management Association.

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Patrick J. Gnazzo
Vice President
Business Practices

October 15, 2002

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

Dear Mr. Courlander,

Enclosed is a copy of my testimony in response to the invitation to testify on November 14, 2002 during the ad hoc Advisory Group's work on Chapter Eight Guidelines.

I will email a copy of this text to your office as well.

I hope to see you on November 14.

Sincerely,

Pat

Testimony of Patrick Gnazzo,
Vice President, Business Practices,
United Technologies Corporation,
prepared for delivery to the
Advisory Group on Organizational Guidelines,
United States Sentencing Commission,
relating to
Chapter Eight of the Sentencing Guidelines
November 14, 2002

I am Pat Gnazzo, Vice President of Business Practices, and on behalf of United Technologies Corporation, I want to thank you for this opportunity to present our views and recommendations regarding Chapter Eight of the Sentencing Guidelines. United Technologies Corporation provides high-technology products and services to the aerospace and building systems industries throughout the world. UTC's industry-leading companies are Pratt & Whitney, Carrier, Otis, Hamilton Sundstrand, Sikorsky, and UTC Fuel Cells.

Before I outline our recommendations, I first would like to give you some background on the confidential Ombudsman/DIALOG Program that UTC has made available to employees since 1986. I intend to reference several aspects of that program in the comments that will follow.

The Ombudsman/*DIALOG* Program

This UTC program is a two-way confidential communication channel designed to provide every UTC employee a means of addressing the company, with a commitment that management will provide a candid and confidential response. Thoughtful,

authoritative answers are provided for questions or concerns on any company-related topic, with the exception of those covered in union (collective bargaining) agreements. Complete confidentiality and anonymity are guaranteed. This guarantee of anonymity fosters a level of candor that otherwise might not be possible, and it encourages communication from employees who otherwise might not be heard.

The Program's Value

The *DIALOG* Program complements UTC's formal ethics program, it enhances internal communication, and it is a convenient vehicle for employees to use to question or report sensitive or legal issues. The program also provides a way for employees to make suggestions for improvement and register concerns or complaints. The program also demonstrates that, by offering each employee the opportunity to ask any question on any business-related topic, UTC is interested in corporate values as well as ethics and business practices. Finally, the program's existence indicates UTC is a company interested in what its employees have to say, so much so that it provides the safest possible way for that input to be heard.

Summary of Testimony

As you suggested in your letter of invitation, I will limit comment to two questions:

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?

And

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?

A Reporting System Without Fear of Retribution

I would like to address Question 1 f. first. The language of Point 5 of the Guidelines is clear and well-intentioned: "...a reporting system that fosters reporting without fear of retribution." Better organizations result from better reporting systems. In the workplace, however, the objective of the language of the Guidelines can be impossible to achieve absent the organization's ability to provide an absolute guarantee of confidentiality for the reporting source.

Workplace surveys reveal that a certain portion of any employee group will not report suspected or observed wrongdoing for fear of retribution or shunning by superiors or colleagues. A 1994 Ethics Resource Center (ERC) workplace survey is a benchmark. Thirty-one percent of respondents reported observing workplace misconduct, and 52 percent of them said they failed to report. When asked "why?" [did you fail to report], 41 percent said they feared retaliation or retribution from supervisor or management; 38 percent did not trust the organization to keep the report confidential; 24 percent feared retaliation or retribution from co-workers; and 25 percent did not want to be known as a

whistleblower. [Note: Respondents could give more than one reason, so the percentages need not total 100.]

A similar survey by the ERC and the Society for Human Resources Management in 1997 and a Year 2000 ERC survey reveal similar results.

A goal of ethics and compliance programs, and the Sentencing Guidelines as well, is to have better organizations filled with employees willing to come forward. But the organization can be a punishing place, and retribution can be hard to prove – whether it surfaces in increasingly poor performance appraisals of the reporting employee by the vengeful manager or tires slashed in the parking lot by disgruntled co-workers.

A spate of articles post-Enron illustrates the potential plight of the whistleblower (see *Blowing the Whistle: Not for the Fainthearted,* N.Y. Times, February 10, 2002; *A Corporate Fear Of Too Much Truth;* N.Y. Times op-ed, February 17, 2002; and *Whistle-Blowers Being Punished, A Survey Shows*, N.Y. Times, September 3, 2002).

We see this in our own work place. Recently, an employee reported to her/his supervisor that a co-worker had made threatening comments about what she/he would do if laid off or fired. The employee did the right thing: went openly to supervision. An investigation was begun, and the alleged offender was removed from the work place pending the outcome of the investigation.

How did the work place react? Employees in the source's work group chastised (and even swore at) the reporting source for being a "snitch."

We can easily see the parallel between this situation from my own company and the case of Jennifer Long, of the Internal Revenue Service. Author C. Fred Alford, in his book Whistleblowers, writes of IRS agent Jennifer Long's testimony about alleged IRS abuses. On the Monday following her testimony, according to Alford, "every single manager was in her face with the same refrain: 'You're not a team player.'"

Employees who need and want to report but fear retaliation need some protection. At United Technologies, we have a Corporate Ombudsman to oversee the *DIALOG* Program I described above. The Ombudsman is an alternate, neutral, and confidential source for employees to use to raise issues. The office of the Corporate Ombudsman at UTC has existed since mid-1986. We have a written and an oral component to our reporting mechanisms through this office, and in the last 16 years employees have used the Program to raise more than 65,000 issues in confidence.

Recently, a secretary called the UTC Ombudsman to report that her boss was cheating the company. She said that only she and her boss knew of his wrongdoing, and if she reported it openly "He would fire me – or worse."

She genuinely feared for her job security and personal safety.

Because our Ombudsman offers the promise of confidentiality (which we have successfully protected using the legal process on a half dozen occasions), the Ombudsman was able to assure the caller that the organization could investigate the issue without anyone knowing that she was the source..

She agreed, the investigation occurred, she was right, the boss is gone, and she's still with us – without anyone (except the Ombudsman) knowing her name.

No law assures us "ombuds privilege", but because of the way our Ombudsman operates (e.g., does not investigate, does not accept notice on behalf of the corporation, does not keep records for the corporation, is truly neutral and independent from management decisions) we feel comfortable in promising absolute confidentiality for employees – even in the potential face of third-party lawsuits.

We promise employees a confidential reporting system, and over the last 16 years more than 65,000 employees have taken us up on the offer.

So in direct response to your Question 1.f., we encourage the Commission to find a way to strengthen the possibility for having "a reporting system that fosters reporting without fear of retribution." We recommend that a promise of confidentiality be somehow incorporated into the system.

One solution would be to encourage organizations to create truly independent and neutral organizational ombudsman offices. Our experience at UTC shows that this model does offer the assurance and comfort of a confidential outlet.

But that costs money, and many organizations might not be willing (or able) to "staff up" for such an office. As an aside, we are asked frequently whether the ethics officer and the ombudsman can be the same person. Our response is a definite "No." The person who accepts notice (the ethics or compliance officer) cannot be the person who does not accept notice (the ombudsman). The person who investigates (the ethics or compliance officer) cannot be the person who does not investigate (the ombudsman).

With respect to the above, if §8A1.2, comment 3(k)(5), that section could be strengthened in its impact by being made more specific to require organizations to implement and publicize a *confidential* reporting system. That could prompt organizations themselves to determine how to meet the objectives.

This (the inclusion of the word *confidential*) might also help accomplish what will benefit organizations the most: a national law that protects the identity of a reporting source even in cases of third-party intervention. Workplace fear is detriment to reporting. The guaranteed assurance of confidentiality can eliminate that fear, with better organizations as a result.

Encouraging Auditing, Monitoring and Self-Reporting

I would now like to comment briefly on your Question 3: "How can Chapter Eight Guidelines encourage auditing, monitoring and self-reporting to discover and report suspected misconduct and potential illegalities…?"

The short answer is that they cannot, except in their ability to provide for strong mitigation of damages incurred by those organizations that have genuinely and sincerely attempted to foster and implement an effective compliance program.

Organization that audit, monitor and self-report might not be as forthcoming as they could (should) be knowing that the reporting might end up being part of a discovery process.

Organizations should want the benefit of a complete, effective compliance program and auditing and monitoring process. Two things would help in this process:

1. Organizations should be protected from third-party lawsuits and civil suits solely on an attorney-client basis, and
2. Companies should have the guarantee of reduced penalties when they do report.

Stronger, responsible organizations help build stronger, responsible societies. That presents an opportunity for the Commission and industry to work together as partners in good governance that is clearly for the larger good.

Summary

Once again, on behalf of United Technologies, I appreciate your invitation to comment here today. I hope our experiences in the workplace will be helpful to you as you work to revise the Sentencing Guidelines to encourage appropriate actions.

CHARLES W. LARSON, SR.
Biography

CHARLES W. LARSON, Sr., is the United States Attorney for the Northern District of Iowa. Prior to this appointment, he was the Chairman of the Iowa Board of Parole. He serves as a member of the President's Drug-Free Communities Commission and was Director of the Governor's Office of Drug Control Policy for five years. Larson also served as United States Attorney for the Northern District of Iowa between 1986 and 1993. He spent from 1979 to 1982 in Saudi Arabia as a consultant to the Kingdom's Highway Patrol Project. From 1973 to 1979 he served as Iowa's Commissioner of Public Safety. Larson retired as a colonel from the Active Army Reserves.

Joseph E. Murphy, Partner, Compliance Systems Legal Group

Joseph E. Murphy, a partner in Compliance Systems Legal Group, and Vice Chairman of Integrity Interactive Corporation, has worked in the organizational compliance area for over twenty-five years. Before joining Compliance Systems Legal Group, Mr. Murphy was Senior Attorney, Corporate Compliance, at Bell Atlantic Corporation in Philadelphia, where he was the lawyer for Bell Atlantic's worldwide corporate compliance program. His experience in the communications industry spans the major Bell System antitrust cases, the AT&T divestiture, and the organization and development of Bell Atlantic. In his practice, Mr. Murphy has covered compliance issues ranging from antitrust to the Foreign Corrupt Practices Act, in places as diverse as Minot, North Dakota, Wellington, New Zealand, and Prague in the Czech Republic. His practice has included the full range of compliance activities including training, investigating allegations of misconduct, drafting code and policy documents, and conducting compliance audits.

Mr. Murphy is Co-Editor of ethikos, a bi-monthly publication on corporate compliance and ethics. He has lectured and written extensively on corporate compliance issues, and co-chairs the PLI programs on corporate compliance. Mr. Murphy is co-editor of Compliance Programs and the Corporate Sentencing Guidelines: Preventing Criminal and Civil Liability (Clark Boardman Callaghan; 1993 & annual updates), with Jeffrey Kaplan and Winthrop Swenson, and co-editor of The Health Care Compliance Professional's Manual (Aspen/HCCA; 1999), with Roy Snell, Brent Saunders and Beth Ryan. Other writings include "The Self-Evaluative Privilege," 7 J. Corporation L. 489 (1982); Interactive Corporate Compliance: An Alternative to Regulatory Compulsion (Greenwood Press; 1988), co-authored with Dr. Jay Sigler; and Corporate Lawbreaking and Interactive Compliance (Greenwood Press; 1991), also co-authored with Dr. Sigler.

Mr. Murphy has been quoted as an expert on compliance and the self-evaluative privilege in national publications, including The Wall Street Journal, The National Law Journal and The American Bar Association Journal, and has served as an advisor to the United States Sentencing Commission regarding its surveys of compliance practices. He has given presentations on these subjects to business, professional and government groups including the ABA, the American Corporate Counsel Association, the United States Sentencing Commission, the Conference Board, the Ethics Officer Association and the Australian Consumer and Competition Commission.

While he was in-house counsel, Mr. Murphy was active in compliance issues through the American Corporate Counsel Association and its Delaware Valley chapter (DELVACCA), where he served on the DELVACCA board including two years as Treasurer. Mr. Murphy received a B.A. from Rutgers University in 1970. He is a 1973 graduate of the University of Pennsylvania Law School, where he was managing editor of the Law Review and a member of the Order of the Coif. He is admitted to practice law in Pennsylvania and New Jersey.

Mr. Murphy practices law as Joseph E. Murphy, P.C. and can be reached at 30 Tanner Street, Haddonfield, NJ 08033. Phone: (856) 429-5355; Facsimile: (856) 429-0866; E-mail: JEMurphy@cslg.com. He is past president of the Historical Society of Haddonfield.

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Testimony of Joseph E. Murphy for the Advisory Group on the Organizational Sentencing Guidelines

The Advisory Group has requested my views on questions relating to organizations' willingness to conduct aggressive compliance activities in light of the risk of the fruits of those activities being used against them in litigation. In my experience, this risk is a significant deterrent to such diligent compliance steps as compliance audits, testing, reviews, and surveys, and can also chill the aggressiveness of internal investigations.

I believe it is essential that there be some form of protection for compliance activities. The key, however, is not shrouding such compliance activities with secrecy. Rather, what matters is that those activities not be used unfairly against companies who engage in them. We should not reinforce the cynic's view that "no good deed goes unpunished." Instead, companies should be able to conduct diligent compliance work without tempering their efforts out of fear that they will be used against them by adversaries.

In the past I have published proposals for a self-evaluative privilege to protect this type of compliance activity. I believe the Sentencing Commission can do much to advance the policy objectives of the Sentencing Guidelines by addressing this issue and helping enforcement agencies to see the value of such protection.

There is, however, a legitimate concern in the enforcement community. If a company commits an offense, the government cannot be expected just to trust the offending company to amend its ways on its own. The government, naturally enough, wants to know what the company found and what it is doing to remedy the wrongdoing. Companies that would otherwise be willing to be candid with the government know that such candor this usually comes with a price – loss of all privilege and confidentiality protections. Because of this dilemma, I have proposed a middle ground that I think would remedy this conflict. I believe the Commission is the one honest broker that could work with industry and the enforcement community to fashion a mutually beneficial compromise along the lines of this proposal.

I have attached a brief introduction to this proposal as well as the draft legislation. I am happy to discuss this further with the Advisory Group.

PROTECTING VOLUNTARY DISCLOSURES: THE SELF-INFORMANT PROTECTION ACT

The issue. This proposal addresses an issue that confronts companies seeking to do the right thing by making a voluntary disclosure of wrongdoing to government. It is a circumstance that can affect any company at any time.

When a company with a compliance/ethics program has reason to believe wrongdoing is occurring, it will undertake an internal investigation. In doing so, companies typically take steps to protect the confidentiality of their investigative work. One important reason for this is to protect the identity of whistleblowers and others who have cooperated in the investigation. Protecting whistleblowers is an element of the Sentencing Guidelines standards for compliance programs, and an important step for building employee confidence in any compliance program. Another important reason for protecting confidentiality is to avoid having the company's own good work used against it in litigation. A thorough investigation can become a roadmap for plaintiffs' lawyers who can use the products of the investigation against the company for such things as punitive damages.

As a result of these concerns about confidentiality companies often elect to have their investigations conducted under privilege protection, most frequently attorney-client privilege and/or work product protection. Such protections prevent the use of the work product by others in litigation against the company, and help shield information like the identities of whistleblowers. Preserving these protections is important in order to encourage management to obtain legal advice and to be candid in communicating with counsel.

If a company discovers wrongdoing it then will generally consider whether to disclose the misconduct to the government. Such disclosure is favored by government as a matter of public policy; of course, under the Sentencing Guidelines prompt disclosure of criminal misconduct is a condition for receiving sentencing credit for a company's compliance program. Disclosure to the government also helps serve as a check on the corporate investigative process.

When the disclosure occurs, however, there can be a very serious issue regarding the protections claimed for the investigative work. If the disclosure includes the materials for which privilege is claimed, the law generally is that disclosure to the government waives the protection completely with respect to all other parties. Thus counsel's work papers and advice become subject to discovery and use in evidence against the company; private plaintiffs and other government agencies have the benefit of all of counsel's work to use against the company. A company's legal counsel could be subjected to depositions and examination in court. This can have a chilling effect on the entire compliance process. It can cause a company to think twice before even opening an investigation. If the investigation is pursued, counsel must be very careful in what is documented, and even what is discussed. Those who are interviewed in an investigation can have no assurance of

confidentiality; indeed, if a voluntary disclosure is made this may assure publicity rather then confidentiality.

This is not a one-sided issue, however. From the government's perspective, a voluntary disclosure may mean that a corporation is reporting a crime, or a very serious civil violation. How can the government just take the word of the company that it has done everything in the investigation correctly, interviewed all the right people, and drawn the same conclusions the government would have drawn? Prosecutors are understandably skeptical and want to know what the company did in its investigation, and whether the government can rely on that work or must institute its own comprehensive investigation.

This dilemma has caused heated debate, and draws polarized responses from government and industry.

The proposal. The attached draft legislation offers a compromise that I believe will appeal to both sides – a limited waiver. Under this proposal a company making a voluntary disclosure would be considered to have waived privilege protection *only for the agency receiving the information.* That agency could use the information for its purposes, but the privilege would still remain with respect to all others. This would give the government what it needs, but still protect the disclosing company's legitimate interests.

While most courts have followed the traditional view that waiver for one is waiver for all, the proposed legislation is not a new concept. One federal circuit court, the 8th Circuit, adopted this approach in just the circumstances contemplated by this proposal. Of course, if this were adopted as legislation all other courts would have to follow the 8th Circuit's approach.

Joe Murphy / by Joanne R. Hezzis

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SELF-INFORMANT PROTECTION ACT

1. Findings and Policy.

   The Congress finds the following:

   a. The potentially disastrous impact of organizational misconduct and the need to improve the breadth and quality of legal compliance and business ethics are issues of great concern.
   b. Full legal compliance by organizations requires the development and rigorous implementation of effective compliance and ethics programs, including efforts to detect misconduct. Organizations undertaking such programs are acting in the public interest.
   c. Detection of misconduct and voluntary disclosures by organizations of violations of law serve important public policy goals, including prevention of harm to the public, and should be encouraged.
   d. The risk of losing privilege and other protections relating to confidential information acts as a deterrent to organizations making such disclosures. It is in the public interest to have at least one agency be aware of a violation rather than have the violation remain unreported because of fear of loss of privilege protection.

2. Definitions.
   a. Agency – The term agency includes the United States Department of Justice, including all United States Attorneys offices, and any agency, administration, commission or other unit of the government of the United States with the authority to institute criminal, civil or administrative proceedings or to take any other action that could result in punitive or remedial action by that agency or any other agency against the organization.
   b. Good faith – A voluntary disclosure is made in good faith if it includes candid disclosure to an agency of information relevant to the violation being reported, and the disclosing organization has no reason to know that the agency already has received any such information being disclosed. Good faith is presumed if an organization has in place an effective program to prevent and detect violations of law, as defined in the sentencing guidelines established pursuant to 28 U.S.C. § 991 *et seq.*, Chapter 8 - Sentencing of Organizations, §8A.1 Application Notes 3(k)(1-7), as amended from time to time.
   c. Organization – This Act applies to any organization, as defined in 18 U.S.C. §18, and includes all subsidiaries and other units of the organization.
   d. Voluntary disclosure – An organization makes a voluntary disclosure when it provides, or offers to provide to any agency, in good faith, and without a legal obligation to do so, information relating to any violation or possible violation, of any law, rule, regulation or order, or relating to the commission of any acts

or failure to take any action, that could result in punitive or remedial action by that agency or any other agency against the organization or any of its employees, directors, or other agents.

3. No adverse use of voluntary disclosures.

   The fact of a voluntary disclosure by any organization to any agency may not be used against that organization or any of its employees, directors or agents for any purpose in any legal or administrative proceeding in any jurisdiction. No such disclosure shall operate as a waiver of any privilege or other legally protected right of confidentiality with respect to that organization or any of its employees, directors, or other agents.

4. Except as provided in section 5, nothing in this Act shall limit the use that the agency receiving the voluntary disclosure may make of any information included in the voluntary disclosure.

5. Agency use of information.

   An agency may use any information provided as part of a voluntary disclosure to verify the accuracy of other, non-privileged information, and for any other purpose related to the agency's dealings with the organization making the disclosure. The agency may not disclose privileged or protected information to any other person, including any other agency or government, if such disclosure would operate as a waiver with respect to the organization that made the disclosure. The agency may condition acceptance of a voluntary disclosure on a requirement that the organization making the voluntary disclosure make a similar disclosure to another agency or government, but only if such agency or government is fully subject to this Act, or has legally enforceable protections at least as effective as the provisions of this Act. No action by an agency may act as a waiver of privilege or protection with respect to any organization making a voluntary disclosure under the protections of this Act.

6. Exemption from FOIA. Privileged or protected information disclosed pursuant to this Act shall be exempt from disclosure under the FOIA.

7. If an organization makes a voluntary disclosure that qualifies for the protections of this Act, no agency may require waiver, or condition the grant of any benefit or favorable treatment on that organization's waiver of any privilege or other protection applicable to the information it disclosed. Assertion of the protections provided by this Act by an organization or individual is fully consistent with a cooperative approach to law enforcement. These protections are to be construed broadly to give full effect to the purpose of this Act.

8. Federal courts and agencies shall recognize, respect and follow similar protection adopted by any state, territory or possession of the United States, of by any other nation.

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Kenneth W. Johnson

Kenneth W. Johnson serves as President, Ethics & Policy Integration Center, Washington, D.C., and Coordinator, the Coalition for Ethics & Compliance Initiatives. Mr. Johnson's work emphasizes the integration of ethics and policy with emphasis on evaluating program effectiveness. He specializes in a systems approach to the ethics of the "learning organization," an organization where people continually expand their capacity to create the futures they truly desire to live.

He has consulted with organizations of various sizes and types internationally, including an international labor union. Recent experience includes assessing corporate ethics and compliance program effectiveness. This summer he designed and coordinated a training program in business ethics for select participants from the former Soviet Union. He is currently consultant to a national program evaluating integration of alternative dispute resolution in state government and on a team drafting a manual for the responsible business enterprise in transitioning economies.

He was an Ethics Resource Center Senior Fellow from 1998-2002. He teaches ethics and change management at the graduate level.

Mr. Johnson brings a unique perspective on the relationship between ethics and policy born of experience as a rifle platoon commander during the Vietnam War, a litigation attorney, the senior Marine Reserve officer in-theater as logistics plans officer during the Gulf War, and nine years as an ethics and policy consultant.

Mr. Johnson holds a J.D., M.A in Ethics and Policy Studies and a diploma in Advanced Studies in Taxation. He has been an editor of the *Arizona Law Review* and an Associate Editor of the newsletter, *Ethical Management*. An accomplished speaker, he has given well-received presentations on ethics and values for a wide variety of audiences, including the National Conference on Applied Ethics, the International Conference on Thinking, Telecomm Egypt, and Valley Forge Military Academy. His approach to ethics can be found at: http://www.EthicalEdge.com. Mr. Johnson is currently working on a guide to organizational ethics: The Essential Human Community: The Ethics of Organizational Learning.

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November 6, 2002

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Subject: Testimony/Statement Before the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines: November 14, 2002

Background. As the Advisory Committee pursues its work, I urge that it specifically consider that the Federal Sentencing Guidelines for Organizations (FSGO) are establishing a *de facto* framework for ethics and compliance programs worldwide.

While the United States Sentencing Commission has no specific mandate to do so, of course, one can no longer discuss ethics and compliance programs, even internationally, without referring to (explicitly or not) the FSGO. This is the case despite its specific provisions being compliance minimums. With this in mind, I recommend modifying the "types of steps" to reflect their nature as a framework. Let me demonstrate why and how.

In international dialogue, of course, practitioners do not generally urge organizations in other countries, especially transitional economies, to follow the FSGO *because* they reflect law in the United States. For obvious reasons, that would lead to virtually wholesale rejection in many cases. Recommending that a foreign organization follow the FSGO in designing an ethics and compliance program is more palatable where it has aspirations of being 'world class,' because such organizations accept the argument that it is a competitive advantage to be able to point explicitly to their compliance. The same logic provides where the foreign organization aspires to be a strategic partner or preferred provider of an FSGO-compliant organization.

These "benefits," however, do not apply for most organizations, foreign or domestic. But, the FSGO are nonetheless a *de facto* framework nonetheless because they provide the foundation for the "best practices" and "benchmarks" in ethics and compliance program design and implementation. But, many of these structures and systems are neither effective nor practical for foreign organizations or the small to medium enterprise (SME). They tend, as a result, to be ignored as "impractical" or "not culturally applicable." Moreover, incorporating specific current legal requirements or best practices risks stifling creativity and moral imagination. It puts the FSGO at further risk of being perceived as less the floor for effective ethics and compliance programs than the ceiling.

The FSGO as a Framework. This being said, where there is, or is expected to be, resistance to the FSGO *per* se, I have had great success with an exercise styled, **"If the FSGO are the answers, what were the questions?"** The pursuit of this exercise points out the value of the FSGO as a framework, suggests that a general approach is better that more detail, and points to one additional "type of step."

Without belaboring the point, the exercise pursues the standard journalist questions (who, what, where, when, why, and how). It concludes that the FSGO offers a framework with a summary that goes something like this:

We can agree now that an ethics and compliance program is a fundamental aspect of good management practice(s) for a self-governing organization. Given a sound set of beliefs, including an organizational vision, what questions must leadership ask itself and its stakeholders if the organization is to guide the [business] conduct of its members and other agents and establish reasonable expectations among its stakeholders?

First, what standards should we to set to guide the [business] conduct of our employees and other agents and establish the reasonable expectations of our stakeholders? (FSGO.1)

Second, consistent with these standards, how should leadership, authority, and responsibility be exercised at all levels? [FSGO.2]

Third, how can we ensure that our members and other agents are motivated and capable of contributing to achieving our organizational vision? [FSGO.3]

Fourth, how can we effectively communicate our standards in order to guide our employees and other and establish reasonable stakeholder expectations? [FSGO.4]

Fifth, given that management needs to know how its organization is performing, how can we know that our employees and other agents are following our standards and we are meeting our stakeholders' reasonable expectations? [FSGO.5]

Sixth, how can we encourage our employees and other agents to follow our standards and manage our stakeholders' expectations? [FSGO.6]

Seventh, when things go wrong—through mistake, misconduct, or misunderstanding—how should we respond? [FSGO.7]

Eighth, how do we know our ethics and compliance program is effective?

Discussion. These general questions suggest that the FSGO will be effective if they set general requirements for an effective program *and* an obligation on the part of the organization to explain how its ethics and compliance program satisfies these requirements with specific reference to its own context and culture. I believe to my core that Federal sentencing will be more rational and uniform if these two conditions prevail: (1) organizations will be expected to justify their program design and implementation and (2) the Federal Judiciary will exercise its Constitutional prerogatives to find whether their explanations are adequate with due process and such expert opinion as it might deem appropriate. With all due respect to Congress, layering on significant details, especially recent, unproven reform legislation, is an undue restriction on organizational and judicial judgment. Today's organizations must be dynamic to survive and thrive. Ethics and compliance programs must invite the same "justifiable flexibility."

Justification for the first question relating to standards would include who issued the standards. Certainly the better view is that the board either initiates or directs their implementation, but I would not require that subject to a reasonable justification of who promulgated what standards—and why—to allow flexibility for foreign firms, foreign operations, and the SME.

The fifth question for self-governing organizations is particularly important for capturing a major issue in the United States and many transitional economies. The specific answers of an organization must at least implicitly address both the context and culture of the organization. In most countries—foreign and domestic—there is a serious reluctance to report misconduct and no means

by which an organization can make an enforceable promise of confidentiality. This is particularly true is some of transitioning economies though it is nowhere near as general in practice as many would have it.

Where this reluctance to report misconduct prevails in an organization, the follow-up question is based on two assumptions: (1) that management needs to know what is going on and (2) that knowledge is embedded throughout the organization.

> Follow-up question: The FSGO suggest that there are two sources of this important knowledge: (1) the employees and other agents will inspire trust from management who will rely on them to regularly seek advice and report misconduct or (2) management will not expect employees and other agents to report misconduct and will have to look over their shoulders through auditing and monitoring. If you will not speak up— and you agree that management needs this information—how much auditing and monitoring do you think is reasonable? And, what will that do to the overall effectiveness of the organization?

This follow-up question generally counters the knee jerk employee reaction to reporting misconduct, at least for purposes of further dialogue. Though it may not be obvious, it captures an essential values issue: if the culture of the organization is such that its employees and other agents are not willing to report misconduct, then, management must necessarily do extensive auditing and monitoring. Employees must make the choice: does it want management to trust them because they can reasonably expect them to report the information management needs to know, or do they want management using important organizational resources looking over their shoulders?

An important contextual issue, of course, is whether the organization can make an enforceable promise of confidentiality through privilege. Without such a privilege, it is very difficult for organizations to design mechanisms that are truly free from the fear of retribution as many studies suggest. Here, as the organization justifies its fifth step process, public policy considerations would suggest that a privilege to support an enforceable promise of confidentiality would require a policy of fullest restitution for harm and disclosure to appropriate authorities.

You will note that the eighth question for self-governing organizations does not have an equivalent FSGO answer. FSGO.7 does refer to the organization learning from its response to misconduct to include: "including any necessary modifications to its program." This is not the same as evaluating whether the program itself is effective.

Management today is adept at measuring performance effectiveness in the nearly ubiquitous total quality programs such as ISO 9002. The same is true for governments such as the Federal government and State of Maryland. The latter recognize that what is important are not structures, systems, and actions, but results and outcomes. See, e.g. Government Performance Results Act and the State of Maryland's Measuring for Results Program. There is no reason why organizations should not be required to demonstrate that they routinely evaluate the effectiveness of their its ethics and compliance programs to explicit, measurable outcomes.

Being able to demonstrate why the organization believes its ethics and compliance program is effective suggests adding an eighth step: "The organization must have taken reasonable steps to regularly evaluate its program for its fitness for purpose and effectiveness in realizing explicit, well-considered program outcomes."

In my experience, this ethics and compliance program evaluation requires attention to at least two categories of information: (1) certain aspects of organizational culture and (2) expected program

outcomes. For example, how does the organization know what the proper balance is to strike between trusting employees to report misconduct and auditing and monitoring unless it has asked focused questions over time about the willingness of its employees to speak up? Or, how does it know its ethics and compliance program is worth the effort (and worthy of consideration on sentencing) if it does not have explicit, measurable program outcomes that it is progressing toward?

Recommendations. Walking through this exercise suggests the following recommendations:

1. Err on the side of establishing general requirements within each step, but require documentation as to why the program was designed and implemented as it was—with specific reference to each step. For example, in arguing that it has an "effective program," the organization must be able to demonstrate precisely why the standards adopted were adequate—and who promulgated them—with documents contemporaneous to their adoption. The sentencing judge would make findings as to adequacy of its justification.

2. Modify the fifth step to provide that "The organization must have taken reasonable steps to determine whether its standards are being followed, for example, by striking the appropriate balance between monitoring and auditing systems and providing a mechanism by which employees and other agents could seek advice and report criminal conduct by him or herself or others within the organization without fear of retribution." This proper balance could only be justified by demonstrating an understanding of its organization culture and program effectiveness.

3. Add an eighth "type of step" requiring the organization to demonstrate that it regularly evaluates its program for effectiveness with specific reference to specific cultural conditions and expected program outcomes, such as: "The organization must have taken reasonable steps to regularly evaluate its program for its fitness for purpose and effectiveness in realizing explicit, well-considered program outcomes."

Hope these comments and suggestions are of value to your important work. Please do not hesitate to contact me if you have any questions. I will send this by email with follow-on letter.

Sincerely,

KENNETH W. JOHNSON

Session IV: Cooperation
and Waiver of Privileges

Public Hearing of the Ad Hoc Advisory Group on Organizational Guidelines

Thurgood Marshall Federal Judiciary Building, Concourse Level, One Columbus Circle, N.E., Washington, D.C. 20002

November 14, 2002

Session IV Agenda

Session IV: Cooperation and Waiver of Privileges
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On January 7, 2002, Jim Comey was appointed United States Attorney for the Southern District of New York. Prior to assuming that position, he served from 1996 through 2001 as Managing Assistant U.S. Attorney in charge of the Richmond Division of the United States Attorney's office for the Eastern District of Virginia.

Mr. Comey was educated at College of William & Mary (B.S. with Honors 1982, Chemistry and Religion majors) and University of Chicago Law School (J.D. 1985). After law school, he served as a law clerk for then-United States District Judge John M. Walker, Jr. in Manhattan, and worked for Gibson, Dunn & Crutcher in their New York Office. He next joined the U.S. Attorney's Office for the Southern District of New York, where he worked from 1987 to 1993, eventually serving as Deputy Chief of the Criminal Division.

As a federal prosecutor, he has investigated and prosecuted a wide variety of cases, including firearms, narcotics, major frauds, violent crime, public corruption, terrorism, and organized crime. In the Southern District of New York, he served as lead prosecutor in United States v. John Gambino et al., a six-month mafia racketeering and murder trial. In the Eastern District of Virginia, he handled the Khobar Towers terrorist bombing case, arising out of the June 1996 attack on a U.S. military facility in Saudi Arabia in which 19 Airmen were killed.

In Richmond, Mr. Comey also served as an Adjunct Professor of law at the University of Richmond. Prior to joining the U.S. Attorney's office in Richmond in 1996, he was a partner at McGuireWoods, LLP specializing in criminal defense and commercial litigation.

Mr. Comey is married and has five children.

American College of Trial Lawyers

THE EROSION OF THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE IN FEDERAL CRIMINAL INVESTIGATIONS

Approved by the Board of Regents
March, 2002

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. THE ATTORNEY-CLIENT PRIVILEGE AND THE WORK PRODUCT DOCTRINE 3

A. Origin and Purpose of the Attorney-Client Privilege 3
B. Origin and Purpose of the Work Product Doctrine 5
C. The Joint Defense Privilege 6
D. Balancing the Unavailability of Evidence Against Need for the Privilege 7
E. The Privilege and Corporations 7
F. Special Need for the Corporate Attorney-Client and Work Product Privilege 7

III. REVIEW OF THE GOVERNMENT ENCROACHMENT ON THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE 8

A. Waiver of the Attorney-Client and Work Product Privilege 8
B. Joint Defense Agreements 12
C. Advancement of Attorneys' Fees 17
D. Crime-Fraud Exception 22

IV. RECOMMENDATIONS AND CONCLUSION 27

A. Specific Recommendations 28
B. Conclusion 29

THE EROSION OF THE ATTORNEY-CLIENT PRIVILEGE AND WORK PRODUCT DOCTRINE IN FEDERAL CRIMINAL INVESTIGATIONS

SUMMARY

The American College of Trial Lawyers (the "College") expresses its concern in this Report that the attorney-client privilege and work product doctrine are being eroded in federal criminal investigations and prosecutions in a way inimical to the fair administration of justice. We believe that the attorney-client privilege and the work product doctrine are essential to the adversary process and the criminal justice system, and request that the federal government review and modify its policies to ensure that these historic privileges are preserved.

I. INTRODUCTION

Federal prosecutors increasingly rely on counsel for the defense to build the government's case by insisting that the individual or corporate defendant waive the attorney-client privilege and turn over both client-lawyer communications and the work product of the lawyer. This provides prosecutors at the outset of an investigation with information defense counsel has obtained from their client, as well as with defense counsel's factual and legal analysis. In previous years, federal prosecutors were more likely to rely primarily on their own investigation of the facts and seek a waiver of the attorney-client privilege only rarely and then in very limited circumstances.

Today, federal prosecutors are able to obtain waivers of the attorney-client privilege and work product protections both by threatening to prosecute and by seeking more serious charges or sanctions if such cooperation is not provided. After the government has selected the crimes to be charged and obtained a conviction, courts must impose the sentence for that level crime prescribed by the Federal Sentencing Guidelines. As a result, prosecutors are able to exert a great measure of control over both the charging and sentencing process, thus requiring that defense counsel take into account the often harsh effect of the Sentencing Guidelines before responding to a federal prosecutor's request for a waiver of the attorney-client privilege or work product protections.

In seeking a waiver of the attorney-client or work product privilege, the government's demands change the very nature of the criminal justice system as well as the adversary process. These demands, which erode the attorney-client privilege and the work product doctrine, commonly include not only waiver of these protections, but also disclosure of corporate internal investigations by counsel, discouragement of payment by the corporation for counsel for individual employees whom the government prosecutor believes are culpable, and requests that information regarding the nature of the government's investigation not be relayed to other suspects through joint defense agreements. This government approach has been likened to the sound of "a requiem marking the death of privilege in corporate criminal investigations."[1]

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[1] David M. Zornow & Keith D. Krakaur, On the Brink of a Brave New World: The Death of Privilege in Corporate Criminal Investigations, 37 AM. CRIM. L. REV. 147, 147 (2000).

Inherent in this approach is that the prosecutor's initial view of the case must be accepted as fact and not be opposed by counsel for the individual or the corporation; to do so is to act at the client's peril. And this approach has recently become more widespread, if not universal, by embodiment in the United States Department of Justice ("Justice Department") standards for the federal prosecution of corporations.[2] Initially circulated as an internal memorandum by then-Deputy Attorney General Eric Holder in June of 1999, these standards are applied to individuals as well as corporations.[3]

The Holder Memo Standards encourage federal prosecutors to seek waivers of the attorney-client and work product privilege. They state that, when weighing whether the corporation has sufficiently cooperated in the investigation phase so as to not be charged with a crime, the prosecutor may consider whether the corporation has identified culprits, turned over its internal investigation and waived the attorney-client and work product protections. The Holder Memo Standards provide:

> In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available, to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges.[4]

The Holder Memo Standards do emphasize that such a waiver is not an absolute requirement, but merely one factor the government should consider in evaluating the corporation's cooperation.[5] For example, the Holder Memo Standards note that:

> This waiver should ordinarily be limited to the factual internal investigation and any contemporaneous advice given to the corporation concerning the conduct at issue. Except in unusual circumstances, prosecutors should not seek a waiver with respect to communications and work product related to advice concerning the government's criminal investigation.[6]

Yet, it is difficult to see or to make this distinction, which is, in any event, left to the sole discretion of the prosecutor.

The Holder Memo Standards also suggest that providing counsel for corporate officers, directors or employees[7] and entering into joint defense agreements may indicate a corporation's

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[2] U.S. Attorneys' Manual, tit. 9, Criminal Resource Manual, art. 162, Federal Prosecutions of Corporations (2000), available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00162.htm, [hereinafter "Criminal Resource Manual"]; see also Jonathan D. Polkes & Renee L. Jarusinsky, Waiver of Corporate Privileges in a Government Investigation: Reaction to the New DOJ Policy, White Collar Crime 2001 J-31, J-31 to J-33 (ABA 2001).

[3] See generally Memorandum from Eric Holder, Jr., Deputy Attorney General, to All Heads of Department Components and U.S. Attorneys (June 16, 1999) (including attachment entitled "Federal Prosecution of Corporations"), reprinted in Criminal Resource Manual, arts. 161, 162, available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00100.htm. The attachment to the Holder Memo will be hereinafter referred to as the "Holder Memo Standards."

[4] Criminal Resource Manual, art. 162, § VI.A.

[5] Id. § VI.B.

[6] Id. § VI.B n.2.

[7] The Holder Memo Standards do recognize in a footnote that "[s]ome states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate." Id. § VI.B n.3.

lack of cooperation; i.e., the company that engages in these practices is more likely to be indicted than the company that avoids them. Indeed, the Holder Memo Standards provide:

> Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.[8]

In addition to the policies expressed in the Holder Memo Standards, the federal government has further undermined the attorney-client privilege and work product doctrine by increasingly attacking the existence of these protections in ex parte proceedings, asserting that the crime-fraud exception vitiates any privilege.[9] In these situations, the defendant or person under investigation has no opportunity to be heard and the government need make only a prima facie showing. As a result, courts often adopt the government's view of the available facts and defense counsel may be required to testify against his or her client on short notice if the court finds that the crime-fraud exception applies.

The College is concerned that these government policies undermine and erode the attorney-client privilege and work product doctrine to an alarming extent and change the balance in the adversary system from one in which opposite points of view may be pursued by opposing counsel to a system in which the federal prosecutor's view can be challenged only at great peril, thereby reducing the ability of defense counsel in a criminal investigation to provide effective assistance to his or her client.[10]

II. The Attorney-Client Privilege And The Work Product Doctrine

A. Origin and Purpose of the Attorney-Client Privilege

The Federal Rules of Evidence have adopted the attorney-client privilege as it existed at common law. Rule 501 states that "the privilege of a witness . . . shall be governed by the

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8 Id. § VI.B (footnote omitted).

9 Under this exception, a client who seeks assistance from counsel for the purpose of committing a crime or fraud is not entitled to the protections of confidentiality. Indeed, "[t]he privilege ends when the client seeks to involve the attorney in wrongdoing." David J. Fried, Too High A Price for Truth: The Exception to the Attorney-Client Privilege for Contemplated Crimes and Frauds, 64 N.C. L. Rev. 443, 443-44 (1986) (tracing the history of the exception, discussing its rationale, and reviewing its expansion).

10 In addition to the concerns expressed in this Report, the College also notes that it recently submitted comments to the Bureau of Prisons, the Attorney General and the Senate Judiciary Committee, regarding the interim rule and amendments to the Code of Federal Regulations that became effective on October 30, 2001, and that authorize the monitoring and recording of communications and meetings between inmates and counsel. See generally Letter from Stuart D. Shanor, President, American College of Trial Lawyers, to Rules Unit, Office of General Counsel, Bureau of Prisons, (Dec. 21, 2001) (on file with the College). These comments stated that, despite the College's support of our government's ongoing efforts to eliminate terrorism, the monitoring authorized in the amendments:

> [W]ill have a chilling effect, inhibit the free exchange between defendant and lawyer and is therefore (i) a threat to the effective assistance of counsel at a time when a defendant who is being held for trial has a constitutional right to competent and effective counsel and (ii) an unwarranted intrusion on the attorney-client privilege of both individuals awaiting trial and of unindicted detainees.

The College refers to these comments for a complete statement of the College's views on the monitoring issue.

principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience."[11] As recognized by Wigmore in his comprehensive and oft-cited work setting forth the history of the attorney-client privilege, this privilege is "the oldest of the privileges for confidential communications."[12]

The earliest reported cases recognizing the privilege date as far back as the early part of the reign of Elizabeth I.[13] The attorney-client privilege is likely not reported prior to this era because the testimony of witnesses and defendants was not a common source of proof at trial and, in general, testimonial compulsion had not been previously authorized.[14]

Although modern federal courts tend to apply the attorney-client privilege narrowly, the elements for establishing the privilege reflect the basic contours of the privilege since its establishment in England. In the seminal case of United States v. United Shoe Machinery Corp., Judge Wyzanski first pronounced that the privilege applies if:

> (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.[15]

The United Shoe rule essentially remains the prevailing law as it relates to the attorney-client privilege when applied by federal courts.[16]

Thus, for centuries in English and American law, the attorney-client privilege has been firmly grounded in the recognition that legal consultation serves the public interest.[17] Federal

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[11] Fed. R. Evid. 501; see also Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (citing this rule with approval).

[12] 8 John Henry Wigmore, Evidence in Trials at Common Law § 2290, at 542 (McNaughton Rev. 1961) [hereinafter "Wigmore"]; see also Upjohn, 449 U.S. at 389; Wigmore, supra, at 542 n.1 (citing, for example, Berd v. Lovelace, Cary 88, 21 Eng. Rep. 33 (Ch. 1577), and Dennis v. Codrington, Cary 143, 21 Eng. Rep. 53 (Ch. 1580)).

[13] Wigmore, supra note 12, § 2290, at 542 n.1 (collecting cases from the late 1500s to the 1600s and indicating that the privilege first appeared as unquestioned in these cases); see also 1 Charles Tilford McCormick, McCormick on Evidence § 87, at 343-44 (John William Strong ed., 5th ed. 1999) [hereinafter "McCormick on Evidence"].

[14] Wigmore, supra note 12, § 2290, at 542-43 (noting that the privilege "appears to have commended itself at the very outset as a natural exception to the then novel right of testimonial compulsion").

[15] 89 F. Supp. 357, 358-59 (D. Mass. 1950); see also John E. Sexton, A Post-Upjohn Consideration of the Corporate Attorney-Client Privilege, 57 N.Y.U. L. Rev. 443, 449 (1982) (indicating that the United Shoe court was the first federal court to discuss the corporate attorney-client privilege at length); Zornow & Krakaur, supra note 1, at 149 n.9 (indicating that the United Shoe rule is one of the most inclusive recitations of the elements of the attorney-client privilege).

[16] See, e.g., In re Grand Jury Subpoena, 204 F.3d 516, 520 n.1 (4th Cir. 2000); Montgomery County v. Microvote Corp., 175 F.3d 296, 301 (3d Cir. 1999); In re Fed. Grand Jury Proceedings 89-10(MIA), 938 F.2d 1578, 1581 (11th Cir. 1991); In re Sealed Case, 737 F.2d 94, 98-99 (D.C. Cir. 1984); Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 601-02 (8th Cir. 1977). The only part of United Shoe that has been called into question is the application of the rule to patent matters. See, e.g., Am. Standard v. Pfizer Inc., 828 F.2d 734, 745-46 (Fed. Cir. 1987); Woods v. N.J. Dep't of Educ., 858 F. Supp. 51, 54 (D.N.J. 1993).

[17] See, e.g., Wigmore, supra note 12, § 2291, at 545-49 (quoting decisions from the 1700s and 1800s that expound on the importance of the privilege).

common law in the United States has long embraced this justification,[18] in both a criminal and civil law context. Indeed, the application of the privilege to criminal as well as to civil cases has been largely unquestioned.[19] Moreover, the privilege is generally considered absolute unless waived by the client.[20] As such, today, the "attorney-client privilege may well be the pivotal element of the modern American lawyer's professional functions."[21]

B. Origin and Purpose of the Work Product Doctrine

The work product doctrine, like the attorney-client privilege, derives from common law origins. As a leading commentator has explained:

> The natural jealousy of the lawyer for the privacy of his file, and the courts' desire to protect the effectiveness of the lawyer's work as the manager of litigation, have found expression, not only as we have seen in the evidential privilege for confidential lawyer-client communications, but in rules and practices about the various forms of pretrial discovery. Thus, under the chancery practice of discovery, the adversary was not required to disclose, apart from his own testimony, the evidence which he would use, or the names of the witnesses he would call in support of his own case. The same restriction has often been embodied in, or read into, the statutory discovery systems.[22]

At common law, the privilege was much broader than its modern day analog: a document in the hands of the attorney, even if it did not come into existence as a communication to

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[18] See, e.g., Hatton v. Robinson, 31 Mass. (14 Pick.) 416, 422 (1833) ("[S]o numerous and complex are the laws . . . , so important is it that [citizens] should be permitted to avail themselves of the superior skill and learning of those who are sanctioned by the law as its ministers and expounders, . . . that the law has considered it the wisest policy to encourage and sanction this confidence [between client and attorney], by requiring that on such facts the mouth of the attorney shall be for ever sealed."); see also Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (explaining that the privilege encourages "full and frank communication between attorneys and their clients and thereby promote[s] broader public interests in the observance of law and administration of justice" and acknowledging that the "rationale for the privilege has long been recognized by the [Supreme] Court"); Hunt v. Blackburn, 128 U.S. 464, 470 (1888) (stating that the privilege is necessary "in the interest and administration of justice").

[19] See, e.g., Swidler & Berlin v. United States, 524 U.S. 399, 408-09 (1998) (rejecting any effort to apply the attorney-client privilege differently in criminal cases); Schwimmer v. United States, 232 F.2d 855, 863-66 (8th Cir. 1956) (assuming without discussion that the attorney-client privilege applied in a criminal case); Gunther v. United States, 230 F.2d 222, 223-24 (D.C. Cir. 1956) (per curiam) (same).

[20] See, e.g., Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d. 1414, 1429 (3d Cir. 1991) (indicating that the attorney-client privilege affords "absolute protection" and discussing waiver standards).

[21] Geoffrey C. Hazard, Jr., An Historical Perspective on the Attorney-Client Privilege, 66 Cal. L. Rev. 1061, 1061 (1978) (stating that the privilege "is considered indispensable to the lawyer's function as advocate on the theory that the advocate can adequately prepare a case only if the client is free to disclose everything," and that a "legal counselor can properly advise the client what to do only if the client is free to make full disclosure").

In fact, the Justice Department itself recognizes the value and usefulness of the attorney-client privilege with respect to its representation of federal employees. In the Justice Department's codified statement of policy, it states that:

> Attorneys employed by any component of the Department of Justice . . . undertake a full and traditional attorney-client relationship with the employee with respect to application of the attorney-client privilege . . . . Any adverse information communicated by the client-employee to an attorney during the course of such attorney-client relationship shall not be disclosed to anyone, either inside or outside the Department, other than attorneys responsible for representation of the employee, unless such disclosure is authorized by the employee.

28 C.F.R. § 50.15(a)(3) (2000).

[22] McCormick's Handbook of the Law of Evidence 201-02 (Edward W. Cleary ed., 2d ed. 1972) (footnotes omitted); see also In re Grand Jury Proceedings, 473 F.2d 840, 844 (8th Cir. 1973).

the attorney, would have been exempt from production.[23] The modern work product doctrine is more narrowly tailored and traces back to the Supreme Court's decision of more than half a century ago in Hickman v. Taylor.[24] As articulated by the Court, the work product doctrine is distinct from and broader than the attorney-client privilege: "[W]ritten statements, private memoranda and personal recollections prepared or formed by an [attorney] in the course of his legal duties," and with an eye toward litigation, are not discoverable, as "[d]iscovery was hardly intended to enable a learned profession to perform its functions . . . on wits borrowed from the adversary."[25] The work product doctrine, however, unlike the attorney-client privilege, is not absolute, and can be overcome if a party seeking discovery shows that "relevant and non-privileged facts remain hidden in an attorney's file and where production of those facts is essential to the preparation of one's case."[26]

The Court in Hickman explained that the doctrine serves both a public and a private purpose. With respect to the former, the work product doctrine directly promotes the adversary system by enabling attorneys to prepare their cases without fear that their work product will be used against their clients.[27] At the same time, it also serves a private purpose by affording an attorney "a certain degree of privacy" so as to discourage "unfairness" and "sharp practices."[28] These same policies remain vital today. The rule first pronounced in Hickman has been codified in Federal Rule of Criminal Procedure 16(a)(2), (b)(2) and in Federal Rule of Civil Procedure 26(b)(3).

In contrast to the attorney-client privilege, which may be asserted only by the client, either the attorney or the client usually may invoke the work product doctrine.[29] Courts have recognized that "the interests of attorneys and those of their clients may not always be the same. To the extent that the interests do not conflict, attorneys should be entitled to claim [work product] privilege even if their clients have relinquished their claims."[30] The ability of the lawyer to claim the privilege has been broadly construed by the courts. For example, the Court of Appeals for the District of Columbia has held that a lawyer had the right to assert the privilege for work product materials even where the attorney was consulted in furtherance of the client's fraud, at least to the extent that the lawyer was unaware of the fraud.[31]

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[23] See WIGMORE, supra note 12, § 2318, at 620-21 & n.3 (collecting extensive list of cases from nineteenth century English courts).

[24] 329 U.S. 495 (1947). In Hickman, the Supreme Court dealt with two forms of work product: written statements from witnesses interviewed by defense counsel and the contents of oral interviews with witnesses, some of which had been summarized in memoranda prepared by the defense lawyers. The court reasoned that the protection for the latter category, often referred to as "opinion" product, exceeded that of the former. Id. at 512-13.

[25] Id. at 510 (Murphy, J.), 516 (Jackson, J., concurring).

[26] Id. at 511.

[27] Id. at 510-11.

[28] Id.

[29] See, e.g., In re Sealed Case, 676 F.2d 793, 809 n.56 (D.C. Cir. 1982) (indicating that work product privilege belongs to the lawyer as well as the client); In re Grand Jury Proceeding (Duffy), 473 F.2d 840, 848 (8th Cir. 1973) (allowing an attorney to invoke the doctrine).

[30] In re Sealed Case, 676 F.2d at 809 n.56 (citing In re Grand Jury Proceedings (FMC Corp.), 604 F.2d 798, 801 (3d Cir. 1979)). The Supreme Court has identified several interrelated interests that the work product doctrine seeks to protect, ranging from a client's interest in obtaining sound legal advice to the interests attorneys have in protecting their own intellectual product. Id. (discussing Hickman, 329 U.S. at 511).

[31] Id. at 812 & n.75 (citing FMC Corp., 604 F.2d at 801 n.4, 802 n.5).

C. The Joint Defense Privilege

The joint defense privilege, first recognized in Chahoon v. Commonwealth,[32] enables multiple parties to share information protected by the attorney-client privilege without waiving the privilege, where the parties "have common interests in defending against a pending or anticipated proceeding."[33] This privilege, however, is not an independent privilege; it is only an extension of the attorney-client privilege and acts as an exception to the general rule that the privilege is waived when privileged information is shared with a third party.[34]

Accordingly, courts have generally recognized that this privilege, also known as the "common interest rule," protects "the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel."[35]

D. Balancing the Unavailability of Evidence Against Need for the Privilege

The attorney-client privilege and the work product doctrine frequently operate to deny powerful evidence to the opposition, i.e., the defendant's very own statement of the case against him. Our courts, however, have consistently found that "[t]he systemic benefits of the privilege are commonly understood to outweigh the harm caused by excluding critical evidence."[36] Federal courts have supported the need for these protections on public policy grounds and have repeatedly recognized that the attorney-client privilege advances the administration of justice, as a "'public good transcending the normally predominant principle of utilizing all rational means for ascertaining truth.'"[37] As the Court of Appeals for the Ninth Circuit has stated, "[t]his valuable social service of counseling clients and bringing them into compliance with the law cannot be performed effectively if clients are scared to tell their lawyers what they are doing, for fear that their lawyers will be turned into government informants."[38] In similar terms, the Supreme Court has observed that the work product doctrine serves "the cause of justice" by preventing "[i]nefficiency, unfairness and sharp practices."[39]

Any perceived harm to the fact-finding process attributable to the attorney-client privilege and work product doctrine may be exaggerated because, without these protections, clients

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[32] 62 Va. (21 Gratt.) 822 (1871).

[33] John F. Savarese & Carol Miller, Protecting Privilege and Dealing Fairly with Employees While Conducting an Internal Investigation, 1178 PLI/Corp 665, 719 (2000); see also Michael J. Chepiga, Federal Attorney-Client Privilege and Work Product Doctrine, 653 PLI/Lit 519, 589 (2001); Deborah Stavile Bartel, Reconceptualizing the Joint Defense Doctrine, 65 Fordham L. Rev. 871, 871-72 (1996).

[34] See United States v. Schwimmer, 892 F.2d 237, 243 (2d Cir. 1989); Waller v. Fin. Corp. of Am., 828 F.2d 579, 583 n.7 (9th Cir. 1987).

[35] Schwimmer, 892 F.2d at 243; see also United States v. Bicoastal Corp., No. 92-CR-261, 1992 WL 693384, at *5 (N.D.N.Y. Sept. 28, 1992) ("[D]efendants with common interests in multi-defendant actions are entitled to share information protected by the attorney-client privilege without danger that the privilege will be waived by disclosure to a third person.").

[36] Swidler & Berlin v. United States, 524 U.S. 399, 412 (1998) (O'Connor, J., dissenting); see also Sampson Fire Sales, Inc. v. Oaks, 201 F.R.D. 351, 356 (M.D. Pa. 2001).

[37] Trammel v. United States, 445 U.S. 40, 50 (1980) (quoting Elkins v. United States, 364 U.S. 206, 234 (1960) (Frankfurter, J., dissenting)); see also Jaffee v. Redmond, 518 U.S. 1, 9 (1996).

[38] United States v. Chen, 99 F.3d 1495, 1500 (9th Cir. 1996).

[39] Hickman v. Taylor, 329 U.S. 495, 511 (1947); see also United States v. Noble, 422 U.S. 225, 236-38 (1975).

may well choose not to disclose sensitive information to their attorneys, and lawyers may not commit their thoughts and analysis to paper in the first instance.[40]

E. The Privilege and Corporations

It is well established that the attorney-client privilege and work product doctrine may be asserted by corporations, as well as by natural persons.[41] The attorney-client privilege protects confidential communications between the attorney and anyone within the corporate structure – directors, officers, as well as middle and lower-level employees – whose duties relate to the issues upon which the attorney is asked to provide legal assistance and who has information that the attorney would need to render adequate legal advice.[42] The Supreme Court has expressly rejected the argument that the privilege should cover only those in the corporate control group (i.e., the directors and officers of the corporation), because such a view ignores the fact that "the privilege exists to protect not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice."[43]

F. Special Need for the Corporate Attorney-Client and Work Product Privilege

A corporation faced with evidence or allegations of illegal behavior will generally conduct an internal investigation to determine the scope of wrongdoing and the extent of its potential liability. Typically, the corporation will retain outside counsel who will interview employees, prepare notes of interviews, review documents (privileged and otherwise), create a chronology of events, and write client memos. Counsel may also prepare a written report of such an inquiry including conclusions and recommendations, but this is not always the case. To accomplish these tasks, the investigating attorney must induce cooperation from numerous employees who, for various reasons, may not wish to cooperate. In a properly conducted investigation, the employees are informed at the outset that communications with counsel for the corporation are not privileged as to the employee; that is, the company lawyer is not the employee's lawyer, and the corporation is free to disclose such communications without the consent of the employee.[44] Nonetheless, corporate employees and officers are generally more willing to cooperate where they receive a measure of assurance that their conversations with counsel will not be divulged to government investigators or prosecutors.[45] An internal investigation would be far less useful, and its demoralizing effect on employees would be far greater, if the investigator's sole means of inducing cooperation was the threat of discipline or termination of employment, and not the protection of confidentiality.[46]

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[40] See, e.g., Hickman, 329 U.S. at 511 (noting that were privileged materials open to the opposition on demand, "much of what is now put down in writing would remain unwritten").

[41] See Upjohn Co. v. United States, 449 U.S. 383, 390-95 (1981) (allowing a corporation to invoke the privilege).

[42] See id. at 391-92.

[43] Id. at 390.

[44] Despite this caution, many employees as a practical matter consider the corporation's lawyers to be their lawyers and are otherwise hesitant for job security reasons not to answer their questions.

[45] Judson W. Starr and Joshua N. Schopf, Cooperating with the Government's Investigation: The New Dilemma, SE72 ALI-ABA 353, 360-61 (2000).

[46] Id. at 361.

In short, by facilitating internal investigations, the corporate attorney-client privilege and work product doctrine advance the administration of justice by enabling the corporation to gather the information necessary to understand the relevant issues, to receive competent legal advice, to identify culpable employees, to determine its own liability, to change existing or institute new compliance programs, and, finally, to fully cooperate with the government. It is important to note that information and documents may be provided to the government to assist it in conducting its investigation and to others without divulging such specific privileged communications.

III. Review Of The Government Encroachment On The Attorney-Client Privilege And Work Product Doctrine

A. Waiver of the Attorney-Client and Work Product Privilege

When a corporation has learned – whether through receipt of a grand jury subpoena, self-reporting by employees, or internal monitoring under a corporate compliance program – that its employees may have acted illegally and an internal investigation has begun, the corporation generally expects that communications with its lawyers and their investigators and documents produced at their request will be protected by the attorney-client privilege and/or the work product doctrine. Unfortunately, in light of the recent practices and policy statements by the Justice Department, particularly those set forth in the Holder Memo Standards, this assumption is no longer tenable.

The Justice Department's policy, as expressed in the Holder Memo Standards, is to obtain waivers of the corporate attorney-client and work product privilege where, in the government's view, these protections might keep information relevant to a criminal investigation from discovery. Indeed, there is no pretense that the values underlying these privileges are to be sacrificed for any reason other than to make the prosecution's job easier: "Such waivers permit the government to obtain statements of possible witnesses, subjects, and targets, without having to negotiate individual cooperation or immunity agreements."[47] The obvious alternative not widely favored by government prosecutors is to conduct a factual investigation by taking statements and obtaining documents from a corporation and its employers, yet without insisting on also obtaining privileged statements made to counsel and attorney work product. It is not inconsistent with preserving the attorney-client privilege and work product protections for a company to provide information and documents to aid the government, since the privilege goes to the specific communication with the client and not necessarily to the information and documents obtained during the course of an internal investigation.

The Holder Memo Standards, now incorporated into the United States Attorneys' Manual's Criminal Resource Manual, provide a blueprint for maximizing the government's leverage to induce waivers of the corporate attorney-client privilege and work product doctrine. For example, one source of leverage arises from the possibility that the prosecutor may enter into a non-prosecution agreement with a corporate target. The Criminal Resource Manual authorizes prosecutors to offer not to indict a corporation where its "timely cooperation appears to be necessary to the public interest and other means of obtaining the desired cooperation are unavailable or would not be effective."[48] And in determining whether a non-prosecu-

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[47] Criminal Resource Manual, art. 162, § VI.B.

[48] Id. (internal quotation omitted).

tion agreement would be appropriate, prosecutors are instructed to consider the "completeness" of the corporation's disclosure, including whether the corporation granted "a waiver of the attorney-client and work product protections, both with respect to its internal investigation and with respect to communications between specific officers, directors, and employees and counsel."[49] Although the Holder Memo Standards do not consider a waiver as an "absolute requirement," they still authorize and even encourage prosecutors to "request a waiver in appropriate circumstances."[50] Fluid and ambiguous terms such as "necessary," "necessary to the public interest" and "appropriate circumstances" are left to the sole discretion of the government and generally to the individual prosecutor.

Another source of leverage that the government enjoys is its control over the sentencing decision. At the outset, the government selects the crime to be charged and the Sentencing Guidelines set forth the appropriate sentence range for such charge from which the court generally may not depart. The Sentencing Guidelines also give credit to corporations that have engaged in self-reporting, cooperation, and acceptance of responsibility for purposes of calculating the corporation's "culpability score."[51] To qualify for this credit, "cooperation must be both timely and thorough."[52] Here, "timeliness" means cooperation must begin "essentially at the same time as the organization is officially notified of a criminal investigation," while "thoroughness" requires "the disclosure of all pertinent information known by the organization."[53] Although courts ultimately decide what sentence must be imposed under the Sentencing Guidelines, the government's recommendation, based on its assessment of whether a corporation has cooperated in a "timely," "thorough," and complete manner, has tremendous influence on the ultimate sentence.[54] Similarly, the government can materially affect the sentencing decision by favorably or unfavorably calculating either the amount of pecuniary gain to the corporation or the pecuniary loss from the offense caused by the corporation.[55]

With regard to the government's raw power implicit under the Sentencing Guidelines, the government is often not willing to make a binding non-prosecution commitment without a reciprocal commitment from a defendant, oftentimes seeking in exchange a full and complete waiver of the attorney-client privilege and the work product doctrine. Yet, as commentators have queried:

> Do such demands ultimately benefit the cause of justice? Are the costs of coercing companies to waive the attorney-client privilege worth the short-term gains in the immediate case? The long-term damage inflicted on both corporate and societal interests by the government's emerging coercive waiver policy far outweighs any short-term utility.[56]

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[49] Id.

[50] Id.

[51] U.S. Sentencing Guidelines Manual § 8C2.5(g) (2001) [hereinafter "U.S.S.G."].

[52] Id., cmt. 12.

[53] Id.

[54] See Zornow & Krakaur, supra note 1, at 154-55.

[55] See id.

[56] Starr and Schopf, supra note 45, at 356.

If the government, however, demands a waiver of the attorney-client privilege and, more specifically, the protections for counsel's work product, the corporation is forced to make a classic Hobson's choice. It either gives in to the government's demand, thereby sending a message to its employees that they should not cooperate in future internal investigations, or rejects the government's conditions and risks indictment and conviction. The chilling effect on corporate self-scrutiny is obvious and there will be a serious adverse impact on the ability of corporations to prevent the occurrence of future violations of law, and of counsel to conduct meaningful and effective internal investigations. Furthermore, this practice serves to drive a harmful wedge between employees and the corporation.

While individual prosecutors may advance a particular case more quickly and effectively under the Holder Memo Standards, the Justice Department's waiver policy is indefensible from a systemic perspective. First, the waiver policy is ultimately counterproductive to the Justice Department's stated objective of obtaining "critical" assistance from the corporation "in identifying the culprits and locating relevant evidence."[57] As a result of this policy, outside counsel for a corporation now commences an internal investigation with the knowledge that the statements taken by the lawyer will likely be sought by and turned over to the prosecution and that the lawyer may be called as a witness. The likelihood of this occurring –and fairness to a company's employees dictates that they be so advised before their interviews – has the dual effect of chilling the inquiry from the outset and of eroding trust between management and staff.[58] Moreover, it can only complicate the task of detecting and preventing future wrongdoing.

Indeed, it has been suggested that today, in response to current Justice Department pressure on corporations to waive the protections of the work product doctrine, counsel often anticipate at the outset of an investigation that "the fruits of the investigation stand a substantial chance of being delivered to the government," and that this may, again, have a chilling effect on the investigative process.[59] As a result, counsel may simply refrain from putting inculpatory information in written form.

Second, the waiver policy also undermines our adversarial legal system. When a company decides to waive its privileges, "the role of the criminal counsel is repositioned from that of the client's confidential legal advisor and the government's adversary into a conduit of information between the client and the government."[60] Contrary to the Hickman Court's admonition, the prosecution then performs its duties "on wits borrowed from the adversary."[61] Moreover, counsel for the company is forced to become a witness against it and its employees, stripping both of their counsel of choice and generally impairing the client's trust in the lawyer.

Third, the government's approach, as expressed in the Holder Memo Standards, may enable federal prosecutors to circumvent employees' Fifth Amendment privilege against self-incrimination. This risk tends to be greatest when the government agrees to defer its investiga-

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[57] Criminal Resource Manual, art. 162, § VI.B.

[58] Zornow & Krakaur, supra note 1, at 157.

[59] Id. at 156.

[60] Id at 156-57.

[61] 329 U.S. at 516 (Jackson, J. concurring).

tion pending completion of the corporation's internal inquiry. Under such circumstances, the government defers with the knowledge that an employee speaking with the corporation's lawyers is less likely to retain separate counsel who, presumably, would advise the employee to invoke the Fifth Amendment privilege against self-incrimination.[62] As a result, the employee is lured into a false sense of security and speaks more freely than perhaps is wise. If, under pressure to demonstrate "complete" cooperation in pursuit of its own interest, the company subsequently decides to reveal the substance of the employee's interview, the government may gain a significant advantage in obtaining incriminating evidence from an employee without having to negotiate immunity or plea agreements.[63] Furthermore, counsel for the corporation could eventually be disqualified if called as a witness by the prosecution to impeach testimony given by one of the interviewed employees. Of course, in rare cases, calling the lawyer as a witness could also be used as a tactical tool by the prosecution to rid the corporation of the counsel of its choice.

Finally, the timing of a corporation's decision to affect a waiver of the protections may also exacerbate the waiver's detrimental impact on the case. A premature waiver may result in the corporation being "deprived of legal advice based on counsel's full development of the facts and an assessment of the strengths and weaknesses of the government's case."[64] Again, because disclosure of an internal investigation to the government by a corporation waives the protections of the attorney-client and work product privilege, the corporation may be subjected to additional litigation regarding what information must be turned over to the government.[65]

In most complicated government criminal investigations, there are parallel proceedings upon which the government's conduct also has an impact. These include civil cases against the company and individuals as well as various civil enforcement proceedings brought by federal or state agencies. If the company has waived the attorney-client privilege in the criminal investigation, it is likely to be found to have waived the privilege in these proceedings as well.

Although the current United States Attorneys' Manual recognizes the value of the attorney-client privilege and seeks to provide some protection and balance before the government may invade it, these provisions seem now to be either outdated or increasingly ignored. For example, the United States Attorneys' Manual states:

> Department of Justice attorneys should recognize that communications with represented persons at any stage may present the potential for undue interference with attorney-client relationships and should undertake any such communications with great circumspection and care. This Department as a matter of policy will respect bona fide attorney-client relationships whenever possible, consistent with its law enforcement responsibilities and duties.[66]

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[62] Zornow & Krakaur, supra note 1, at 157.

[63] See Criminal Resource Manual, art. 162, § VI.B.

[64] Zornow & Krakaur, supra note 1, at 157.

[65] See, e.g., Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d. 1414, 1418 (3d Cir. 1991) (indicating that disclosure of internal investigation report to the SEC and the Justice Department constituted waiver of both protections).

[66] U.S. Attorneys' Manual, tit. 9, § 9-13.200, available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/13mcrm.htm#9-13.200.

Another section of the United States Attorneys' Manual provides:

> In considering a request to approve the issuance of a subpoena to an attorney for information relating to the representation of a client, the Assistant Attorney General in charge of the Criminal Division applies the following principles:
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> - The information shall not be protected by a valid claim of privilege.
> - All reasonable attempts to obtain the information from alternative sources shall have proved to be unsuccessful.
> - In a criminal investigation or prosecution, there must be reasonable grounds to believe that a crime has been or is being committed, and that the information sought is reasonably needed for the successful completion of the investigation or prosecution.
>
> . . . .
>
> - The need for the information must outweigh the potential adverse effects upon the attorney-client relationship.[67]

These expressions of support for the value of the attorney-client privilege and the work product doctrine, however, are belied by the current Justice Department practices and guidelines and appear to be in conflict with the Holder Memo Standards.

B. Joint Defense Agreements

In addition to government pressure to waive the protections of the attorney-client and the work product privilege, lawyers representing clients in corporate criminal matters today encounter federal prosecutors who view joint defense agreements with suspicion and sometimes even as improper or illegal, although such agreements have long been recognized in the law as appropriate and necessary to the function of providing adequate legal advice.

The sharing of information by co-defendants under the joint defense privilege can greatly assist counsel in their efforts to represent their clients while offering substantial benefits to the agreement's participants.[68] Indeed, lawyers increasingly seek to enter into formal joint defense agreements with another party's counsel which set forth the applicability and scope of the privilege prior to the sharing of any otherwise privileged information.[69]

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[67] Id. § 9-13.410C, available at http://www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/13mcrm.htm#9-13.410.

[68] Bartel, supra note 33, at 879.

[69] Under certain circumstances, disqualification issues may arise when a joint defense agreement exists. Indeed, seeking disqualification is one method by which the government may seek to attack a joint defense agreement. Several commentators discuss this matter in greater detail. See, e.g., Chepiga, supra note 33, at 593 (indicating that although the government has moved in several criminal cases to disqualify an attorney who represented one party to a joint defense agreement after another party became a witness for the prosecution, courts have routinely rejected these motions) (citing United States v. Anderson, 790 F. Supp. 231 (W.D. Wash. 1992), and United States v. Bicoastal Corp., No. 92-CR-261, 1992 U.S. Dist. LEXIS 21445, at *17-18 (N.D.N.Y. 1992)); Arnold Rochvarg, Joint Defense Agreements and Disqualification of Co-Defendant's Counsel, 22 Am. J. Trial Advoc. 311 (1998) (reviewing and analyzing cases dealing with joint defense agreements and disqualification); A. Howard Matz, Lawyers on the Attack: Prosecutors' and Defense Lawyers' Efforts to Curb the Other Side's Perceived Misconduct, 161 PLI/Crim 177, 181-90 (1991) (discussing attempts to disqualify counsel, potential conflicts of interest and measures to avoid disqualification).

An attorney seeking to invoke the joint defense privilege on behalf of a client must be aware that the definition and scope of the privilege, as well as factors relevant to its existence, differ markedly among the Circuits. For instance, while a defendant in the Ninth Circuit need only point to a "common interest" between himself and a co-defendant in order to assert the privilege,[70] that same defendant in the Third Circuit must demonstrate that the communications he seeks to protect arose from an "on-going and joint effort to set up a common defense strategy."[71] These differences between the Circuits can have a profound impact on whether or not a client can successfully invoke the privilege.

The Courts of Appeals for the First, Second, Third and Tenth Circuits have set rigid standards for invoking the joint defense privilege. The law in these Circuits requires evidence of common defense strategy between parties before allowing the privilege to be invoked.[72] Indeed, the Court of Appeals for the Second Circuit has held that "only those communications made in the course of an ongoing common enterprise and intended to further the enterprise are protected."[73]

The Court of Appeals for the Fourth Circuit also espouses a more limited scope for the joint defense privilege. Although the court has stated in one case that, "persons who share a common interest in litigation should be able to communicate with their respective attorneys and with each other to more effectively prosecute or defend their claims,"[74] the facts of that case actually suggest a narrower holding. Specifically, the parties were engaged in a joint effort to prosecute a claim and had documented their cooperation in a written agreement.[75]

Arguably, the Circuit most vigorous in protecting otherwise privileged communications divulged to third parties is the Ninth Circuit.[76] The Court has stated that the common interest exception was "not limited . . . to situations where codefendants share a common defense or have interests that are not adverse."[77] The Ninth Circuit has also indicated that the criterion for invoking a joint defense privilege is not whether the meeting was called to prepare trial strategy, stating:

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70 See, e.g., Hunydee v. United States, 355 F.2d 183, 185 (9th Cir. 1965).

71 Matter of Bevill, Bresler & Schulman Asset Mgt Corp., 805 F.2d 120, 126 (3d Cir. 1986) (citing Eisenberg v. Gagnon, 766 F.2d 770, 787 (3d Cir. 1985)).

72 Id. (citing In re Grand Jury Subpoena Duces Tecum Dated Nov. 16, 1974, 406 F. Supp. 381 (S.D.N.Y 1975)). Moreover, the communications must be made in confidence to further the joint defense effort. Id. The party must also present concrete evidence of an actual agreement between the parties to adopt a joint defense strategy. Id. See also Grand Jury Proceedings v. United States, 156 F.3d 1038, 1043 (10th Cir. 1998) (stating that failure to "produce any evidence, express or implied, of a joint defense agreement" precluded application of the joint defense privilege to documents); United States v. Bay St. Ambulance and Hosp. Rental Serv., 874 F.2d 20, 28-29 (1st Cir. 1989) (adopting the Bevill test and finding that while the parties at issue had "many interests in common," a particular document was not covered by the joint defense privilege because there was no evidence that it related to the joint defense).

73 United States v. Weissman, 195 F.3d 96, 99 (2d Cir. 1999) (citing United States v. Schwimmer, 892 F.2d 237, 243 (2d Cir. 1989)). The Court of Appeals for the Seventh Circuit is also moving toward the Second Circuit's restrictive interpretation of the joint defense privilege and currently requires that the parties be engaged in an actual joint defense strategy. See United States v. McPartlin, 595 F.2d 1321, 1336 (7th Cir. 1979); see also United States v. Keplinger, 776 F.2d 678, 701 (7th Cir. 1985) (applying McPartlin, but finding no joint defense privilege because the communications at issue were not made in confidence).

74 In re Grand Jury Subpoenas, 89-3 and 89-4, 902 F.2d 244, 249 (4th Cir. 1990).

75 Id. at 246; see also Sheet Metal Workers Int'l Ass'n v. Sweeney, 29 F.3d 120, 124-25 (4th Cir. 1994) (indicating that a defendant's belief that he shared a common interest with another party would not suffice to invoke the common interest privilege).

76 See United States v. Montgomery, 990 F.2d 1264, 1993 WL 74314 (9th Cir. Mar. 15, 1993) (unpublished); Hunydee v. United States, 355 F.2d 183, 185 (9th Cir. 1965); see also United States v. Zolin, 809 F.2d 1411, 1417 (9th Cir. 1987) (holding that the defendant need not show that the party with whom he allegedly shared a "common interest" faced any immediate liability; a shared interest in "sorting out . . . affairs" was sufficient), vacated in part on other grounds, 842 F.2d 1135 (9th Cir. 1988).

77 Montgomery, 1993 WL 74314, at *4.

> [W]here two or more persons who are subject to possible indictment in connection with the same transactions make confidential statements to their attorneys, these statements, even though they are exchanged between attorneys, should be privileged to the extent that they concern common issues and are intended to facilitate representation in possible subsequent proceedings.[78]

Another Ninth Circuit case highlights the expansiveness of this prior holding, noting that while the "paradigm case [of joint defense privilege] is where two or more persons subject to possible indictment arising from the same transaction make confidential statements that are exchanged among their attorneys," the privilege is not limited to such a case.[79] Indeed, "[e]ven where the non-party who is privy to the attorney-client communications has never been sued on the matter of common interest and faces no immediate liability, it can still be found to have a common interest with the party seeking to protect the communications."[80]

With regard to the existence of a joint defense privilege as to documents and not just oral communications, the Court of Appeals for the Tenth Circuit has held that for a privilege to apply to documents, the party invoking the privilege must establish that "(1) the documents were made in the course of a joint-defense effort; and (2) the documents were designed to further that effort."[81]

In sum, although courts tend to impose different requirements before validating a joint defense agreement, courts nonetheless recognize the importance of, and generally uphold, such agreements. The agreements, however, still make prosecutors "uneasy."[82] Indeed, commentators suggest that prosecutors disfavor the use of joint defense agreements because they fear that the cooperation and confidentiality amongst defendants inherent in a joint defense agreement will shield pertinent evidence and hinder the government's ability to get convictions because it will be more difficult for prosecutors to isolate individuals.[83] Moreover, prosecutors worry that joint defense agreements "may include unlawful efforts to impede justice, provide a group of co-defendants with the opportunity to influence improperly the memories of witnesses, or otherwise permit a concerted attempt to obstruct grand jury investigations."[84] Prosecutors also express concern that the joint defense privilege enables the continuation of criminal conspiracies.[85]

During the past two decades, as the Justice Department prosecuted corporations with increasing frequency, it began to discourage the use of joint defense agreements. In 1991, the

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[78] Hunydee, 355 F.2d at 184.

[79] Zolin, 809 F.2d at 1417.

[80] Id.

[81] Grand Jury Proceedings v. United States, 156 F.3d 1038, 1042-43 (10th Cir. 1998); see also Chepiga, supra note 33, at 586. In fact, one court has held that the privilege was not waived where an attorney shared his work product with another attorney representing a different client with a common interest, but not involved in the same litigation. Chepiga, supra, at 586-87 (citing United States v. AT&T, 642 F.2d 1285, 1299 (D.C. Cir. 1980)). Of course, transferring documents to another party's attorney under a joint defense agreement does not work to extend the privilege if the protection did not apply before the transfer. Id. at 588 (citing Aiken v. Texas Farm Bureau Mut. Ins. Co., 151 F.R.D. 621, 624 (E.D. Tex. 1993)).

[82] Savarese & Miller, supra note 33, at 720.

[83] Chepiga, supra note 33, at 591; Bartel, supra note 33, at 879.

[84] Bartel, supra note 33, at 879 (citation omitted).

[85] Id.

Justice Department outwardly expressed its suspicion of such agreements in an article published in "The DOJ Alert," which reported, "a select group of DOJ's senior white-collar prosecutors has launched a systematic survey of the nation's U.S. attorneys to gauge their views on joint defense agreements."[86] The then chief of the Criminal Division's Fraud Section also noted in the article that "[p]rosecutors are uneasy . . . because they see in [joint defense agreements], even unintentionally, an opportunity to get together and shape testimony."[87] Yet, despite this uneasiness, prosecutors were still cautioned in the article against having a "knee-jerk reaction" against joint defense agreements and were directed to focus instead on the investigation, unless there was a "specific reason to believe the agreement [was] being used for improper purposes."[88]

The Justice Department's view of joint defense agreements is consistent with the notion of cooperation found in the Organizational Sentencing chapter of the federal Sentencing Guidelines ("Corporate Sentencing Guidelines").[89] The Corporate Sentencing Guidelines, which became effective in November 1991, aid federal prosecutors in determining whether a target for prosecution should receive a more lenient sentence based on the quality of the cooperation with the government. Under the Corporate Sentencing Guidelines, corporations receive a more lenient sentence if they disclose the violation prior to an "imminent threat" of disclosure or if they "fully cooperate" with the government investigation.[90] The Corporate Sentencing Guidelines require that the cooperation be "timely" and "thorough."[91] "Thorough" cooperation requires the corporation to provide pertinent information "sufficient for law enforcement personnel to identify the nature and the extent of the offense and the individual(s) responsible for the criminal conduct."[92] In applying the Corporate Sentencing Guidelines, prosecutors have interpreted "cooperate" broadly and pressed corporations to disclose privileged information in order to receive credit for cooperating.[93] Therefore, the Justice Department's uneasiness with joint defense agreements reflects the fact that these agreements are perceived as inherently uncooperative since they seek to benefit the parties, while hindering the free flow of information to the government if one party seeks to cooperate under the Corporate Sentencing Guidelines. (In fact, that perception is exaggerated since the agreements hinder the flow only of privileged information which, but for the agreement, the recipient would not have.)

It is unclear whether the Holder Memo Standards, when first issued, were meant merely to clarify the Justice Department's view of joint defense agreements or whether they were meant as a warning to attorneys that pressure on corporations to waive privilege to receive

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[86] White-Collar Prosecutors Probe Joint Defense Agreements, 1 The DOJ Alert 3, July 1991 [hereinafter "DOJ Alert"].

[87] Id. (internal quotation omitted) (alteration in original); see also Savarese & Miller, supra note 33, at 720.

[88] DOJ Alert, supra note 86, at 3.

[89] U.S.S.G. ch. 8.

[90] Id. § 8C2.5(g)(1), (2).

[91] Id. § 8C2.5(g), cmt. 12.

[92] Id.

[93] See, e.g., Zornow & Krakaur, supra note 1, at 148. One former United States Attorney described this cooperation as an "enforced partnership" between prosecutors and corporations, declaring it the best route to compliance with the law. Id. (citing Otto G. Obermaier, Drafting Companies to Fight Crime, N.Y. Times, May 24, 1992, at 11). Legal commentators have documented how this "enforced partnership" conflicts with Upjohn Co. v. United States, 449 U.S. 383, 389 (1981), in which the Supreme Court held that the best route to corporate compliance with the law is "full and frank communication between attorneys and their clients." See, e.g., Zornow & Krakaur, supra, at 148-49.

credit for cooperating will increase, thereby indicating that joint defense agreements that undermine this cooperation would not be viewed favorably.[94] A former Assistant Attorney General, however, has denied that the Justice Department requires corporations to waive privilege in order to receive the benefits of cooperation.[95] "There certainly is no department policy requiring companies to waive the attorney-client privilege to receive credit for cooperating with the government . . . [and] I, for one would be opposed to [such a] policy."[96] But, this same former Justice Department official also noted that it "should not be surprising" that prosecutors will continue "to give greater consideration to a corporation which cooperates extensively and provides substantial assistance" to the government, and stated:

> I should fully disclose that when I was doing white collar criminal defense work, I certainly participated in joint defense agreements and recognized their value. On the other hand, their value has to be balanced because there is the potential for mischief and the potential for utilizing the agreements to allow targets to circle the wagons and make it difficult for prosecutors successfully to complete an investigation or prosecution. That is, of course, why these agreements are viewed by some investigators and prosecutors as potential vehicles to obstruct a successful investigation and prosecution.[97]

While the Holder Memo Standards and this former Justice Department official's comments outwardly seem to suggest some Justice Department suspicion of joint defense agreements, the United States Attorney's Office for the Southern District of New York has been more explicit in its disapproval of the use of joint defense agreements for at least a decade. In cases where individual employees have entered into joint defense agreements with a target corporation:

> [T]he office of the United States Attorney for the Southern District of New York routinely coerces corporate waivers of the privilege by informing corporate managers that their failure to waive the privilege will be evaluated in determining whether the corporation has been sufficiently cooperative to avoid indictment and/or a severe guidelines sentence.[98]

Indeed, the United States Attorney for the Southern District of New York "has publicly called for a complete waiver of the attorney-client privilege by all corporate targets wishing to obtain credit for their cooperation."[99] Accordingly, both corporations and individual employees need to take this hostility towards joint defense agreements into account prior to formalizing such agreements.

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[94] See generally Polkes & Jarusinsky, supra note 2.

[95] Irvin B. Nathan, Assistant Attorney General James Robinson Speaks to White Collar Criminal Issues, 6 No. 12 BUS. CRIMES BULL. 3 (Jan. 2000).

[96] Id.

[97] Id.

[98] Robert Morvillo, The Decline of the Attorney Client Privilege, N.Y.L.J., Dec. 2, 1997, at 3.

[99] Judson W. Starr & Brian L. Flack, The Government's Insistence on a Waiver of Privilege, WHITE COLLAR CRIME 2001 J-1, at J-4 (ABA 2001); see also Polkes & Jarusinsky, supra note 2, at J-31 (noting that beginning in the early 1990s, the United States Attorney's Office for the Southern District of New York began transgressing former standards for corporate cooperation).

In addition, the Government view, as expressed in the guidelines and elsewhere, sees all joint defense agreements as similar, while in fact they vary widely--from full disclosure of client communications to providing corporate documents to merely explaining the corporate structure and process.

It has been suggested, however, that, despite the apparent lack of clarity as to the government's position regarding joint defense agreements, the Justice Department's stance may actually be relaxing. The American Bar Association ("ABA") a few years ago held a session addressing attacks on the joint defense privilege,[100] and a lawyer who spoke at the session commented that several years ago the Justice Department saw joint defense agreements mainly as a "mechanism simply to obstruct justice," but that "[t]hrough education, the [Justice] Department has come to see that these agreements are simply a way for defense counsel to legitimately preserve privileges while sharing information."[101] It was further noted that the federal prosecutor who has a negative "knee-jerk" reaction against joint defense agreements has become "the exception rather than the rule."[102] If this is in fact the case, this positive development needs to be further supported by Justice Department policies and guidelines.

C. Advancement of Attorneys' Fees

Defense counsel and their clients increasingly find government resistance to corporate efforts to advancing attorneys' fees to individual employees once a government investigation has been commenced. Although individuals under investigation or charged by the government are entitled to obtain qualified, independent counsel without interference from the government, federal prosecutors frequently object to a corporation providing counsel for its employees and penalizes the company for not cooperating with the government investigation. This federal government policy, however, undermines a well-established and necessary practice and imposes itself where law enforcement has no real interest.

In recognition that "[t]he sort of litigation in which corporate executives are involved . . . is likely to be protracted, complex, and expensive,"[103] the vast majority of states have enacted statutes that expressly authorize corporations to adopt provisions within the company's bylaws, articles of incorporation, or employment contracts that automatically provide for the advancement of legal fees of officers and directors.[104] Given today's litigious environment, many corporations have adopted such provisions.[105] Since these bylaws, articles, and employment agreements are enforceable contracts, corporations that refuse to advance the fees to

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[100] The session was entitled "Assault on the Privilege: Protecting and Defending the Attorney-Client Privilege, Work Product, and Joint Defense Agreements in Criminal Investigation." Interview with Jan Handzlik, Kirkland & Ellis and Vincent J. Marella, Bird, Marella, Boxer & Wolpert, Los Angeles, California, 13 Corp. Crime Rep. 12 (1999).

[101] Id. at 15.

[102] Id.

[103] Joseph Warren Bishop, Jr., Law of Corporate Officers and Directors - Indemnification and Insurance § 6.27, at 45 (Gail A. O'Gradney ed., 2000).

[104] See, e.g., Del. Code Ann. tit. 8, § 145(f) (2000); Model Bus. Corp. Act Annotated § 8.58(a) (3d. ed. Supp. 1998/99) [hereinafter "MBCA"]. Some state statutes directly require a corporation to advance fees. See, e.g., Minn. Stat. Ann. § 300.083(3) (West 2000); N.D. Cent. Code § 10-19.1-91(4) (1999).

[105] See 1 Rodman Ward, Jr. et al., Folk on the Delaware General Corporation Law § 145.7, at 237 (4th ed. Supp. 2000-1) ("Mandatory advancement provisions frequently appear in corporate charters, by-laws, and indemnification agreements.").

directors and officers in accordance with the agreements face declaratory judgments and damages verdicts.[106]

For example, Delaware's code extends the scope of this authority allowing for the adoption of mandatory advancement provisions to include employees, as well as directors and officers.[107] Although some corporations have bound themselves to advance fees to employees pursuant to a bylaw or merger agreement,[108] the far more common practice is for corporations to adopt provisions that provide the corporation with discretion to advance fees to employees:

> Under bylaws, articles of incorporation, or other contractual provisions, a corporation may provide for advancement of expenses, including attorneys' fees. The corporation may agree to make such advancements mandatory . . . . The provisions in bylaws and articles of incorporation dealing with indemnification all cover directors and officers, and a substantial minority apply also to "employees" and "agents," even if the statute does not . . . . But . . . , most of those that cover employees provide that the corporation "may" indemnify employees . . . .[109]

A discretionary fee advancement provision allows the corporation's board of directors to assess the circumstances underlying an employee's need for separate counsel (and a concomitant need for fees to be paid in advance) and render a decision that is subject to a reasonableness requirement.[110] Typically, the corporations that adopt such discretionary provisions will require the employee to provide a written affirmation of good faith or an undertaking to repay the fees if he or she is later found to be ineligible for indemnification.[111]

Significantly, Delaware's corporate code and the codes of many other states expressly permit this discretionary advancement of fees to employees.[112] The Model Business Corporation Act, which endeavors to leave unregulated the issue of advancement of expenses to employees, similarly acknowledges that its provisions are "not in any way intended to cast doubt on the power of the corporation to indemnify or advance expenses to . . . employees and agents . . . ."[113]

In addition to the state corporation codes, legal ethics rules also permit a corporation to pay an employee's attorney's fees, provided that the attorney maintains professional independence and loyalty to the employee. For example, Model Rule 1.8(f) of the ABA Model Rules of Professional Conduct ("Model Rules") requires a lawyer who accepts compensation from a third party to take steps to ensure no conflict of interest exists:

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[106] See generally Ridder v. CityFed Fin. Corp., 47 F.3d 85 (3d Cir. 1994) (holding that officer is entitled to injunction requiring corporation to advance fees prior to final disposition of the claim); Citadel Holding Corp. v. Roven, 603 A.2d 818 (Del. 1992) (awarding damages and prejudgment interest to director after corporation refused to advance fees as mandated in employment agreement).

[107] See DEL. CODE ANN. tit. 8, § 145(f).

[108] See Ridder, 47 F.3d at 86-87 (indicating bylaw required advancement of expenses to all employees).

[109] BISHOP, supra note 103, §§ 7.07.50 to 7.08, at 18-19 (footnote omitted).

[110] See Citadel Holding, 603 A.2d 823-24.

[111] See, e.g., BISHOP, supra note 103, App. 7A, at 5-8 (reprinting resolution that confers the discretion to advance fees to an employee and agent if an undertaking is provided on his or her behalf).

[112] See, e.g., DEL. CODE ANN. tit. 8, § 145(f).

[113] MBCA § 8.58(e) & cmt.

> A lawyer shall not accept compensation for representing a client from one other than the client unless:
>
> (1) the client consents after consultation;
>
> (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
>
> (3) information relating to representation of a client is protected as required by Rule 1.6.[114]

The ABA's Standards for Criminal Justice contain a comparable direction:

> In accepting payment of fees by one person for the defense of another, defense counsel should be careful to determine that he or she will not be confronted with a conflict of loyalty since defense counsel's entire loyalty is due the accused. Defense counsel should not accept such compensation unless:
>
> > (i) the accused consents after disclosure;
> >
> > (ii) there is no interference with defense counsel's independence of professional judgment or with the client-lawyer relationship; and
> >
> > (iii) information relating to the representation of the accused is protected from disclosure as required by defense counsel's ethical obligation of confidentiality.
>
> Defense counsel should not permit a person who recommends, employs, or pays defense counsel to render legal services for another to direct or regulate counsel's professional judgment in rendering such legal services.[115]

Accordingly, the exercise of discretion by a corporation to advance fees on behalf of an employee is permitted by law and ethical codes. Corporations that exercise this discretion are guided by a legitimate concern for employee morale as well as the view that it is unfair to require employees whose corporate conduct is under investigation to pay for their own defense before any adjudication of guilt, much less before any determination of their individual guilt or responsibility could even be made. Moreover, the principles underlying the advancement of expenses to directors and officers – i.e., that those who serve the corporation should not be forced to bear the expense of their own defense, as that would discourage competent people from serving in such capacity – apply equally to a corporation's decision to advance fees to employees.[116] Therefore, the exercise of discretion to advance fees typically reflects sound corporate governance goals, rather than an effort to not cooperate with a government investigation.

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[114] Model Rules of Prof'l Conduct R. 1.8(f) (1999). Rule 1.8(f) is very similar to its predecessor, Disciplinary Rule 5-107 of the Model Code of Professional Responsibility, which is still in force in some states.

[115] A.B.A. Standards for Criminal Justice Standard 4-3.5(e) (1993). If the lawyer could not exercise independence, such as in a "crime family" case, the court may order disqualification. See, e.g., United States v. Locascio, 6 F.3d 924, 932-33 (2d Cir. 1993).

[116] See MBCA § 8.58 & cmt (recognizing that the authority also exists for corporations to indemnify or advance fees to employees).

The legitimacy of the policy goals espoused by these state statutes and ethical standards is confirmed by the Justice Department's own internal regulations, which permit the Justice Department itself to pay for a prosecutor's outside counsel if the prosecutor is a subject of a federal criminal investigation.[117] Unfortunately, the guidance recently issued to federal prosecutors in the Holder Memo Standards could, and does, generate interference with the principle that non-government employees facing government investigation or prosecution are entitled to qualified, competent representation. Today, it is common for defense counsel to be confronted by a federal prosecutor who believes that a corporation is not fully cooperating with the government in a federal criminal investigation solely because the corporation is paying the legal fees for an officer, director or employee.

Although the Holder Memo Standards quite logically instruct prosecutors that the cooperation of the corporation may be a relevant factor in determining whether to charge the company, this guidance includes flawed commentary that authorizes a prosecutor to view as non-cooperative the advancement of legal fees for employees that have been deemed "culpable" by the prosecutor. Specifically, the Holder Memo Standards state that:

> [W]hile cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation.[118]

A footnote, fortunately, does add that "[s]ome states require corporations to pay the legal fees of officers under investigation prior to a formal determination of their guilt. Obviously, a corporation's compliance with governing law should not be considered a failure to cooperate."[119] But where this state requirement is lacking, the Holder Memo Standards undermine an otherwise legal, ethical and useful practice.

The Justice Department policy expressed in the Holder Memo Standards may unfairly prejudice corporations and their employees and, thus, compromise the administration of justice. Although corporations are often obligated under state law and their by-laws to advance fees to officers and directors, they may have statutory authority not to pay attorneys' fees for officers and directors if the corporation determines that an officer or director acted with criminal intent or acted to harm the company.[120] In addition, corporations typically retain discretion to advance fees for lower-ranking employees. Since a decision to advance fees most often must be made long before there is a sufficient factual basis to allow a corporation to assess "culpability" of the employee, the Holder Memo Standards may cause premature judgments by a corporation about an employee's criminal intent and conduct and will have a chilling effect on a corporation's exercise of discretion to advance fees.

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[117] See 28 C.F.R. §§ 50.15(a)(7), 50.16.

[118] Criminal Resource Manual, art. 162, § VI.B (footnote omitted) (emphasis added). Section VI.B. contains numerous other relevant provisions as well.

[119] Id. at n.3.

[120] See, e.g., Del. Code Ann. tit. 8, § 145(a) (2000).

In addition, the Holder Memo Standards are subject to abuse by prosecutors who could gain a strategic advantage by interfering with the ability of corporate employees to retain competent counsel if they are unable to do so absent financial support from the company.

The purported application of the Holder Memo Standards to the advancement of fees only to "culpable" employees creates a paradigm that is both incompatible with the legal standards governing advancement and impractical in its application to white-collar criminal investigations. Culpability may play a role in a corporation's decision whether to ultimately indemnify an employee, as the corporation may choose not to indemnify an employee who acted in bad faith or with reason to believe that his or her conduct was unlawful.[121] Whether an employee is guilty of the offense for which he or she is under investigation, however, frequently cannot be determined by a corporation at the investigation or pre-trial stage. Indeed, the ultimate decision to not indemnify an employee is often made long after the need to do so has arisen and fees have already been advanced.

Under Delaware law, for example, a corporation's decision to advance fees is an issue resolved independently of the employee's ultimate entitlement to indemnification, and is instead resolved by answering questions that do not touch upon culpability.[122] In general, courts applying Delaware law will first determine whether the employee is entitled to the advancement of fees by virtue of a bylaw, resolution, or contractual provision.[123] If not, the decision to advance fees is left to the discretion of the corporation and the sole requirement that must be fulfilled is for the employee to file an undertaking to repay the advanced fees if such an undertaking is required by the relevant bylaw, resolution, or contract.[124]

In contrast, the Holder Memo Standards would require a corporation to determine an employee's "culpability" well before such a determination is ripe. As noted by one state legislature, "during the early stages of a proceeding (when advances are often needed) the facts underlying the claim cannot be fully evaluated and the board of directors therefore cannot accurately ascertain the ultimate propriety of indemnification."[125] This is particularly the case in corporate criminal investigations, where the proscribed behavior "is often difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct."[126] As summarized by one commentator, "[t]he jurisprudence of white collar crime, in particular, is littered with examples of courts and legislatures struggling to clarify what is or is not a crime."[127]

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[121] Id. § 145(a)-(b).

[122] See Ridder v. CityFed Fin. Corp., 47 F.3d 85, 87 (3d Cir. 1994) ("Under Delaware law, appellants' right to receive the costs of defense in advance does not depend upon the merits of the claims asserted against them and is separate and distinct from any right of indemnification they may later be able to establish.").

[123] See, e.g., id.

[124] See Del. Code Ann. tit. 8, § 145(e).

[125] S.C. Code Ann. § 33-8-530 cmt. (Law. Co-op. 2000).

[126] United States v. U.S. Gypsum Co., 438 U.S. 422, 441 (1978); see also Pamela H. Bucy, Indemnification of Corporate Executives Who Have Been Convicted of Crimes: An Assessment and Proposal, 24 Ind. L. Rev. 279, 293 (1991) (concluding that many white-collar criminal statutes and regulations create a "gray area between legal and illegal conduct").

[127] Bucy, supra note 126, at 293.

In light of this uncertain legal backdrop and the large volume of documents that typically must be reviewed in corporate investigations, a company will often be unable to realistically assess the culpability of its employees until the conclusion of the legal proceedings. In the case where an employee has made a serious mistake in judgment, the company may not have sufficient information to conclude that the employee had the necessary criminal intent. In most United States corporations, a basic tenet of human resources management is that an employee should be given the benefit of the doubt when determining something as serious as whether he or she acted with criminal intent. As a result, companies often properly refrain from premature determinations regarding an employee's criminal culpability. The Holder Memo Standards, however, unwisely pressures a company to rush to judgment.

In addition, the guidance set forth in the Holder Memo Standards is subject to abuse. Every lawyer – including a prosecutor – has an obligation not to interfere with an individual's legal representation, particularly in a criminal matter.[128] As Model Rule 8.4 states: "It is professional misconduct for a lawyer to . . . engage in conduct that is prejudicial to the administration of justice."[129] Although the paramount duty of a prosecutor is to seek justice,[130] the Holder Memo Standards unfortunately create a framework that allows a prosecutor to use his or her leverage to interfere with an employee's ability to obtain a well-qualified lawyer, which in fact undermines the interests of justice.

Given that most business-related investigations concern complex regulatory issues, an experienced attorney is frequently necessary to competently safeguard an employee's interests. Many employees, however, lack sufficient funds to retain such an attorney. An employee who is denied the advancement of fees is unlikely to be able to obtain competent counsel. This reasoning applies with equal – if not greater – force to low-ranking employees. Prosecutors may gain a strategic advantage by chilling a company's exercise of discretion to advance fees for employees and impeding an employee's ability to retain a capable and experienced attorney. Such strategic interference with an individual's ability to obtain representation is inconsistent with the ethical standards governing attorney conduct and ultimately impedes the fair administration of justice.[131]

D. Crime-Fraud Exception

Today, defense lawyers are confronted by government efforts to overcome the attorney-client privilege by assertion of the crime-fraud exception. A defense counsel's first notice of such a claim is often in an ex parte order of a court requiring the lawyer to provide testimony regarding communications with a client.

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[128] Under the McDade Amendment adopted in 1998, federal prosecutors are subject to state ethics rules and local federal court rules governing attorneys in each state where such attorney engages in that attorney's duties. See 28 U.S.C. § 530B(a).

[129] Model Rules of Prof'l Conduct R. 8.4(d) (1999).

[130] "The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done." Berger v. United States, 295 U.S. 78, 88 (1935).

[131] The Holder Memo Standards' guidance regarding advancement of attorney's fees is also incompatible and inconsistent with the apparent approval of this practice as expressed in state statutes permitting corporations to exercise discretion to advance fees, despite the exemption in the Justice Department guidelines when such advances are required by law.

Although the crime-fraud exception to the attorney-client privilege is as universally recognized as the privilege itself, it is justified only on the grounds that the traditional rationale for the privilege – attorneys may give sound legal advice only if clients can fully and frankly communicate with them – does not apply when the intent of the communications is to further criminal activity.[132] The crime-fraud exception to the privilege dates back to the 1743 English case of Annesley v. Earl of Anglesea.[133] A later English case, Regina v. Cox, was the first to give widespread effect to the exception, applying it to both civil and criminal wrongs in 1884.[134] Regina established the principle that the client's intent in consulting an attorney controls whether the communication is privileged, holding, "[i]n order that the rule may apply there must be both professional confidence and professional employment, but if the client has a criminal object in view in his communications with his solicitor one of these elements must necessarily be absent."[135]

In the 1891 case of Alexander v. United States, the United States Supreme Court endorsed the Regina rule, but added the limitation that the exception should only apply to wrongs for which the party is currently being tried.[136] This restriction, however, has since become a dead letter.[137] The Court further refined the crime-fraud exception in Clark v. United States by limiting its application to cases in which the party opposing the privilege had presented "prima facie evidence that it has some foundation in fact."[138] Another early limitation to the exception was the "independent evidence" requirement, whereby the government was required to establish its prima facie case through evidence acquired independently of the communications at issue.[139] Yet, since prosecutors invoked it relatively infrequently, the crime-fraud exception remained an undeveloped doctrine throughout much of this century.

More recently, federal prosecutors have taken advantage of the increased criminalization of white-collar and regulatory offenses to invade the attorney-client privilege by asserting the crime-fraud exception.[140] Such government efforts have a low procedural threshold, allowing prosecutors to compel testimony about attorney-client communications based only on an ex parte showing that the exception applies. In most cases, the decision to proceed and the ex parte showing to the court are both made by the individual prosecutor handling the investigation without any additional review or approval within the Justice Department.

Most courts recognize that in order for the exception to apply, prosecutors must demonstrate two elements: (1) the client was involved in planning criminal conduct at the time of the

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[132] In re Grand Jury Proceedings, 87 F.3d 377, 381 (9th Cir. 1996); Haines v. Liggett Group, Inc., 975 F.2d 81, 90 (3d Cir. 1992); Coleman v. Am. Broad. Co., Inc., 106 F.R.D. 201, 206 (D.D.C. 1985).

[133] 17 How. St. Tr. 1225 (1743), quoted in WIGMORE, supra note 12, § 2291; see also MCCORMICK ON EVIDENCE, supra note 13, § 87, at 344 n.3 (citing Annesley); Fried, supra note 9, at 446-50 (discussing the history and significance of Annesley).

[134] 14 Q.B.D. 153 (Cr. Cas. Res. 1884); see also Christopher Paul Galanek, Note, The Impact of the Zolin Decision on the Crime-Fraud Exception to the Attorney-Client Privilege, 24 GA. L. REV. 1115, 1123 (1990) (discussing Regina).

[135] 14 Q.B.D. at 168; see also Galanek, supra note 134, at 1123 n.45 (quoting Regina).

[136] 138 U.S. 353, 360 (1891); see also Fried, supra note 9, at 460.

[137] Fried, supra note 9, at 460.

[138] 289 U.S. 1, 15 (1933) (internal quotation omitted); see also Fried, supra note 9, at 462-63.

[139] See, e.g., United States v. Shewfelt, 455 F.2d 836, 840 (9th Cir. 1972); United States v. Bob, 106 F.2d 37, 40 (2d Cir. 1939); see also Fried, supra note 9, at 463-65. This limitation has since been abrogated by United States v. Zolin, 491 U.S. 554 (1989), discussed infra.

[140] Fried, supra note 9, at 470.

consultation; and (2) the attorney's assistance was obtained in furtherance of this activity.[141] It is the client's subjective intent, and not the attorney's knowledge of the planned criminal activity, that controls.[142] In most federal Circuits, the exception applies even if the client never completed the planned crime or fraud.[143]

The minimal prima facie ex parte showing required of prosecutors underlies the current concern regarding the government's efforts to use the crime-fraud exception. The Supreme Court has addressed this issue only once, in United States v. Zolin, a case in which the IRS sought to compel the defendant in a criminal tax investigation to produce various documents and audiotapes that the defendant claimed were protected by the attorney-client privilege.[144] The IRS submitted statements from agents working on the case, as well as partial transcripts of the tape recordings obtained from a confidential source, to demonstrate that the crime-fraud exception applied. The district court refused to conduct an in camera review of the privileged material, but ordered that the defendant produce five of the requested documents based on the prosecutor's evidence. The Court of Appeals for the Ninth Circuit affirmed.[145]

The Supreme Court vacated and remanded, holding that a court can review privileged material in camera to determine whether the exception applies. To obtain an in camera review, the party opposing the privilege "must present evidence sufficient to support a reasonable belief that in camera review may yield evidence that establishes the exception's applicability."[146] Disposing of the traditional "independent evidence" requirement, the Court held that any relevant evidence that was lawfully obtained and not privileged could be used to make this threshold showing.[147] Furthermore, the decision whether to grant the in camera review is within the district court's discretion.[148]

The Zolin Court declined to define the quantum of proof ultimately necessary to invoke the crime-fraud exception following the in camera review.[149] Most federal courts, however, continue to apply the Clark prima facie standard when deciding whether the exception applies. Although various Circuits have different formulations of what constitutes a prima facie case, none of the standards are very stringent.[150]

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[141] See, e.g., United States v. Jacobs, 117 F.3d 82, 87 (2d Cir. 1997); United States v. Collis, 128 F.3d 313, 321 (6th Cir. 1997); In re Grand Jury Proceedings, 87 F.3d 377, 381 (9th Cir. 1996).

[142] See, e.g., In re Grand Jury Proceeding, 87 F.3d at 381-82; United States v. Chen, 99 F.3d 1495, 1504 (9th Cir. 1996).

[143] See, e.g., Collis, 128 F.3d at 321; In re Grand Jury Subpoena Duces Tecum Dated Sept. 15, 1983, 731 F.2d 1032, 1039 (2d Cir. 1984). But see In re Sealed Case, 107 F.3d 46, 49 (D.C. Cir. 1997) ("[T]he client must have carried out the crime or fraud . . . . [T]he exception does not apply even though, at one time, the client had bad intentions.").

[144] 491 U.S. 554, 557 (1989).

[145] Id. at 558-61.

[146] Id. at 574-75.

[147] Id. at 575.

[148] Id. at 572.

[149] Id. at 563.

[150] See, e.g., Haines v. Liggett Group, Inc., 975 F.2d 81, 96 (3d Cir. 1992) (indicating that all that may be required is "evidence which, if believed by the fact finder, supports plaintiff's theory of fraud"); In re Grand Jury Proceedings, 857 F.2d 710, 712 (10th Cir. 1988) (holding that a partial transcript of grand jury proceedings and affidavits established prima facie case that documents were not privileged, because the evidence showed that the allegation of attorney participation in a crime or fraud has some foundation in fact); In re Int'l Sys. & Controls Corp. Sec. Litig., 693 F.2d 1235, 1242 (5th Cir. 1982) (endorsing Black's Law Dictionary definition of prima facie case – evidence that "will suffice until contradicted and overcome by other evidence" – and finding that mere allegations in plaintiff's pleadings did not meet this standard).

In applying Zolin, Circuits have generally required that prosecutors either make an ex parte showing to meet the threshold for an in camera review or establish a prima facie case. According to the Ninth Circuit, Zolin does not require that a court consider "other available evidence" outside of what the prosecutor presents to it in determining whether the exception applies.[151] In an in camera review of privileged statements, a defendant asserting the privilege also has no right to notice or opportunity to be heard. Instead, the "prima facie foundation may be made by documentary evidence or good faith statements by the prosecutor as to testimony already received by the grand jury."[152] For example, in one case, the government subpoenaed defense counsel for a hospital that was the target of a grand jury investigation and, in arguing that the crime-fraud exception applied to counsel's testimony, prosecutors submitted an in camera, ex parte "good faith" statement of evidence about the alleged criminal activity. The district court ruled that the government had established a prima facie case and refused to allow the hospital's counsel to view the government's evidence or to present rebuttal evidence. The Tenth Circuit affirmed, holding that instead of affording an opportunity to be heard, the court need only protect the privileged communication by defining the "scope of the crime-fraud exception narrowly enough so that information outside of the exception will not be elicited."[153]

Courts' willingness to rely on a prima facie, ex parte showing to establish the applicability of the crime-fraud exception likely stems from dual concerns. First, that a determination of this foundational issue will become a "preliminary minitrial" and waste judicial resources.[154] Second, in the context of grand jury proceedings, that the government's interest in protecting the secrecy of the proceedings outweighs a defendant's due process rights.[155] Although the increasing use of the crime-fraud exception stems in large part from the courts' willingness to find it applies, the detrimental effect of this development is greatly exacerbated by the efforts of federal prosecutors to invoke the exception, often in ex parte proceedings.

The United States Attorneys' Manual contains no specific guidelines regarding the invocation of the crime-fraud exception by federal prosecutors. Despite the warnings against invading the attorney-client relationship, federal prosecutors have increasingly invoked the crime-fraud exception to compel testimony about privileged communications. One review of reported case law in the mid-1980's alone indicated an "extraordinary increase" in attempts to compel attorney testimony throughout the previous twenty years.[156] Invocations of the excep-

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[151] In re Grand Jury Subpoena 92-1(SJ), 31 F.3d 826, 830 (9th Cir. 1994). In Zolin, the government sought documents relating to the defendant corporations' allegedly illegal exports and presented affidavits from former employees to demonstrate that the exception applied. The district court found the government's evidence sufficient to obtain an in camera review of the documents and declined to consider countervailing evidence from the corporation. 491 U.S. at 573-74.

[152] In re Grand Jury Subpoenas, 144 F.3d 653, 662 (10th Cir. 1998).

[153] Id. at 661. But see Haines, 975 F.2d at 97 ("The importance of the privilege . . . as well as fundamental concepts of due process require that the party defending the privilege be given the opportunity to be heard, by evidence and argument, at the hearing seeking an exception to the privilege."). The Third Circuit, however, eventually distinguished Haines and held that relying solely on an ex parte affidavit to determine the application of the crime-fraud exception does not violate due process. In re Grand Jury Subpoena, 223 F.3d 213, 218 (3d Cir. 2000) ("This case differs from Haines not only because Haines was a civil case and this is a criminal one but, even more important, because Haines involved adversarial proceedings whereas grand jury proceedings are investigative, and the rules of the game are different.").

[154] See, e.g., In re Grand Jury Proceedings, 857 F.2d at 712 (expressing such concern); see also H. Lowell Brown, The Crime-Fraud Exception to the Attorney-Client Privilege in the Context of Corporate Counseling, 87 Ky. L.J. 1191, 1259 (1999) (discussing courts' concerns).

[155] See, e.g., In re Grand Jury Subpoena, 884 F.2d 124, 126 (4th Cir. 1989) (holding that in camera review of the government's evidence did not violate defendant's due process rights); see also Brown, supra note 154, at 1259 (discussing these secrecy concerns).

[156] Fried, supra note 9, at 445 (citing a review of the case digests).

tion "proliferate" in the context of federal grand juries.[157] Federal prosecutors' use of subpoenas for lawyers have been described as a "growing trend . . . [that] has troubled both practitioners and legal scholars."[158] This trend can be at least partially explained by the increase in criminalization of regulatory offenses and in federal prosecutions for white collar and organized crime.[159]

Although federal prosecutors are increasingly using the crime-fraud exception to overcome the attorney-client privilege, the evidence presented by prosecutors to make a prima facie case is often not disclosed in court opinions, thus making an analysis of the full extent of the problem difficult. Nonetheless, the current Justice Department practices that jeopardize the privilege and undermine the policies behind it include: (1) using unsubstantiated statements to establish the application of the exception; (2) utilizing communications outside the bounds of the exception; and (3) not following the proper procedures for the introduction of privileged evidence.

As various legal scholars have commented, there are significant consequences arising from the Justice Department's increased reliance on the crime-fraud exception, particularly because of the potential for prosecutorial abuse inherent in the law pertaining to the exception itself. The most common criticisms are the abandonment of the "independent evidence" requirement, the lack of restrictions on the legitimacy and accuracy of evidence, and the ex parte nature of the proceeding. The current rules allow prosecutors to obtain an in camera review based on unsubstantiated information that they may have collected through an unlawful intrusion into the privilege, without giving defendants an opportunity to challenge the reliability or validity of that evidence.[160] Safeguards are necessary even during an in camera review because "each time a court entertains a motion to defeat the privilege with any information, qualitatively acceptable or not, the court risks disclosing privileged information that should not be disclosed to any party."[161] In addressing the ex parte nature of the in camera review, this process has also come under attack by commentators who criticize its inherent weaknesses:

> The absence of notice of the basis of the crime-fraud claim further aggravates the inability of the privilege holder to meaningfully respond and to preserve the privilege. The court is also deprived of the robust factual development and legal argument necessary for an informed judicial decision.[162]

Oftentimes, the evidence that prosecutors use either to obtain an in camera review or to establish a prima facie case contains no indicia of reliability or derives from third parties with

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[157] Ann M. St. Peter-Griffith, Abusing the Privilege: The Crime-Fraud Exception to Rule 501 of the Federal Rules of Evidence, 48 U. MIAMI L. REV. 259, 279 (1993).

[158] Ross G. Greenberg, et al., Eighth Survey of White Collar Crime Procedural Issues: Attorney-Client Privilege, 30 AM. CRIM. L. REV. 1011, 1021 (1993).

[159] Fried, supra note 9, at 445.

[160] See Brown, supra note 154, at 1252; St. Peter-Griffith, supra note 158, at 269-71; Galanek, supra note 134, at 1139-40 (each noting these concerns).

[161] St. Peter-Griffith, supra note 157, at 271.

[162] Brown, supra note 154, at 1259-60 (footnotes omitted); see also Michael M. Mustokoff, et al., The Attorney/Client Privilege: A Fond Memory of Things Past An Analysis of the Privilege Following United States v. Anderson, 9 ANNALS HEALTH L. 107, 114-17 (2000) (reflecting the current criticism of these practices).

an interest in the matter. For example, in one case, the government relied on affidavits from two former employees of the defendant corporation to meet the threshold for an in camera review of documents it claimed were in furtherance of export control violations.[163] Both employees' affidavits contained hearsay evidence about specific words and acts of the company's executives:

> According to one former employee, the Corporation's president shipped GPS units to the [United Arab Emirates] in July 1989 and, a short time later, received a telex from Iran thanking him for the units . . . . He further stated that both an Iranian trainee and the Corporation's vice-president indicated that the GPS units in Iran came from a [United Arab Emirates] front company deliberately set up for that purpose.[164]

In another case, the prosecutor used testimony from a government agent that likely included hearsay to make its prima facie case.[165] In both of these cases, the courts accepted the evidence and revoked the privilege. Furthermore, although the exception is supposed to apply to communications that take place before an intended crime or fraud is committed, federal prosecutors frequently attempt to apply it to communications after the crime has occurred.[166] Indeed, the district courts in two cases compelled production of documents dated after the completion of the alleged crime. Fortunately, the appellate courts reversed and limited the lower courts' orders to evidence of communications before the crime occurred.[167] These efforts to use such evidence, however, is alarming.

Federal prosecutors have also attempted to circumvent the two-step procedure outlined in Zolin. For example, in one case, the prosecutor sought application of the exception, and the trial court initially applied it to a letter to the defendant from his attorney. Because the prosecutor did not establish a basis for an in camera review, the Court of Appeals for the Ninth Circuit found this to be error.[168] In another Ninth Circuit case, a federal prosecutor relied on disclosures of attorney-client communications from a former employee of the defendant and from an agent's affidavit regarding these communications, but without first requesting an in camera review or making a prima facie showing.[169]

Federal prosecutors have also argued that attorney-client communications can be evidence of a particular "crime" and are therefore not privileged, even if the facts of the case do not make out the elements of the alleged crime.[170] Another "extraordinary ploy" used by prosecutors is to turn a past offense into a continuing one so that the communications fall

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[163] In re Grand Jury Subpoena 92-1(SJ), 31 F.3d 826, 830 (9th Cir. 1994).

[164] Id.

[165] In re Grand Jury Subpoena, 884 F.2d 124, 127 (4th Cir. 1989).

[166] See, e.g., In re Grand Jury Subpoena, 31 F.3d at 831; In re Grand Jury Subpoena Duces Tecum Dated Sept. 15, 1983, 731 F.2d 1032, 1041 (2d Cir. 1984).

[167] See, e.g., In re Grand Jury Subpoena, 31 F.3d at 831; In re Grand Jury Subpoena, 731 F.2d at 1041-42.

[168] United States v. de la Jara, 973 F.2d 746, 749 (9th Cir. 1992). The Ninth Circuit admitted the letter on other grounds, however, and, as a result, did not reverse the lower court decision. Id. at 750.

[169] United States v. Chen, 99 F.3d 1495, 1502 (9th Cir. 1996). Although the evidence was admitted, the lower court expressly stated that it had disregarded the privileged statements in ruling that the crime-fraud exception applied to them. Id. at 1503-04.

[170] See In re Grand Jury Subpoena, 731 F.2d at 1039-40 (stating that the court was "skeptical" that defendant corporation's sale of its stock could be considered an obstruction of justice or part of a conspiracy to defraud the United States, as the prosecutor had argued).

within the exception.[171] For example, in a Fifth Circuit case, following the defendant's indictment for extortion, defense counsel wrote a letter to the alleged victim enclosing the money allegedly extorted.[172] The prosecutor then subpoenaed the attorney to testify about conversations that occurred prior to the return of the money, which, according to the prosecutor, acted as an obstruction of justice.[173]

Last, while evidence about attorney-client communications can take a variety of forms, prosecutors most often invoke the crime-fraud exception in order to force attorneys to testify against their clients.[174] As a result, "opposing counsel could use the subpoena to eliminate troublesome, qualified defense counsel" by compelling an attorney to testify about the client's communications and thereby forcing the subpoenaed attorney to withdraw as counsel.[175] It is particularly troubling when the government's use of this exception results in the lawyer being compelled to testify against his or her client.

Because of the extraordinary impact this result necessarily has on the attorney-client privilege and relationship, the government should establish a level of review within the Justice Department that would be required before the prosecutor could make such an ex parte application to the Court.

IV. Recommendations And Conclusion

The current Justice Department policies and practices regarding the attorney-client privilege and the work product doctrine have significant negative consequences. By eroding the attorney-client privilege and work product doctrine, they undermine defense counsel's ability to effectively represent his or her client. The values enshrined in these protections are deep-rooted and broadly embraced by the entire legal community. As the Supreme Court has stated:

> The attorney-client privilege is the oldest of the privileges for confidential communications known to the common law .... Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.[176]

Rather than undermining and eroding the attorney-client privilege and work product doctrine by viewing them as obstacles to the legitimate prosecution of crimes, the Justice Department should recognize that these protections provide the foundation for a lawyer to offer an informed opinion and sound legal advice to a client based upon full knowledge of the issue at hand, and play a vital role in the American system of justice. Federal prosecutors should not exact a waiver of these important protections. The Justice Department should modify and clarify its guidelines regarding the attorney-client privilege and the work product doctrine in order to ensure the fullest protection possible for these fundamental principles of American

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171 Fried, supra note 9, at 474.

172 United States v. Dyer, 722 F.2d 174, 176 (5th Cir. 1983); see also Fried, supra note 9, at 474-75.

173 Dyer, 722 F.2d at 176; see also Fried, supra note 9, at 474-75.

174 See, e.g., Mustokoff, supra note 162, at 110 (discussing a case in which this occurred).

175 Greenberg, supra note 158, at 1022.

176 Upjohn Co. v. United States, 449 U.S. 383, 389 (1981) (citation omitted).

law, while still allowing vigorous enforcement of the criminal statutes. The two are not incompatible.

Cooperation with the government in its investigation may be full and complete without the coerced waiver of these protections. The proliferation of a policy of prosecutorial coercion is, in the long run, a disservice to the public interest and to the fair administration of justice. The waiver of the attorney-client and work product privilege should only be made voluntarily and not as a result of government coercion. And the government has a long standing policy in conflict with seeking such waivers. The U.S. Attorney's Manual requires that all reasonable attempts be made to obtain the information from other sources and only when these efforts have been unsuccessful, may a prosecutor serve a subpoena on an attorney for testimony or documents, and then only after approval of the Assistant Attorney General in charge of the Criminal Division.[177] There is no reason to abandon this policy.

The government has also weakened these protections by attacking joint defense agreements. Joint defense agreements provide the opportunity for defense attorneys to preserve the attorney-client privilege and work product protections while sharing information crucial to the preparation of an adequate defense. The Justice Department policy regarding joint defense agreements, however, appears to be in flux, leaving ample discretion to individual prosecutors to develop their own policies and strategies.

Some prosecutors recognize the importance of a joint defense agreement in order for a corporation's counsel to be able to obtain adequate information to advise the corporate client and provide accurate information to the government as well as its importance for an individual employee. Other prosecutors, however, find the existence of a joint defense agreement a basis for charging the corporation with interfering with a government investigation. This is an issue the Justice Department should clarify with a statement of policy supporting a presumption that joint defense agreements are valid unless there is substantial reason to believe one is being used in an illegal manner. Prior to such a determination, the fact that a joint defense agreement exists should not be used by the government as evidence of non-cooperation or obstruction on the part of a corporation.

With regard to the advancement of fees, it should be recognized in the Justice Department guidelines that this practice is permitted under state corporation law and ethical codes and is necessary to enable employees to be adequately represented in a criminal investigation of corporate conduct. The current Justice Department guidelines discourage the legitimate advancement of fees and permit prosecutors to abuse their authority and impose law enforcement where it has no real interest in order to gain a strategic advantage and thereby deprive the employee of a funded defense.

Finally, while developing case law has made it easy for prosecutors to invoke the crime-fraud exception, and perhaps this is a matter of concern best addressed to the courts, it is important that Justice Department attorneys not seek to use every opportunity available to them to invade the attorney-client privilege and work product doctrine for the purpose of building a case when other avenues are available. The government should make ex parte claims that these protections have been breached by the crime-fraud exception only after facts are estab-

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[177] See discussion supra at 22.

lished that fully support that a challenge to the attorney-client privilege is warranted. Such a challenge should not be merely an advocate's tool. Prosecutors must be mindful of the societal importance of the attorney-client privilege and the work product doctrine and the dangers that result from their erosion by excessive invocation of the crime-fraud exception. The Justice Department should establish more specific guidelines on compelling disclosure of attorney-client communications or work product that stress strict compliance with the few safeguards and limits that do exist in the law, particularly in regard to the ex parte showing that prosecutors must make to invoke the crime-fraud exception.

Since courts will not customarily provide the party asserting the privilege the opportunity to challenge the evidence establishing a prima facie case, the Justice Department guidelines should assure that the government's evidence originates from reliable, credible sources without a personal interest in the matter. Any ex parte application should first be approved by the Attorney General or appropriately designated person following a review of the facts. And prosecutors should not attempt to compel disclosure of communications that do not relate directly to a planned crime.

A. Specific Recommendations

In order to alleviate the concerns expressed in this report that the attorney-client privilege and the work product doctrine have been and continue to be eroded in federal criminal investigations, the College makes the following specific recommendations:

- The policies and guidelines of the Justice Department should reflect the critical importance of the attorney-client privilege and work product doctrine and incorporate alternatives to circumventing them. The following proposed guideline should be incorporated into the Holder Memo Standards:

  > The attorney-client privilege and work product doctrine are essential to the American justice system and should not be diluted for the sake of expediting a prosecution. Prosecutors should exhaust other alternatives to obtain information before requesting that a corporation cooperate by waiving privilege.

- The current guidelines provide in part, as follows:

  > "In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, to make witnesses available to disclose the complete results of its internal investigation, and to waive the attorney-client and work product privileges."

  This should be changed to read:

  > In gauging the extent of the corporation's cooperation, the prosecutor may consider the corporation's willingness to identify those within the corporation whom it is aware or becomes aware have engaged in culpable wrong doing, including senior executives, to make witnesses available and otherwise cooperate.

- The Justice Department, in assessing whether a corporation is cooperative, should consider its refusal to disclose the results of internal investigations by counsel or otherwise

waive the attorney-client and work product privilege only when evidence is unavailable from any other sources.

- With regard to joint defense agreements or payment of employees' legal fees, the guidelines should state:

> A corporation's promise of support to employees and agents, either through advancing of legal fees or through providing information to the employees about the government's investigation pursuant to a joint defense agreement, should be considered by the prosecutor in weighing the value of a corporation's cooperation only if such support continues in an inappropriate manner after a determination of culpability or misconduct on the part of an employee.

- The government should not attempt to breach the attorney-client privilege and work product protections by an ex parte application to the court claiming a crime-fraud exception to the privileges without clearly establishing a solid factual basis that this exception applies. The proposed guideline should state:

> In every case in which a claim of crime-fraud is to be made to a court for the purpose of voiding the attorney-client or work product privilege, the application should be approved by the Attorney General or an appropriately designated person within the Justice Department following a review of the factual basis for such an application.

B. Conclusion

Any impediment to obtaining relevant information that is presented by the attorney-client privilege and work product doctrine is counterbalanced by the benefits these protections afford the criminal justice system and society in general. While a prosecutor's job may be rendered more difficult by a corporation's or its attorney's invocation of a privilege, this is not a valid reason to compromise the longstanding and important legal principles that underlie the privilege. Despite the challenges that the attorney-client privilege and work product doctrine may present to prosecutors, the overall benefits make these protections indispensable and deserving of preservation.

The attorney-client privilege and work product doctrine play a central role in corporate governance. In order to fully comply with the law, corporate employees must be able to seek the advice of corporate and outside counsel. It is necessary for the communication between counsel and corporate employees to be privileged to ensure an open and honest exchange of information. Any policy that equates the assertion of the attorney-client privilege and work product protections with non-cooperation or obstruction ignores the harmful consequences to proper corporate governance. It is in society's interest to ensure that corporations have the means to comply with often complicated and intricate regulations and laws. Corporate officers and employees need to be assured that what they reveal to corporate or outside counsel will not be used against them at a later date.

Whether invoked by a corporation or an individual, the attorney-client privilege and the work product doctrine are essential to the due administration of the American criminal justice system. Justice Department guidelines and prosecutorial standards should be revised to reflect adequately the central importance of these protections. ◆

SUMMARIES OF
PUBLIC COMMENT

Advisory Group on Organizational Guidelines to the United States Sentencing Commission

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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.

<u>Questions</u>

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.

PUBLIC COMMENT SUBMITTED IN RESPONSE TO AUGUST 21, 2002 REQUEST BY ORGANIZATIONAL ADVISORY GROUP

American Chemistry Council
David T. Buente
Sidley Austin Brown & Wood LLP

American Express Company
John Parauda
Managing Counsel

Antitrust Law Section.
American Bar Association
Robert T. Joseph, Chair

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

Eastman Kodak Company
A. Terry VanHouten
Assistant General Counsel

Ethics Resource Center
Patricia J. Harned, PhD.
Managing Director of Programs

Health Care Industry Clients
David E. Matyas, Esq.,
Epstein, Becker & Green, P.C.

Joseph Murphy
Compliance Systems Legal Group

Novartis International AG
Peter Tobler
Group Compliance Officer

Pharmaceutical Companies
John T. Bentivoglio, Arnold & Porter
Brent L. Saunders, PricewaterhouseCoopers LLP

Philip Morris Companies, Inc
David I. Greenberg
Senior Vice President and Chief Compliance Officer

Probation Officers Advisory Group
Cathy A. Battistelli, Chair

Redmond, Williams & Associates
Arlene Redmond
Randy Williams

The Ombudsman Association
John S. Barkat, Ph.D., President

United Technologies Corporation
Patrick J. Gnazzo
Vice President of Business Practices

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 (<u>which may consist of periodic auditing of the effectiveness of the organization's compliance systems, as appropriate</u>) 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.

Advisory Group on Organizational Guidelines to the United States Sentencing Commission

Richard Bednar
Mary Beth Buchanan
Richard Gruner
Eric H. Holder, Jr.
Michael Horowitz
Charles Howard
Ron James
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Lisa A. Kuca
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Winthrop M. Swenson
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March 19, 2002

REQUEST FOR PUBLIC COMMENT

The United States Sentencing Commission has recently established a working group to review the general effectiveness of the Chapter Eight guidelines. The Sentencing Commission's charge states that particular emphasis should be given to the application of the criteria for an effective compliance program, and requests that the working group report back to the Commission with its recommendations as to any improvements that may be warranted. (See attached press release of February 21, 2002) This group, which will be known as the Advisory Group on Organizational Guidelines, recently convened and decided, among its first items of business, to solicit written public comment on the nature and scope of issues which the Advisory Group might wish to address during its (18) eighteen-month term.

Given the limited time and resources currently available, the Advisory Group does not intend to consider fines for environmental crimes committed by organizations, nor the structure of the fine tables generally. Instead, consistent with its mandate from the Sentencing Commission, the Advisory Group will primarily focus on the application of the criteria for an effective compliance program, as listed in Application Note 3(k) to '8A1.2 of the Sentencing Guidelines, and the ways in which those criteria affect the operation of Chapter Eight as a whole. The Advisory Group will also consider whether there are other features of the organizational guidelines that merit review or change.

Toward this end, the Advisory Group would welcome written comment from all interested individuals and organization on or before **May 20, 2002.** All submissions should be addressed to the Attention of the Advisory Group on Organizational Guidelines, c/o Office of Public Affairs, United States Sentencing Commission, Suite 2-500 South Lobby, One Columbus Circle, NE, Washington, D.C. 20002. (Fax 202 502 4699; Phone 202 502 4500).

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.

PUBLIC COMMENT SUBMITTED IN IN RESPONSE TO MARCH 19, 2002 REQUEST FOR COMMENT BY ORGANIZATIONAL ADVISORY GROUP

	Letter Dated
Alliance for Health Care Integrity Robert Olson, PhD, MPH Executive Director 1035 Winthrop Drive Corona, CA 92882-6178	**May 15, 2002**
American Bar Association Antitrust Section 750 North Lake Shore Drive Chicago, IL 60611	**June 27, 2002**
Arnold & Porter John T. Bentivoglio, Esq } 555 Twelfth Street, N.W. Washington, D.C. 20004 **PriceWaterHouseCoopers** } Brent L. Saunders 1301 K Street, N.W.,Suite 800 Washington, D.C. 20005	**May 20, 2002** On behalf of 18 pharmaceutical companies
Coalition for Ethics & Compliance Initiatives (CECI) Jay M. Cohen, Chair, Oversight Committee 1747 Pennsylvania Ave, N.W. Suite 400 Washington, D.C. 20006	**May 20, 2002**
de la Parte & Gilbert, P.A. Ronald A. Christaldi 100 E. Kennedy Blvd. Suite 3400 Tampa, Fl 33601	**May 20, 2002**
Ethical Leadership Group Steven Priest 1935 Schiller Avenue Wilmette, Illinois 60091	**May 16, 2002**

Ethics & Policy Integration **May 20, 2002**
Kenneth W. Johnson
1747 Pennsylvania Ave, N.W.
Suite 400
Washington, D.C. 20038

Ethics Resource Center **May 20, 2002**
Stuart Gilman, President
1747 Pennsylvania Ave, N.W.
Suite 400
Washington, D.C. 20006

Hale and Dorr LLP **May 20, 2002**
Kenneth R. Meade, Esq. } On behalf of Corporate Environmental Enforcement Counsel
1455 Pennsylvania Ave, N.W.
Washington, D.C. 20004

Johnson & Johnson **May 16, 2002**
Roger S. Fine,
Vice President & General Counsel
One J&J Plaza
New Brunswick, NJ 08933

LR Solutions **May 8, 2002**
Ray Nussbaum
CEO & General Counsel
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PriceWaterhouseCoopers LLP **May 20, 2002**
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Global Leader, Ethics & Business Conduct
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Sideman & Bancroft **May 23, 2002**
David P. Bancroft, Esq.
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Sidley Austin Brown & Wood LLP **May 20, 2002**
David T. Buente, Esq. } On behalf of the American Chemical Council
Christopher Bell, Esq.
1501 K Street, N.W.
Washington, D.C. 20005

Stewart & Stevenson — **May 16, 2002**
Kevin Teismann
Director, Business Practices
2707 North Loop West (77008)
PO Box 1637
Houston, Texas 77251

The Regence Group — **May 20, 2002**
Rosemary Reeve, Ass't VP &
Associate General Counsel }
Randall L. Romrell
Ass't VP, Corporate Ethics } On behalf of Blue Cross/Blue Shield plans in Northwest
& Compliance Officer And Mountain States
2890 East Cottonwood Parkway
Salt Lake City, Utah 84121

U.S. Office of Gov't Ethics — **May 20, 2002**
Amy Comstock, Director
1201 New York Avenue, N.W.
Suite 500
Washington, D.C. 20005

Washington Legal Foundation — **May 20, 2002**
2009 Massachusetts Ave, N.W.
Washington, D.C. 20036

ADVISORY GROUP ON ORGANIZATIONAL GUIDELINES PUBLIC COMMENT SUMMARIES

Arnold & Porter and PriceWaterhouseCoopers (18 pharmaceutical companies)

- emphasized bolstering incentives for companies to adopt and maintain effective compliance programs
- seven criteria provide a sound framework for compliance program, while preserving flexibility necessary for individual companies to design customized programs
- designing effective compliance program is an art rather than a science, reflecting that effective compliance programs must be customized to fit individual companies; thus, Commission wisely refrained from mandating precise details for implementation; thus, Government can fully harness the private sector's experience, expertise and energy and encourage innovation, all of which are particularly important because research regarding compliance is just beginning
- organizations should not be penalized for vigorous self-policing; thus, need to reduce disincentives for self-policing by embracing self-evaluative privilege
- whole concept of compliance programs is premised on clear rules with which to comply, particularly because clear rules result in meaningful compliance guidance for employees
- consider incorporating criteria similar to those by DOJ regarding the False Claims Act

Coalition for Ethics & Compliance Initiatives

- critical to hear from compliance practitioners
- employees fear coming forward without assurance of confidentiality; yet, organizations cannot assure confidentiality
- need to examine legal and regulatory rules, policies and procedures which can influence, assist, impede or prevent successful implementation of guidelines' requirements

de la Parte & Gilbert

Recommend specific language amendments:

- Application Note (k) to §8A1.2: In the second sentence, delete the words "the instant" and change "offense" to "offenses." This change would prevent the existence of other prior offenses from meaning that a compliance program is not effective; the number of past offenses is not, by itself, a true indicator of whether a program is effective, and such offenses should be considered as a, but not the only, factor in determining the effectiveness of a program.

- Application Note (k)(3) to §8A1.2: Delete "propensity to engage" and replace with "history of engaging." The "propensity to engage" in language indicates that an organization has a duty to identify those individuals with tendencies to engage in illegal activities; this directive suggests inappropriate profiling; an organization's compliance program should not be deemed ineffective for not identifying potential criminals before a crime is committed.

- Application Note (k)(6) to §8A1.2: In the first sentence, delete "detect an" and replace with "report a known." It is unreasonable to believe that each and every offense will be detected and prevented and to request that an organization discipline individuals for trying in good faith to detect, but nonetheless failing to detect, an offense. The focus should be on failing to report a known offense, not failing to detect an offense.

- Application Note (k)(7) to §8A1.2: Delete "all." The modifier "all" seems to put an inordinate burden on organizations to take response steps which may be duplicative or mutually exclusive to other response steps. Frequently, response steps result from choices among options, some of which are mutually exclusive thus "all" of the steps cannot be taken.

Ethical Leadership Group

- organizational culture must value ethical, responsible, law-abiding behavior

- employees don't know if ethics messages are to be believed, and companies are afraid to find out because it may be used against them in legal proceedings

- need to know employees' perception of ethics and compliance

- need to provide clearer guidance on role, responsibility, and resources required by ethics/compliance officer

- ethics officers should have a strong defined relationship with board of directors

Ethics Resource Center

- integrate ethics standards into all aspects of organization; thus, guideline should include details relating to effective implementation and integration of effective program

- need to regularly assess ethics program to determine current effectiveness and areas for program improvement and, thus, guideline should expand references to audits and monitoring to address the assessment of implementing and monitoring programs

- propose specific amendment that in order for a program to be deemed a good faith effort, it must include a regular assessment and demonstrate improvement in 1) employee

recognition of company values and standards, 2) employee awareness of reporting mechanisms and supports, 3) employee perception of existing pressure to commit misconduct, 4) communication of how the standards and values are integrated into daily decisions and actions of the organization, its management team and its employees, and 5) employee trust and confidence in the efficacy and safety of the reporting structures

- need evidence of a good faith effort to ensure that compliance systems are effectively implemented

Hale and Dorr (Corporate Environmental Enforcement Counsel)

- companies have used guideline to develop and enhance internal compliance programs; no need to amend

- Advisory Group should publish notice of solicitation of comments in the *Federal Register*

- Advisory Group should limit scope of review to that stated in Commission's charge

- strongly oppose any consideration of expansion of guideline to include social responsibility programs or "integrity and ethics based" systems

LR Solutions

Effective compliance learning requires:

- interactivity to ensure employee is learning proactively
- courses designed by experts and relevant to job performance
- learning by doing so employees can drill down core concepts
- on-line learning system with testing to verify successful learning
- solutions geared to particular needs of organizations
- use of these criteria to certify compliance training programs

Ken Johnson (Coalition for Ethics and Compliance Initiatives)

- guidelines should refer to importance of designing and implementing ethics and compliance programs premised on ethical organizational culture, not just comport with guidelines criteria, per Trevino article

- current standards are cost effective only for large businesses; challenges facing small to medium enterprise deserve special attention

Johnson & Johnson

- oppose guidelines starting down slippery slope of mandating ethical behavior or even trying to define what ethical means

- focus should be on criminal conduct and on programs designed to detect and prevent such conduct

- mistake to require a chief ethics officer and to require particular educational requirements for such a position

Office of Government Ethics

- retain seven criteria for effective compliance program

- support continuing flexible approach to what it means to be "effective" so customized ethics programs can be tailored to address unique issues

- seven criteria form foundation of executive branch ethics program

- benchmark compliance programs against programs and practices in the relevant industry

- instilling core values in employees ultimately critical to success of compliance program

PriceWaterhouseCoopers

- request further specificity on how the Commission applies the guideline in evaluating the effectiveness of a compliance program; specifically, it is unclear how an organization's adherence to §§8A1.2(k)(5) and 8A1.2(k)(6) is evaluated and greater clarity, via points of focus, would allow organizations to more confidently deploy appropriate systems and processes for monitoring and auditing and for ensuring consistent enforcement

- clarification of any intended requirement for organizations to measure the effectiveness of their programs and the definition of appropriate measures to do so would assist organizations in understanding how the guidelines evaluate effectiveness of a compliance program

- important to encourage organizations to undergo periodic risk assessment; without the protection of self-evaluative privilege, organizations often hesitate to conduct expanded self-evaluations, reviews, investigations and auditing programs, fearing that the uncovered information may be used against them

- §8C2.5(f): the participation in an offense by high-level personnel solely does not necessarily mean that the program is ineffective; evaluation of the compliance program

should consider the frequency of such an event and action taken by management upon occurrence or discovery; the culpability score should be calculated on a graduated scale (like in §8C2.(g))

<u>The Regence Group</u> (Blue Cross/Blue Shield plans in Northwest and Mountain States)

- Advisory Group should publicize ideas for improvement by providing a succinct summary of comments followed by a second request so as to sharpen the issues and allow for deeper, more meaningful feedback

- the "due care not to delegate substantial discretionary authority," per note 3(k)(3) to §8A1.2, piles subjective standard on top of subjective standard: a more workable standard would focus on what the company actually knows and what employees and applicants have actually done

- some government agencies have taken (initial) position that a compliance program cannot be effective without self-reporting

- appears to be a disconnect between guidelines' interpretation of "cooperation" and that employed by federal prosecutors; specifically, waiver of privilege and work product immunity required by DOJ creates a disincentive for companies to act aggressively to detect and deter improper conduct; it would be beneficial to recognize a federal self-evaluative privilege to encourage internal investigations

<u>Sidlely Austin Brown and Wood</u> (American Chemical Council)

Advisory Group should be guided by:

- guidelines should be limited to sentencing context and not expanded to address more general ethical issues; ethics should not be confused with criminal conduct thus guidelines should focus on compliance with legal requirements and effective systems preventing criminal behavior; even though guidelines have evolved as a template for the development of effective corporate compliance programs, the guideline should not be expanded for this purpose

- proposed changes should be based upon objective evidence and a demonstrable need for change; factual inquiry should focus on performance of organizations that have implemented guideline-based compliance systems; material changes should only be considered after a showing that the guidelines are flawed or defective and that there is a demand for change; guidelines are working well unless such evidence produced

- guidelines should be capable of being implemented by organizations of any size and sector and not become a compilation of best practices that smaller organizations may not be able to implement; any additional criteria for compliance programs should be at the

same level of general applicability as the current guidelines; reviewed other sources for obtaining compliance system direction; thus, Group should consider whether there is a "market need" for additional direction

- public comment should be sought through the *Federal Register*

Stewart & Stevenson

- senior executive should be actively engaged in compliance program (with suggested acts)

Sideman & Bancroft

- downward departure for "technical culpability" (low-level agent acting contrary to corporate policy) or "composite liability" (illegal synergism of various agents, even though none individually violated the law)

- upward departure where liability based upon execution of organizational policy that is itself a violation of the law

Washington Legal Foundation

- urge further public comment, particularly after Group reports to the Commission

- urge public meetings

- Advisory Group should have considered environmental guidelines; an advisory group should be established for those guidelines (§§2Q1.2 and 2Q1.3); at the least, Group should examine corporate compliance programs for those companies subject to environmental laws to determine their effectiveness relative to general organizational guidelines

- conduct extensive empirical research to determine effectiveness of corporate compliance provisions to answer whether corporate compliance programs outlined in the guidelines change behavior and reduce the incidence of violations

- Group should review as many corporate compliance programs and interview corporate counsel and officers to determine what works and what does not
- Group's membership does not fully represent corporate interests (i.e., no in-house counsel or corporate officers)

- Group should consider effectiveness of compliance programs in both context of strict liability system and negligence systems

Alliance for Health Care Integrity

- revise guidelines to integrate compliance and organizational ethics

- guidelines should strongly emphasize integrated compliance-ethics performance measures designed and verified by all major stakeholders (not just corporate representatives)

- Advisory Group should consider value of independent, multi-stakeholder body that can certify results of the above two recommendations

ABA Section of Antitrust Law

- eliminate §8C2.5(f) provisions relating 1) to participation of high level individuals and 2) to self-reporting

    - with an antitrust violation, because DOJ currently focuses on price-fixing, the violation will result from employees who have "pricing authority," who DOJ defines as high level employees, thus the §8C2.5(f) reduction is nullified as an incentive in the antitrust area; accordingly, Section recommends that the good faith of the organization be evaluated separately from identity of the perpetrators and the ultimate success of the compliance program; also encourages a reduction if an organization has implemented the seven criteria

    - self-reporting requirement does not promote compliance programs nor does it provide an incentive to implement them; in antitrust context, self-reporting is not an easy issue because companies may, in good faith, dispute market size, length of the conspiracy, and scope of involved products; decision to report may be detached from compliance program and instead focus on whether the company believes it can resolve dispute with the government; other regulatory factors also influence decision; instead of self-reporting, guidelines should look to whether company terminates illegal conduct

- requiring legal privileges waiver creates a disincentive to establish compliance programs and to self report; Section recommends amending guidelines to clarify that waiver is not necessary to gain cooperation credit under §8C2.5(g)

- a separate study should analyze whether antitrust violations should be treated differently from similar crimes in terms of calculating the base fine and thus examine whether there is empirical support for the current presumptions and what base fine calculation methodology would best promote the overall goals of the guidelines and antitrust laws

- §2R1.1 sets base fine for antitrust violation at 20 percent of the volume of commerce affected, independent of the actual harm caused; the Section believes that this is too gross an approximation and thus recommends that a study be conducted to evaluate the base

fine calculation methodology for antitrust offenses; according to the Section, the courts' broad construction of "volume of commerce affected" has compounded the potential inaccuracy of this calculation; the Section notes that there is no publicly available data to support the presumption and recommends that any review of the guideline should include such an empirical study

- in addition to its central criticisms that the base fine calculation is a gross approximation unsupported by empirical evidence, the Section identified several factors not accounted for in the current methodology: the type of antitrust agreement alleged, the extent to which the agreement was followed, the historical margins earned in the markets at issue, competition, the elasticity in demand for the product; contrary to the Application Notes, any resulting error can exceed the prescribed fine range and thus cannot be adequately accommodated within the fine range; consequently, antitrust violators are treated more severely than other white collar offenders

SUPPLEMENTARY
TESTIMONY

Johnson & Johnson

Roger S. Fine
Vice President and General Counsel
Member, Executive Committee

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October 28, 2002

B. Todd Jones, Chair
Advisory Group on Organizational Guidelines
To the US Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle, NE
Washington, DC 20002

Dear Mr. Jones:

This is in response to your letter of September 27 inviting me to appear to testify at your November 14th public hearing. In lieu of testifying, I am enclosing a copy of a letter I wrote to the Advisory Group on May 16th that was in response to your Request for Public Comment dated March 19, 2002. I do hope you will take our comments into account as you consider incorporating "ethical" standards into the Guidelines.

Sincerely,

Roger S Fine (L)

Roger S. Fine

Johnson & Johnson

Roger S. Fine
Vice President and General Counsel
Member, Executive Committee

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May 16, 2002

VIA FEDERAL EXPRESS

Advisory Group on Organizational Guidelines
c/o Office of Public Affairs
United States Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle, NE
Washington, D.C. 2002

To the Advisory Group on Organizational Guidelines:

I am the General Counsel of Johnson & Johnson, and submit this letter in response to the Advisory Group's Request for Public Comment dated March 19, 2002.

I understand that the Advisory Group has already received a number of comments urging changes to Application Note 3(k) to Section 8A1.2 of the Organizational Sentencing Guidelines, describing the criteria for an "effective program to prevent and detect violations of law." In particular, I understand that the Advisory Group has been urged to state that a program cannot be considered "effective" unless it deals with *ethical* violations, not just *legal* violations; and that a program cannot be considered "effective" unless it includes an ethics officer and/or a neutral ombudsman. I understand that at least one comment has suggested that a program cannot be considered "effective" unless it includes an ethics officer who completed at least three university courses in ethics.

I write in opposition to these suggestions. But first a word of background. Johnson & Johnson is an organization that takes ethics seriously. At the heart of our corporate culture is our statement of ethics, the Credo, which clearly sets out the responsibilities of each and every employee of the Company. Many companies have statements of ethics, I know. But it is hard for me to convey to you the overarching influence the Credo exerts on everything we do in the Johnson & Johnson family of companies, and the extent to which it is woven into the fabric of everyday life here – through constant education, discussion, and leadership by example. We understand that sometimes the law is just the floor, not the ceiling. We know that the Credo often demands more than the law requires. We struggle with tough moral issues. We use

the Credo as our guide. We strive to behave fairly, ethically, honorably. And when we fall short, we step forward to pay for our mistakes, and we do what we can to make things right.

So it should be no surprise that we have extensive programs at Johnson & Johnson designed to inculcate the Credo's values into our employees around the world. Put another way, we do ethical compliance, not just legal compliance.

But it would be profoundly wrong for the Advisory Group to *require* that every organization include ethics as a part of its compliance program, or risk having its program considered "ineffective" under the Sentencing Guidelines. The Organizational Sentencing Guidelines are simply not the place for the government to start down the slippery slope of mandating "ethical" behavior – or even to try to define what "ethical" may mean.

The Advisory Group is not considering the general, theoretical question of whether it's a good idea for ethics to be part of a compliance program. These are *sentencing* guidelines we are talking about, for which there are *criminal* consequences. The Advisory Group's focus should be on criminal conduct, and on programs designed to detect and prevent that criminal conduct.

Johnson & Johnson has *chosen* to include ethics in its compliance activities. We have *chosen* to hold our employees to standards higher than the law requires. But the government has no authority to define those higher standards or to require adherence to them. It is not the government's place to mandate that we be virtuous or moral or high-minded – or to define what virtue, morality, or high-mindedness is. It is the government's place to require that we obey the law. The Organizational Sentencing Guidelines is no place for a back-door requirement that organizations behave "ethically" or punish those employees who do not.

Similarly, it would be a mistake for the Advisory Group to require a chief ethics officer or ombudsman (and certainly a mistake to require particular educational requirements for such a position). Such a requirement would elevate form over substance: it is possible to have an ethics officer on the organizational chart, but a poor ethics program in fact, and it is also possible to have a strong ethics program with no single officially-designated ethics officer. At Johnson & Johnson, for example, we have consciously considered and rejected having a chief ethics officer or ombudsman. That is because we have worked so hard to create an organization in which each person is an ethics officer – in which each person is obligated to wrestle with ethical dilemmas and share them with co-workers and supervisors, rather than defer the question to the judgment of some office at corporate headquarters. In our case, putting in place a chief ethics officer or ombudsman would actually degrade our ethical climate. It would be a shame if we were forced to choose between maintaining the most ethical organization

we can, and complying with a one-size-fits-all approach enshrined in the Organizational Guidelines.

Thank you for your consideration.

Sincerely,

Roger S. Fine

November 8, 2002

Advisory Group on Organizational Guidelines
C/O Office of Public Affairs, US Sentencing Commission
Suite 2-500 South Lobby
One Columbus Circle, NE
Washington, DC 20002
Attn: Michael Courlander

Dear Mr. Courlander:

LRN, The Legal Knowledge Company is pleased to have the opportunity to respond to the Advisory Group on Organizational Guidelines' Request for Additional Public Comment Regarding the U.S. Sentencing Guidelines for Organizations. We commend the Advisory Group for its thoughtful and timely request for comment on this important issue.

As a provider of online legal, ethics and compliance training for Global 1000 corporations, we have had the opportunity to work with and understand the needs of some of the largest companies in the world when trying to increase legal and ethical knowledge throughout their workforce. In that regard, we therefore respond below to those questions raised by the Advisory Group specifically relating to training on legal, ethics and compliance issues.

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The Legal Knowledge Company™

Question 1.e.

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. §999 et seq.?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?"

Response:

As many of the public comments have already noted, the strength of the Organizational Guidelines lies in their flexibility. This flexibility should also apply to the standards used to measure how effectively the organization communicated its standards and procedures to all employees and other agents. Thus, the "necessary components" of "communicating effectively" may vary significantly from organization to organization, but they all should have the same goal: to make employees aware of and understand the organization's standards and procedures.

Rather than impose on all organizations a requirement that they both require participation in training programs and that they disseminate publications, the Guidelines

should remain illustrative and not prescriptive as to what constitutes an effective communications system. Moreover, with the advent of Web-based and other electronic communications, the distinction between "training programs" and "publications" has blurred. And by focusing simply on the disjunctive or conjunctive implications of the single conjunction "and" or "or," an organization could easily lose sight of the larger point of the internal communications process—namely that it be *effective*. In other words, not only did the organization physically reach its intended audience with the communication, the audience also understood the content of the communication.

In that regard, we suggest that Comment 3(k)(4) could do more to provide guidance as to what constitutes an effective communications process. It should therefore address more fully two issues: (1) additional illustrative examples of training, publications or other forms of communications, and (2) examples of how an organization may demonstrate that its system of communication effectively reached the desired audience.

We therefore suggest that Comment 3(k)(4) provide additional examples of the types of communications that may be used to implement an effective communications process. Examples could include the organization's intranet or website, online and Web-based training, e-mail notices, and "disconnected learning," such as CD-ROM or downloadable media. Each could play a role in an effective system for communicating the organization's standards and procedures.

The Guidelines recognize that all the communication in the world is useless unless that communication is also effective. However, the Guidelines and comments remain relatively silent concerning how to measure that effectiveness. Comment 3(k)(4) should also provide guidance to organizations as to how the effectiveness of the communications process can be measured. Again, illustrative examples—and not prescriptive standards—of the mechanisms that may be used to demonstrate employee awareness and comprehension of the organization's compliance standards and procedures provide the most flexibility.

Examples of such guidance may include

- certifications by employees (either written or electronic) that they have received and understood the organization's standards and procedures; and
- examination or testing of the knowledge provided by the organization to the employee.

We therefore suggest that Comment 3(k)(4) be amended to read as follows:

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, by disseminating publications that explain in a practical matter what is

required, or by other forms of communications. Such other forms may include the organization's Website or intranet, e-mail, online or Web-based training programs, workshops, or other electronic media.

The effectiveness of an organization's communications may be demonstrated through one or more mechanisms, as appropriate, such as by acknowledgement or certification by the employee that he has received and understands the organization's standards and procedures, or via a testing method.

Question 6

Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to insure 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 in the organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of chapter 8?

Response

The notion of examining an organization's ethical culture is not entirely unique or new in a regulatory scheme. For example, in the securities industry it is not unheard of for the securities regulators to examine the "tone at the top" set by management with regard to the system of financial reporting and internal controls. Thus, even if an organization's standards and procedures are communicated, to the extent technicalities are emphasized over substance, the securities regulators have felt free to criticize that tone. Thus, should senior management fail to set the appropriate tone--and a securities violation has occurred--the securities regulators may point to that evidence to infer the organization's failure to establish adequate internal controls.

Similarly, much of the Organizational Guidelines' comments relate to the effective communication of compliance standards and procedures. Many of these standards and procedures are based on fundamental ethical principles, as the convergence of compliance and ethics is already discernible in the business world. Indeed, the Sarbanes-Oxley Act was, to an extent, an attempt to legislate the creation of ethical cultures within organizations where that convergence had not yet occurred. In addition, the securities regulators have proposed a code of ethics for senior executives and directors for publicly-traded companies, and any waivers of such codes must be disclosed. Encouragement of an ethical culture in the Guidelines seems like the next logical step.

But that step should be taken cautiously.

For example, it may be appropriate to examine the extent management has set the proper "tone at the top" fostering compliance. One element of such a tone could be whether the organization, as part of its effective communications process, has addressed

ethics in those communications. To that extent, Comment 3(k)(4) could be amended to include, as another example of effective communications, information or training relating to ethics.

The Guidelines serve as a flexible tool for both regulators and organizations that has thus far fostered the development of successful compliance programs. However, the balance between that flexibility and the structure needed to provide concrete guidance could easily be disrupted by a legally prescribed ethics component. Ethics is about more than simply following a set of legal requirements. It is about the distinction, to paraphrase Justice Potter Stewart, between that which you have a right to do and that which is right to do.

While we fully support the guidelines encouraging the development of an ethics initiative, there is an inherent risk in mandating a program. Once ethics is mandated, it is no longer about ethics, it is about compliance with a requirement. As a result, there is an inherent risk of downgrading the ethics discussion from one about doing right to one about formulaic satisfaction with Guidelines requirements.

* * *

LRN appreciates the opportunity to participate in the Advisory Group's discussion and analysis of the Organizational Guidelines and the preparation of its report to the Sentencing Commission. We hope these comments will be useful.

Sincerely,

Dov

Dov Seidman
Chairman and Chief Executive Officer

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WRITTEN TESTIMONY©
By Lynzy Wright, Legal Criminalist

When I received the Request for Additional Public Comment regarding Chapter Eight, I was elated about the opportunity to submit public comment. However, upon reviewing the Questions presented by the Advisory Group of the Commission, I realized that our vision for corporate criminal liability compliance differed from that of the Advisory Group and the Commission. Therefore, instead of addressing the Questions posed, recommendations for amendments to Chapter Eight of U.S. Sentencing Guidelines will follow for your review.

These suggested amendments arise from many years of participation in corporate compliance, both internally and externally. Our goal remains preventive in nature, and, yet, structured. Any business entity, whether small or large, public or private, must constantly strive for compliance and lawfulness at the expense of heavy fines, possible jail time and felony prosecution of, not just the organization, but the officers and directors of the business entity. As you well know, most legal business entities are specifically designed to limit the liability of its officers and board of directors and those designs have

been pivotal to the growth of United States business commerce. The future of compliant and lawful business entities lies in our hands and we must rise to the occasion by implementing a new Chapter Eight designed to bring compliance and lawfulness to fruition.

REPLACEMENT RECOMMENDATIONS

§8A1.2, comment 3(e)

An individual "condoned" an offense if the individual knew of the offense and did not take reasonable steps to prevent the offense, terminate the offense or report the offense to the corporate criminal liability compliance officer of the organization.

§8A1.2, comment 3(j)

An individual was "willfully ignorant of the offense" if the individual did not investigate nor advise the corporate criminal liability compliance officer of the possible occurrence of unlawful conduct despite knowledge of circumstances that would lead a reasonable person to investigate or advise whether unlawful conduct had occurred.

§8A1.2, comment 3(k)(2)

A specific individual within high-level personnel of the organization must be designated as corporate criminal liability compliance officer, who accepts full responsibility and possesses complete authority from organization to oversee compliance with such standards and procedures. This compliance officer reports to the president ONLY and shall fulfill the role of designated company-authorized representative for all external and internal claims inquiries, lawsuits and administrative proceedings involving the organization outside of the purview of inside or outside counsel for the organization.

§8A1.2, comment 3(k)(4)

The organization must have taken steps to communicate effectively its compliance standards and procedures to all employees and other agents, e.g. by publicizing internally and externally the name of the corporate criminal liability compliance officer, requiring participation in training programs relating to prevention, reporting and investigation of criminal conduct and disseminating publications that explain in an informative manner the procedures to follow relating to compliance.

§8A1.2, comment 3(insert)

"Corporate criminal liability compliance officer" means the designated individual within the organization who possesses the investigative, civil, criminal and administrative law expertise to deter organizational criminal conduct.

§8B1.2(insert)

The organization shall be required to submit mandatory compliance reporting to the Court for a minimum period of two (2) years and designate a corporate criminal liability compliance officer.

§8C2.5(b)(insert)

If the organization had between 1 and 10 employees and an individual with substantial authority participated in, condoned, or was willfully ignorant of the offense, add 1 point.

§8C2.5(insert)

Ineffective Program to Prevent and Detect Violations of Law

If the offense occurred and the program to prevent and detect violations of law was grossly inadequate and willfully ignored by the majority of the high-level personnel of the organization, add 10 points.