

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

1. REMEDYING HARM FROM CRIMINAL CONDUCT

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2. PREVENTING AND DETECTING VIOLATIONS OF LAW

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

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

(1) Exercise due diligence to prevent and detect violations of law; and

(2) otherwise promote and organizational culture that encourages a commitment to the ethical principles that inform, law

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

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

(1) The organization shall establish ethics and compliance standards and procedures to prevent and detect violations of law, as well as to promote an organizational culture committed to ethical principles.

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

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

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

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

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

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

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

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

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(5) The organization shall take reasonable steps—

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

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- (i) are designed to prevent and detect violations of law and ethical principles that inform law, and
- (ii) function at all levels and in all functions of the organization, including, but not limited to, the executive and governing authority level;

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

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

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

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

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

Commentary

Application Notes:

1. Definitions. For purposes of this guideline:

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

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

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

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

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

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

(A) In General.—Each of the requirements set forth in subsections (a) and (b) shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, the organization shall consider factors that include (i) the size of the organization, (ii) applicable government regulations, and (iii) any ethics and compliance practices and procedures that are well-documented as standard or model practices for businesses similar to the organization.

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(B) The Size of the Organization.—

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

3. *Application of Subsection (b)(2).*—

(A) *Governing Authority.*—The responsibility of the governing authority under subsection (b)(2) is to exercise reasonable oversight of the organization's efforts to ensure compliance with the law and ethical principles that inform law. In large organizations, the governing authority likely will discharge this responsibility through oversight, whereas in some organizations, particularly small ones, it may be more appropriate for the governing authority to discharge this responsibility by directly managing the organization's ethics and compliance efforts.

(B) *Executive-Level Personnel.*—The organization has discretion to delineate the activities and roles of the specific individual(s) within executive-level personnel of the organization assigned overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles; however, the individual(s) must be able to carry out their overall and direct responsibility consistent with subsection (b)(2), including the ability to report on the effectiveness and operation of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, to the governing authority, or to an appropriate subgroup of the governing authority.

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In addition to receiving reports from the foregoing individual(s), the governing authority or an appropriate subgroup thereof typically should receive at least annually information on the implementation and effectiveness of the program to detect and prevent violations of law, as well as to promote an organizational culture committed to ethical principles, from the individual(s) with day-to-day operational responsibility for the program.

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(C) *Organizational Leadership.*—Although the overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent

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

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4. Application of Subsection (b)(3).—

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

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

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

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

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

- (i) *The nature and seriousness of such violations of law.*
- (ii) *The likelihood that certain violations of law or ethical principles that inform law may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of violations of law or ethical principles that inform law may occur, the organization shall take reasonable steps to prevent and detect those types of violations of law or ethical principles that inform law. For example, an organization that, due to the nature of its business, handles toxic substances shall establish ethics and compliance standards and procedures designed to ensure that those substances are always handled properly. An organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish ethics and compliance standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its business, employs sales personnel who have the flexibility to represent the material characteristics of a product shall establish ethics and compliance standards and procedures designed to prevent fraud. Furthermore, an organization shall establish ethics and compliance standards and procedures designed to prevent corporate malfeasance that may result from the decisions of executive management and governing authority.*
- (iii) *The prior history of an organization. The prior history of an organization may indicate types of violations of law or ethical principles that inform law that it shall take actions to prevent and detect. Recurrence of similar violations of law or ethical principles that inform law creates doubt regarding whether the organization took reasonable steps to prevent and detect violations of law or ethical principles that inform the law.*
- (B) *Prioritizing, periodically as appropriate, the actions taken under each step set forth in subsection (b), in order to focus on preventing and detecting the violations of law or ethical principles that inform law identified under subdivision (A) as most likely to occur and most serious.*
- (C) *Modifying, as appropriate, the actions taken under any step set forth in subsection (b) to reduce the risk of violations of law or ethical principles that inform law identified in the risk assessment.*
- (D) *Assessing at least annually one or more of these characteristics of organizational culture: executive decision making process, impact and/or outcome of this process through use of an "ethics impact report," level of organizational trust, public image, relative disparity in employee compensation, bottom-line mentality and others that are well-documented in the literature.*

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

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

* * *

CRAIG DREILINGER, Ph.D.

LICENSED PSYCHOLOGIST

(301) 229-3434, 6508 80th Street, Cabin John, MD 20818-1209

January 25, 2004

United States Sentencing Commission
One Columbia Circle, NE
Suite 2-500, South Lobby
Washington, DC 20002

RE: Proposed Chapter 8 Amendments to the United States Sentencing
Commission

Dear Commissioners:

I write in response to the Commission's request for comments regarding the proposed amendments to Chapter 8 of the Federal Sentencing Guidelines and very much appreciate the opportunity to do so. I am a licensed clinical and consulting psychologist whose practice focuses on assisting organizations to introduce and implement significant changes at the workplace. I am also the cofounder of the Ethics Officer Association, which currently has more than 800 members, and have worked for 19 years as a consultant to organizations engaged in introducing, implementing, and evaluating broad-based ethics and compliance initiatives.

The Commission has proposed a new guideline at §8B2.1 Effective Program to Prevent and Detect Violations of Law, and, as part of that, has established two obligations of an effective compliance program—i.e., the exercise of due diligence and the promotion of an organizational culture that encourages a commitment to compliance. My experience is that culture always trumps specific rules or guidelines that aim to influence behavior in organizations. Therefore, this enormously significant addition will directly contribute to the efforts of ethics and compliance officers throughout the United States. I would, however, urge that the Commission add the phrase "and shared accountability," so that the final wording reads, ". . . promotion of organizational culture that encourages a commitment to and shared accountability for compliance throughout the organization." Taken even further, this phrase might read, ". . . that promotes an organizational culture that encourages a commitment to compliance and that expects all employees to hold themselves and one another personally accountable for ethical and legal conduct." The benefit of incorporating accountability into the wording is that it will provide specific direction to the construct of organizational culture. It will, in effect, tell ethics and compliance officers and, more significantly, their superiors and other organizational stakeholders that a commitment to compliance is one in which all employees hold themselves and each other accountable for specific types of behavior. Organizational culture is much more than what senior management "says." In its truest form, it is a reflection of what employees actually "do."

Again in §8B2.1 the Commission defined the purpose of a compliance program to be, in part, "taking reasonable steps to prevent illegal conduct in organizational activities." I would urge the Commission to consider changing the phrase "illegal conduct" to "violations of law," in all mentions (e.g., including §8B2.1 (a) (b), etc.). The Commission's words, when published, will be read closely and carefully. The term "violations of law" creates a subtle but potentially very significant change in the spirit of that statement in two ways. First, the "violations of law" has, in common usage, a much broader implication than the phrase "illegal conduct" and speaks to the Commission's increased focus on getting organizations to speak to the spirit, not simply the letter, of the guidelines. Second, many tend to think of violations of law as something to prevent (i.e., before they occur) and illegal conduct as something to address (i.e., after it occurs).

Part of proposed guideline §8B2.1 (i.e., subsection (b) (2)) speaks to the role of "high level personnel of the organization" who shall "be assigned direct, overall responsibility to ensure the implementation and effectiveness of the program to prevent and detect violations of law." The guideline, in part, speaks to the requirement that these individuals engage in periodic meetings with the "governing authority or an appropriate subgroup of the governing authority." I would urge the Commission to make two changes to the wording of this statement.

First, change "periodically" (i.e., as stated in the Commentary) to "quarterly" and consider stating that as part of the guideline itself. The danger of using the term "periodically" is that it may, de facto, encourage adherence to the letter but not the spirit of this proposed guideline. As I have observed so many times, organizations and their management rarely embrace change simply because they believe it is the right thing to do. Most often, they embrace change when the "cost" for not doing so becomes too great. Providing senior level managers with specific guidance in this and other areas takes into account the fact that many will, at least initially, not embrace the spirit of the guidelines and will, instead, comply with the most narrow definition (i.e., that definition that requires the least change) instead. I assume that the goal of this proposed guideline (and others) is to provide the structure and clarity necessary to ensure that the behavioral change the Commission seeks not only becomes habit on the part of those organizations that are affected by the Federal Sentencing Guidelines but that they also adopt the right kind of habit.

Second, I would urge the Commission to add the phrase (provides the high level person) with "overall responsibility for ensuring the implementation of the program with direct access to the governing authority in between designated meetings." The goal of this modification is to ensure that person has access on an as needed basis (i.e., when he or

she specifically believes such contact is necessary) in addition to regularly scheduled access. As before, my experience is that, at least initially, engaging in the culture change the Commission aims to engender will be facilitated by as much clarity as can be provided without becoming too rigid or unnecessarily constraining. Put even more bluntly, unless this is stated in the final wording, it is most unlikely to ever occur in the real world of organizations. Further, and equally important, that high-level person must have, and indeed be mandated to, meet with the governing authority or the appropriate subgroup in private, and I would urge the Commission to rewrite the proposed text to reflect that. All too often I have been witness to meetings such as these where the responsible person changes what he or she might otherwise say to the members of the governing authority (almost always in the direction of being less candid than might otherwise occur or than the situation actually requires) when his/her superiors or other more senior level people are present in the room.

Regarding proposed guideline §8B2.1 subsection (b) (4), I recommend that the Commission take this further and specifically extend the training requirement to upper levels of the organization. Even more important, I recommend that this phrase require that the training upper-level individuals participate in be of the same length and depth as the training in which others within the organization participate. Too often ethics and compliance training for the broad employee population is “condensed” for senior managers, either because they claim, or because others presume, that their time is “too valuable” to do otherwise. The nature of the training that senior managers take part in may be different from the nature of the program that employees take part in, and that is as it should be—but not the length (and, therefore, the commitment it symbolically speaks to). So, for example, when I designed and helped facilitate training for employees, managers, and senior managers at Pacific Bell, following a series of widely publicized unethical and illegal sales practices during the 1980s, we required training for senior managers be of the same length as that of first level supervisors. We did, however, change the orientation of the training for senior managers to focus on their unique ability to build and maintain an ethical work culture throughout the organization.

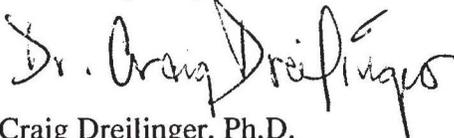
Proposed guideline §8B2.1 subsection (b) (5) would require organizations to take reasonable steps to periodically evaluate the effectiveness of their programs to prevent and detect violations of law. Measuring the effectiveness of a compliance and ethics programs has been the subject of enormous debate for years. Central to that debate is the question, “How do we define effectiveness?” The Commission’s guidelines could help provide direction in answering that question. Ultimately, the effectiveness of any training should be measured by its impact in changing employee’s behavior (or sustaining and maintaining desired behavior). So, for example, an evaluation that simply reports the number of calls to the Hotline as a measure of effectiveness often masks the real truth. The program may be completely effective or completely ineffective regardless of the

number of calls received. If training results in changed behavior, it works. If it doesn't, it does not.

Regarding the unreasonable delay in self-reporting by organizations (Section 8C2.5 (f)), which mandates a three point reduction in the culpability score for effective compliance programs if the organization delays unreasonably in reporting offenses, I urge the Commission to maintain this as it is currently described. As stated previously, organizations typically only change when the penalties associated with not changing become too great. The more personal and consequential those changes are, the more likely behavior will change. This is not meant to represent a Machiavellian view of management or of organizations in general, nor to suggest that senior managers are really Rasputins in disguise, waiting for opportunities to say, in effect, "If it's not prohibited, then I can do it." Rather, the argument is that providing specific, concrete guidance regarding requirements and consequences is much more likely to produce the desired behavior than anything that does not.

I hope that these comments are relevant and useful and speak to some of the issues the Commission hopes will be addressed during the public comment period. I would be most interested in testifying before the Commission in person if the benefit of my experience would be of help.

Yours very truly,

A handwritten signature in black ink that reads "Dr. Craig Dreilinger". The signature is written in a cursive, somewhat stylized font.

Craig Dreilinger, Ph.D.
Clinical and Consulting Psychologist

cc: Paula Desio, Deputy General Counsel

**Ethics & Policy
Integration
Centre**

1717 K Street, NW • Suite 600
Washington, DC 20036-5346
(202) 547-1789 ~ FAX: (202) 517-9108
info@Ethics-Policy.net
<http://www.EPIC-Online.net>

28 January 2004

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

Re: Response to Request for Public Comment on Amendments to Chapter Eight

This letter and attachment are offered in response to the Commission's request for public comment. I have consulted internationally on ethics and compliance programs since 1993 with an emphasis on program evaluation and good governance in emerging market economies. My practice has involved evaluating ethics and compliance programs for the U.S. Air Force under its Voluntary Disclosure Program and work with the Maryland Mediation and Alternative Conflict Resolution Office on a national project to evaluate public policy programs.

We believe that, on balance, the proposed changes/additions reflect well-considered evaluation of the corporate experience in designing and implementing an effective program to prevent and detect violations of the law ("compliance programs"). We are confident that the provisions, such as those aimed at achieving a culture of commitment to compliance, will provide greater guidance to organizations and courts regarding the criteria for evaluating such programs.

There are areas, however, where we think they can be improved as set forth in the following pages and the attachment. We think three issues are important enough to warrant further discussion and request the opportunity to address the Commission: (1) prominent display of the requirements for program evaluation, (2) prominent recognition of the challenges of designing and implementing ethics/compliance programs for small to medium enterprises, and (3) promising confidentiality to encourage employees to come forward with their concerns.

Sincerely,



KENNETH W. JOHNSON
Director,
Ethics & Policy Integration Centre

Attachment: Proposed Amendments/EPIC Recommendations

cc: Paula Desio Deputy General Counsel

A. Require a more active, policy role for the governing authority

It is helpful to distinguish between governance and management and ensure that both aspects of organization life are covered by the Federal Sentencing Guidelines for Organizations (FSGO). We recommend that the FSGO make more explicit that the governing authority has an active role in—and responsibility for—requiring and setting broad guidance for the compliance program.

The source of a corporate board's authority is the owners of the enterprise.¹ The board is the pivotal authority. Its authority is neither granted nor defined by management. Policies generated by the board control everything, both governance and management.

In practice, however, the board is often considered an advisor to management rather than its source of authority. Indeed, many recent corporate ethics failures in the U.S. can be traced to the failure of boards to exercise their authority as representatives of the owners.

The FSGO should require a more active board role. See e.g., *IN RE CAREMARK INTERNATIONAL INC. DERIVATIVE LITIGATION*, 698 A.2d 959 (Del.Ch. 1996) where Chancellor Allen noted the Federal Sentencing Guidelines for Organizations and expressed the view that “a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists.”

The Chancellor also said such a reporting system should be designed to provide “timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with laws and its business performance.”

This more active role of the governing authority should be reflected in three areas:

- Recommendation: §8B2.1 subsection (b)(1) Include term “governing policies,” to read:

“The organization shall establish governing policies and compliance standards and procedures to prevent and detect violations of law.”

¹ John Carver and Caroline Oliver, *Corporate Boards that Create Value: Governing Company Performance from the Boardroom* (San Francisco: Jossey-Bass, 2002), pp. xxi-xxii.

- Recommendation: §8B2.1 subsection (b)(2): Change order to place governing authority first in order, then organizational leadership and provide that governing authority shall:

- (1) Set policy for the compliance program
- (2) Ensure that the compliance program meets its own requirements for information

See proposed language in the attachment.

- FSGO 3 Recommendation: §8B2.1 subsection (b)(3): define members of the “governing authority” as “substantial authority.”

B. Provide for a more active role for organizational leadership

- Recommendation: §8B2.1 subsection (b)(2): require that they also demonstrate commitment to the compliance program as a matter of leadership. See proposed language in the attachment.
- Recommendation: §8B2.1 subsection (b)(4): Include statements of the organizational leadership demonstrating their commitment to the program as examples of appropriate communication. See proposed language in the attachment.

C. Include requiring the senior personnel administering the compliance program to have access to the governing authority

As presently drafted, subsection (b)(2) requires only that the “high-level responsible officer” report to the board. In practice, such an officer often does not administer the program. Indeed, the “ethics/compliance officer,” is frequently not the responsible officer, yet has significant insight into the operations of the compliance program. We recommend that this division of authority be recognized in the guidelines. See proposed language in the attachment.

D. Integrate risk assessment and program evaluation in §8B2.1(c)

The provision requiring risk assessment is a positive development, but it should be expanded to require that the risk assessment be translated into specific expected program outcomes and the program be regularly evaluated to determine whether the program is effective at meeting expect outcomes.

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Where the corresponding commentary specifies that organizations must prioritize the actions taken to implement an effective compliance program and modify such actions in light of the risks identified in the risk assessment, this can best be done with reference to expected program outcomes.

In the same vein, the requirement for program evaluation should be removed from subsection (b)(5) and placed in §8B2.1(c). The provisions for auditing, monitoring, and reporting in subsection (b)(5) are internal to the program itself. Evaluation of the program itself is not aimed at compliance per se, but rather the program effectiveness. Program evaluation is more akin to risk assessment and establishing program outcomes. For example, subsection (b)(1) is informed by the risk assessment in §8B2.1(c). It could be a part of that subsection, but is properly some that must be done to inform the “steps” required in the program. See the attachment for proposed language.

E. Do not require training in subsection §8B2.1(b)(4)

The importance of subsection (b)(4) is that the [governing policy and] compliance standards and procedures be adequately communicated, not that any particular form be required. Especially for the small to medium enterprise (SME), training may not be the best or most cost-effective way to proceed. Without more definition, requiring training invites training merely for the sake of meeting a requirement. Furthermore, if any communication is advisable, it is that the organizational leadership communicate its commitment to the program.

We recommend retaining the “e.g.,” but add the language extending the scope of training and including “statements of organizational leadership demonstrating commitment,” or words to that effect. See the attachment for proposed language.

F. Add language requiring that a program offer a promise of confidentiality where appropriate and enforceable at law

The proposed amendment replaces the existing reference to “reporting systems without fear of retribution” with the more specific requirement for the implementation of “mechanisms to allow for anonymous reporting.” The FSGO should follow the relevant provision in Sarbanes-Oxley, which requires a “confidential, anonymous” reporting mechanism.² As has been pointed out in the

² Under Section 301 of the Sarbanes-Oxley Act of 2002, audit committees are required to establish procedures for receipt of complaints by employees:

(4) COMPLAINTS- Each audit committee shall establish procedures for--

literature, this precise wording is grammatically problematic, but the intent reflects experience that the appropriate officials will gain more information where they are able to promise confidentiality than when they only offer anonymity. See proposed language in the attachment.

G. In all steps other than §8B2.1(b)(1) refer to “compliance standards and procedures,” not “violations of law”

Since an organization must establish adequate compliance standards and procedures to “prevent and detect violations of law”, the test thereafter should be whether they have adequate structures, systems, procedures, and practices to follow those standards and procedures. For example, the mechanism to seek guidance and report concerns will be more valuable if employees and other agents can raise issues of compliance standards and procedures precisely because they are designed to prevent and detect actual violations.

Therefore, after successfully complying with §8B2.1(b)(1), references in steps 5, 6, and 7, in particular, should refer to these compliance standards and procedures, not just to violations of law.

H. In all steps after §8B2.1(a) refer to “compliance program”

We further recommend that in §8B2.1(b)(1) the cumbersome term “program to prevent and detect violations of law” be described as a “compliance program” thereafter.

I. Response to Issue Number 1: Self-reporting should be treated as a rebuttable presumption

The Commission requests comment regarding whether the prohibition should be eliminated so that an organization could be considered for the reduction under §8C2.5(f) regardless of whether the organization unreasonably delayed reporting the offense after its detection.

In our view, elimination of this prohibition may be appropriate to encourage organizations to implement compliance programs without having to deal *ab initio*

(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

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with the issue of self-reporting. Self-reporting as a matter of policy is problematic for many counsel in view of the “litigation dilemma” so well discussed in the Advisory Group’s report. While we feel strongly that organizations should both self-report and remedy any harm they cause, it is also our view that the two factors (an “effective program” and “self-reporting”) should not be bound together except where the failure to self-report tends to indicate that the program was not effective.

If this is followed, however, the reduction in the culpability score under §8C2.5(f) for an effective program to prevent and detect violations of law currently should remain at three.

J. Response to Issue Number 4: Provide a separate provision re: the challenges to the small to medium enterprise (SME)

The Commission asked whether there were factors or considerations that could be incorporated into Chapter Eight (Sentencing of Organizations), particularly §8C1.2, to encourage small and midsize organizations to develop and maintain compliance programs?

Domestically and around the globe, approaching ethics and compliance programs for the small to medium enterprise (SME) has been challenging. While there are references to these challenges throughout the guidelines, we recommend that an additional section, §8B2.1(d), be added to give specific guidance to the judiciary. The Commission’s doing so will be particularly helpful to those making the case for the SME ethics/compliance program as they will be able to point to a separate provision addressing the SME.

We recommend language and commentary covering the following points:

Each small to medium enterprise (“SME”)³ is unique, often taking on the character of its owners and managers. There is surprisingly little research ethics and compliance programs for the SME. Moreover, it is difficult, at best, to generalize the SME experience.

In most economies, SMEs provide the bulk of jobs, especially new jobs, and contribute significantly to the welfare of their communities because they are so closely connected. On the other hand, SMEs often lack the capital, staff, or time of large, complex enterprises (“LCEs”) to address many business

³ There are many definitions of the SME, especially the small enterprise. The World Bank definition of the small enterprise is under 300 employees, while the U.S. Small Business Agency definition is 500 employees.

issues. For example, tracking and meeting changing laws and regulations are relatively more costly for the SME.

Though many of the best practices developed over the last two decades reflect the experiences of LCEs, the process of developing standards, procedures, and expectations is the same for all enterprises. The answers for each enterprise will depend upon the size and complexity of the enterprise itself. The goal for the SME, then, is not to duplicate the standards, procedures, infrastructure, practices, and expectations of LCEs, but to learn from them—and to improve them.

SMEs have an additional incentive to adopt the discipline of responsible business conduct: to create a wider commercial network. Where owners and managers embrace the global language of responsible business through a Business Ethics Program, a network of business enterprises and supportive NGOs based on shared values is possible. Such a network allows the individual SME to develop some of the synergies and economies of scale that only larger enterprises can afford.

Due to resource limitations, most small to medium enterprise (“SME”) program strategy and planning will be informal. Owners and managers will be less apt to use formal teams and processes to set goals, objectives, strategies, and action plans than large enterprises. Nonetheless, they can adapt the processes and best practices of LCEs to meet their circumstances.⁴

The following table is included in the forthcoming work identified above intended to address the concerns of SMEs. We do not recommend that it be included in the Guidelines, but it is illustrative of what may be possible.

⁴ This language summarizes various provisions in a forthcoming work, Kenneth W. Johnson and Igor Y. Abramov, *Business Ethics: Manual on Managing the Responsible Business Enterprise in Emerging Market Economies* (Washington, D.C.: Government Printing Office, 2004).

Business Ethics Infrastructure SME Conversion Chart	
Function	Typical SME Staffing
High-level responsibility for program oversight (the “Responsible Officer”)	Often an owner, but another highly respected employee, who has substantial authority in the enterprise, is preferable.
Performing or coordinating the specific functions of the Business Ethics Program (the “Business Ethics Officer”)	<p>Typically, a respected staff member performs or coordinates the functions of the Business Ethics Officer.</p> <p>An SME can form or join a business association to develop training materials and provide a forum for managers to discuss ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>The SME can employ an independent answering service to provide a mechanism for employees and agents to seek advice or report concerns anonymously.</p> <p>The SME can use an outside service to conduct a periodic evaluation of its Business Ethics Program.</p>
Advising the Responsible Officer and Business Ethics Officer that represents the enterprise as whole (“Business Ethics Council”)	<p>An SME can conduct regular meetings of all or representative employees, perhaps 30-60 minutes per meeting, once a month, to discuss enterprise core beliefs; standards, procedures, and expectations; and current ethics, compliance, and social responsibility issues.</p> <p>A medium enterprise, especially one with multiple locations, can appoint</p>

Business Ethics Infrastructure SME Conversion Chart	
Function	Typical SME Staffing
	<p>members to such a council, but meet regularly by telephone.</p> <p>An SME can form or join a business association to provide a forum to discuss current ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>A college, university, or business development council might host a forum for SMEs.</p> <p>A large enterprise can, and often should, host a forum for its suppliers and service providers to address the requirements of its program.</p>
<p>Advising the Responsible Officer, Business Ethics Officer, and employees and agents about professional ethics, compliance and social responsibility issues, most often seen in hospitals, (“Professional Ethics Council”)</p>	<p>An SME can conduct regular meetings of all or representative professionals, perhaps 30-60 minutes, once a month, to discuss enterprise core beliefs, standards, procedures, and expectations on current professional ethics, compliance, and social responsibility issues.</p> <p>A medium enterprise, especially one with multiple locations, can appoint members to such a council, but meet regularly by telephone</p> <p>An SME can form or join a business association to develop training materials and provide a forum to discuss current professional ethics, compliance, and social responsibility issues, problems, and solutions.</p> <p>A college, university, or business</p>

Business Ethics Infrastructure SME Conversion Chart	
Function	Typical SME Staffing
	<p>development council can host a forum for SMEs.</p> <p>A large enterprise might host or sponsor a forum for its suppliers and service providers.</p>
<p>Individuals at various levels of the enterprise who link a central ethics office with the field (“Business Conduct Representatives”)</p>	<p>For the SME, these may be respected, knowledgeable staff members at its various levels or locations, who have the right to communicate directly with the Owner/Owner-representatives, Responsible Officer, or Business Ethics Officer on responsible business conduct issues: ethics, compliance, and social responsibility.</p> <p>These Business Conduct Representatives can also conduct responsible Business Conduct training and education and assist in program evaluation at local levels.</p>
<p>Related executive and department functions, such as the Chief Financial Officer; Legal Counsel; Human Resources; Internal Audit; Environmental, Health and Safety; government procurement; and Investor Relations</p>	<p>The SME often uses trusted, independent professionals to perform many of these functions. If so, they should participate in enterprise responsible business conduct training programs and, where practicable, its discussions of current ethics, compliance, and social responsibility issues.</p> <p>These independent professionals can form their own independent forums to discuss current ethics, compliance, and social responsibility issues.</p> <p>They may also be engaged to advise SME owners and managers on how to</p>

Business Ethics Infrastructure SME Conversion Chart	
Function	Typical SME Staffing
	design and implement a Business Ethics Program using this Manual and other resources. Provided they respect the confidences and proprietary information of each SME, they can amortize the cost of providing these services over multiple clients.
The individual responsibility of every employee and agent of the enterprise to abide by the standards and procedures and strive to meet reasonable stakeholder expectations	Individual responsibility of employees and agents applies to all enterprises regardless of size. In the SME, it may be difficult for employees to seek advice or report concerns confidentially and anonymously. Owners and managers of SMEs must work to develop an organizational culture where employees and agents are able to speak up confidently and safely.



SPECIFIC PROPOSALS FOR AMENDMENTS TO THE DEFINITION OF AN “EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW”

DEFINITION OF AN “EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW”			
Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>Background</p>		<p>Consequently, the new guideline at §8B2.1 proposed by the Advisory Group contains separate subdivisions describing several important characteristics of an effective compliance program:</p> <ul style="list-style-type: none"> • the purpose of a compliance program and the importance of preventive due diligence and organizational culture in carrying out such a program (§8B2.1(a)); • the seven minimum attributes that should be present in all compliance programs (§8B2.1(b)); and • the need for risk assessments and related compliance program adaptation as a basis for constructing and operating a generally effective program to prevent and detect violations of law (§8B2.1(c)). 	<p>Needs assessment is properly recognized as necessary for an effective compliance program. It provides the factual basis for each step. No less important—in the same vein—is for the organization to establish expected program outcomes <i>and</i> regularly evaluate the compliance program to determine whether it was effective. A program is unlikely to hit targets it does not explicitly aim for.</p> <p><i>Epic Recommendation</i></p> <p>In implementing subsection (b), the organization shall conduct ongoing risk assessment; take appropriate steps to design, implement, or modify each step set forth in subsection (b) to reduce the risk of violations of law identified by the risk assessment; and regularly evaluate its program with reference to specific expected program outcomes. (§8B2.1(c)).</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
	<p>(k) <i>An "effective program to prevent and detect violations of law" means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct. Failure to prevent or detect the instant offense, by itself, does not mean that the programs was not effective. The hallmark of an effective program to prevent and detect violations of law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents.</i></p>	<p>§8B2.1(a) To have an effective program to prevent and detect violations of law, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—</p> <p>(1) exercise due diligence to prevent and detect violations of law; and</p> <p>(2) otherwise promote an organizational culture that encourages a commitment to compliance with the law.</p> <p>Such program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting violations of law. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting violations of law.</p>	<p><i>Epic recommendation</i></p> <p>§8B2.1(a) To have an effective program to prevent and detect violations of law ..., an organization shall—</p> <p>....</p> <p><u>Due diligence includes governing policies; risk assessment; designing and implementing compliance structures and systems; communication and feedback; aligning operations; and evaluating and learning from the compliance program's governing policies, standards, and procedures.</u></p> <p>Such program, hereinafter referred to as a "<u>compliance program,</u>" shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting violations of law. The failure to prevent or detect the instant offense leading to sentencing does not necessarily mean that the program is not generally effective in preventing and detecting violations of law.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>What norms, values and standards should we set to guide our members and foster reasonable expectations among our stakeholders?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(1) <i>The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.</i></p>	<p>§8B2.1(b) (b) Due diligence and the promotion of an organizational culture that encourages a commitment to compliance with the law within the meaning of subsection (a) minimally require the following steps:</p> <p>(1) The organization shall establish compliance standards and procedures to prevent and detect violations of law.</p> <p>Application Note</p> <p>Under this definition, "compliance standards and procedures" are and internal control systems that are reasonably capable of reducing the likelihood of violations of law." This definition emphasizes that standards of conduct and internal controls are essential aspects of effective compliance programs and that these measures should be developed, implemented, and evaluated in terms of their impact on reducing the likelihood of violations of law.</p>	<p>To encourage more governing authority involvement in the compliance program, require that the governing authority set "governing policy" for the compliance program.</p> <p><i>Epic recommendation</i></p> <p>(1) The organization shall establish <u>governing policy and compliance standards</u> and procedures to prevent and detect violations of law.</p> <p>Commentary</p> <p><u>The governing authority shall establish policy governing a compliance program to prevent and detect violations of law and the organizational leadership shall establish consistent compliance standards and procedures addressing its identified risks, which are consistent with its organizational culture.</u></p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>What style, structure, and systems of authority and responsibility at all levels should we exercise?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(2) <i>Specific individuals within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.</i></p>	<p>§8B2.1(b)(2) The organizational leadership shall be knowledgeable about the content and operation of the program to prevent and detect violations of law.</p> <p>The organization's governing authority shall be knowledgeable about the content and operation of the program to prevent and detect violations of law and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program to prevent and detect violations of law.</p> <p>Specific individual(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to ensure the implementation and effectiveness of the program to prevent and detect violations of law. Such individual(s) shall be given adequate resources and authority to carry out such responsibility and shall report directly to the governing authority or an appropriate subgroup of the governing authority regarding the implementation and effectiveness of the program to prevent and detect violations of law.</p>	<p><i>Epic recommendation</i></p> <p>§8B2.1(b)(2) <u>The organization's governing authority shall establish the guiding policy for the organization's program to prevent and detect violations of law, be knowledgeable about its design and exercise reasonable oversight with respect to its implementation and effectiveness.</u></p> <p><u>The organizational leadership shall be knowledgeable about the design of a compliance program consistent with the governing policy and support its operation.</u></p> <p>Specific individual(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to ensure the implementation and effectiveness of the compliance program. <u>The organization may also use responsible personnel to administer the compliance program. Both such individual(s) shall be given adequate resources and authority to carry out their responsibility and shall report directly to the governing authority or an appropriate subgroup of the governing authority as set forth in governing policy regarding the implementation and effectiveness of the compliance program directly.</u></p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we ensure that we have the right people in the right places to pursue our purpose as an enterprise?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(3) <i>The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of reasonable due diligence, had a propensity to engage in illegal activities.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has a history of engaging in violations of law or other conduct inconsistent with an effective program to prevent and detect violations of law.</p> <p>Application Note</p> <p>Definition of "substantial authority."</p>	<p>Agreed</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>What norms, values and standards should we set to guide our members and foster reasonable expectations among our stakeholders?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(1) <i>The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.</i></p>	<p>§8B2.1(b) (b) Due diligence and the promotion of an organizational culture that encourages a commitment to compliance with the law within the meaning of subsection (a) minimally require the following steps:</p> <p>(1) The organization shall establish compliance standards and procedures to prevent and detect violations of law.</p> <p>Application Note</p> <p>Under this definition, "compliance standards and procedures" are and internal control systems that are reasonably capable of reducing the likelihood of violations of law." This definition emphasizes that standards of conduct and internal controls are essential aspects of effective compliance programs and that these measures should be developed, implemented, and evaluated in terms of their impact on reducing the likelihood of violations of law.</p>	<p>To encourage more governing authority involvement in the compliance program, require that the governing authority set "governing policy" for the compliance program.</p> <p><i>Epic recommendation</i></p> <p>(1) The organization shall establish <u>governing policy and compliance standards and procedures to prevent and detect violations of law.</u></p> <p>Commentary</p> <p><u>The governing authority shall establish policy governing a compliance program to prevent and detect violations of law and the organizational leadership shall establish consistent compliance standards and procedures addressing its identified risks, which are consistent with its organizational culture.</u></p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>What style, structure, and systems of authority and responsibility at all levels should we exercise?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(2) <i>Specific individuals within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.</i></p>	<p>§8B2.1(b)(2) The organizational leadership shall be knowledgeable about the content and operation of the program to prevent and detect violations of law.</p> <p>The organization's governing authority shall be knowledgeable about the content and operation of the program to prevent and detect violations of law and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program to prevent and detect violations of law.</p> <p>Specific individual(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to ensure the implementation and effectiveness of the program to prevent and detect violations of law. Such individual(s) shall be given adequate resources and authority to carry out such responsibility and shall report directly to the governing authority or an appropriate subgroup of the governing authority regarding the implementation and effectiveness of the program to prevent and detect violations of law.</p>	<p><i>Epic recommendation</i></p> <p>§8B2.1(b)(2) <u>The organization's governing authority shall establish the guiding policy for the organization's program to prevent and detect violations of law, be knowledgeable about its design and exercise reasonable oversight with respect to its implementation and effectiveness.</u></p> <p><u>The organizational leadership shall be knowledgeable about the design of a compliance program consistent with the governing policy and support its operation.</u></p> <p>Specific individual(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to ensure the implementation and effectiveness of the compliance program. <u>The organization may also use responsible personnel to administer the compliance program. Both such individual(s) shall be given adequate resources and authority to carry out their responsibility and shall report directly to the governing authority or an appropriate subgroup of the governing authority as set forth in governing policy regarding the implementation and effectiveness of the compliance program directly.</u></p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we ensure that we have the right people in the right places to pursue our purpose as an enterprise?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(3) <i>The organization must have used due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of reasonable due diligence, had a propensity to engage in illegal activities.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has a history of engaging in violations of law or other conduct inconsistent with an effective program to prevent and detect violations of law.</p> <p>Application Note</p> <p>Definition of "substantial authority."</p>	<p>Agreed</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we most effectively communicate our standards and procedures and foster reasonable expectations among our stakeholders?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps: . . .</i></p> <p>(4) <i>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.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture . . . minimally require the following steps:</p> <p>(4) (A) The organization shall take reasonable steps to communicate in a practical manner its compliance standards and procedures, and other aspects of the program to prevent and detect violations of law, to the individuals referred to in subdivision (B) by conducting effective training programs and otherwise disseminating information appropriate to such individual's respective roles and responsibilities.</p> <p>(B) The individuals referred to in subdivision (A) are the members of the governing authority, the organizational leadership, the organization's employees, and, as appropriate, the organization's agents.</p>	<p>Agree with (b), but prefer original language. Epic is concerned about requiring training. This tends to suggest that formal training is the best means of communicating organizational standards and procedures. This is not necessarily true, especially for small to medium enterprises. Emphasizing the general importance of training can best be described in Application Note.</p> <p>Provision is awkwardly drafted, including circular reference to "individuals."</p> <p>The recommended language below expands the elements of an effective program and expands the list of target audiences to include suppliers and service providers, which is an emerging best practice.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we most effectively communicate our standards and procedures and foster reasonable expectations among our stakeholders?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps: . . .</i></p> <p>(4) <i>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.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture . . . minimally require the following steps:</p> <p>(4) (A) The organization shall take reasonable steps to communicate in a practical manner its compliance standards and procedures, and other aspects of the program to prevent and detect violations of law, to the individuals referred to in subdivision (B) by conducting effective training programs and otherwise disseminating information appropriate to such individual's respective roles and responsibilities.</p> <p>(B) The individuals referred to in subdivision (A) are the members of the governing authority, the organizational leadership, the organization's employees, and, as appropriate, the organization's agents.</p>	<p>Agree with (b), but prefer original language. Epic is concerned about requiring training. This tends to suggest that formal training is the best means of communicating organizational standards and procedures. This is not necessarily true, especially for small to medium enterprises. Emphasizing the general importance of training can best be described in Application Note.</p> <p>Provision is awkwardly drafted, including circular reference to "individuals."</p> <p>The recommended language below expands the elements of an effective program and expands the list of target audiences to include suppliers and service providers, which is an emerging best practice.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
			<p><i>Epic recommendation</i></p> <p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(4) The organization shall take reasonable steps to communicate its compliance standards and procedures, and other aspects of the program to prevent and detect violations of law. An effective communication program shall involve:</p> <p>(A) <u>A balance of formal and informal means of communication that reflects the organization's style of leadership, resources available, and organizational culture: e. g., leaders declaring support for the compliance program, requiring participation in training programs, or disseminating publications that explain what is required of individuals, and</u></p> <p>(B) Communication of governing policy and compliance standards and procedures, as appropriate, to all members of the organization, including its governing authority, leadership, and employees, as well as its agents and suppliers or service providers.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we know that our members are following our standards and procedures and meeting reasonable stakeholder expectations?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>(5) <i>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 by criminal conduct by others within the organization without fear of retribution.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(5) The organization shall take reasonable steps—</p> <p>(A) to ensure that the organization's program to prevent and detect violations of law is followed, including using monitoring and auditing systems that are designed to detect violations of law;</p> <p>(B) to evaluate periodically the effectiveness of the organization's program to prevent and detect violations of law; and</p> <p>(C) to have a system whereby the organization's employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms that allow for anonymous reporting.</p>	<p><i>Epic Recommendation</i></p> <p>(5) The organization shall take reasonable steps—</p> <p>(A) To ensure that the organization's compliance program is followed, including using monitoring and auditing systems that are designed to detect its compliance standards and procedures; and</p> <p>(B) To have a system whereby the organization's employees and agents may <u>report or seek guidance regarding potential or actual violations of its compliance standards and procedures without fear of retaliation, including mechanisms that allow for anonymous reporting and promises of confidentiality, where appropriate and enforceable as a matter of law.</u></p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How can we encourage our members to follow our standards and procedures and meet the reasonable expectations of our stakeholders?</p>	<p>(k) ... Due diligence requires at a minimum that the organization must have taken the following types of steps:</p> <p>(6) The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.</p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(6) The organization's program to prevent and detect violations of law shall be promoted and enforced consistently through appropriate incentives to perform in accordance with such program and disciplinary measures for engaging in violations of law and for failing to take reasonable steps to prevent or detect violations of law.</p>	<p><i>Epic recommendation</i></p> <p>(6) The organization's <u>compliance program</u> shall be promoted and enforced consistently through appropriate incentives to perform in accordance with said program and disciplinary measures for <u>violating its compliance standards and procedures</u> or failing to take reasonable steps to prevent or detect violations thereof.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>What do we owe our stakeholders when mistakes, misconduct, or misunderstandings occur that involve our standards and procedures or their reasonable expectations?</p>	<p>(k) . . . <i>Due diligence requires at a minimum that the organization must have taken the following types of steps:</i></p> <p>7) <i>After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law.</i></p>	<p>§8B2.1(b) Due diligence and the promotion of an organizational culture ... minimally require the following steps:</p> <p>(7) After a violation of law has been detected, the organization shall take reasonable steps to respond appropriately to the violation of law and to prevent further similar violations of law, including making any necessary modifications to the organization's program to prevent and detect violations of law.</p>	<p>If an organization must self-report violations of law to receive credit for having an effective program, recommend including that as a required response.</p> <p><i>Epic recommendation</i></p> <p>(7) After a violation of it compliance <u>standards and procedures</u> has been detected, the organization shall take reasonable steps to respond appropriately and prevent similar violations, e. g., including self-reporting a violation of law to appropriate authorities and making any necessary modifications to the its compliance program.</p>

DEFINITION OF AN "EFFECTIVE PROGRAM TO PREVENT AND DETECT VIOLATIONS OF LAW"

Basic Questions	Existing Provisions	Proposed Amendment	Epic Recommendations
<p>How should we monitor, track, and report our performance as an enterprise, and continuously learn from it?</p>		<p>§8B2.1(c) In implementing subsection (b), the organization shall conduct ongoing risk assessment and take appropriate steps to design, implement, or modify each step set forth in subsection (b) to reduce the risk of violations of law identified by the risk assessment.</p>	<p>Needs assessment is properly recognized as necessary for an effective compliance program. It provides the factual basis for each step. No less important—in the same vein—is for the organization to establish expected program outcomes and regularly evaluate the compliance program to determine whether it was effective. A program is unlikely to hit targets it does not explicitly aim for.</p> <p><i>Epic Recommendation</i></p> <p>§8B2.1(c) In implementing subsection (b), the organization shall conduct ongoing risk assessment; regular program evaluation with reference to specified expected program outcomes; and take appropriate steps to design, implement, or modify each step set forth in subsection (b) to prevent and detect violations of law.</p>

February 20, 2004

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

Attention: Public Affairs.

This letter is on behalf of the Ethics Resource Centers (ERC) Fellows Program. The Fellows Program is made up of corporate, academic, non-profit and government representatives who focus on questions of ethics in business. The Fellows Program appreciates the opportunity to comment and the tremendous effort that both the Ad Hoc Advisory Group and the entire United States Sentencing Commission have spent in clarifying and modifying the current organizational sentencing guidelines.

There are many excellent improvements that the proposed guidelines offer. We think the change in §8B2.1(b)(3) is a good one. The new language in this section and the commentary to this section, provide a much more objective standard by which to judge the substantial authority personnel.

The change to §8C2.5(f)(3) is also a positive change. We think creating only a rebuttable presumption as to the effectiveness of the program based on high-level personnel participation in the alleged misdeed provides a more balanced approach. Rogue employees can be found at all levels and if only one of many high-level employees acts contra to the program the entire program should not be discounted.

The Fellows Program does have some concerns with several of the proposed changes. The following sections will discuss the concerns, plus propose possible modifications.

Expanding the definition of Violation of Laws:

Under the current Chapter 8 Guidelines, §8A1.2, Application note (k), the Sentencing Commission defines an "effective program to prevent and detect violations of law" as "a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct." This is the requirement that organizations have been basing their compliance and ethics effort on for the past thirteen years. It is also logical and consistent with the mission of the United States Sentencing Commission, to focus on criminal conduct.

The Fellows Program does have some concern about the proposed §8B2.1, Application note 1 definition of the concept “violations of law”. The proposal would expand the scope of violations of law to include, “criminal or noncriminal (including a regulation) for which the organization is or would be liable, or in the case of Application note 4(A), for which the individual would be liable.”

Part of the rationale for expanding the definition is cited in the Ad Hoc Advisory Group’s Report (pp.54):

The consideration of an organization’s prior efforts and success in preventing violations of law beyond just criminal offenses is consistent with existing provisions of the organizational sentencing guidelines that treat prior civil and administrative offenses (§8C2.5(c)) and prior misconduct leading to restrictive court orders (§8C2.5(d)) as relevant sentencing considerations justifying elevated organizational fines.

Closer inspection of these current Guideline provisions may not justify the expansion of violations of laws to include “violation of any law, whether criminal or noncriminal (including a regulation) for which the organization is or would be liable. §8C2.5(c) currently states:

If the organization (or separately managed line of business) committed any part of the instant offense less than ten years after (A) a criminal adjudication based on similar misconduct; or (B) civil or administrative adjudication(s) *based on two or separate instances of similar misconduct* (emphasis added by author) ...

§8C2.5(d)(1) Violation of an Order seems to provide even less of a rationale for expanding the definition of laws to include criminal and noncriminal. This section states:

(A) If the commission of the instant offense violated a judicial order or injunction, other than a violation of a condition of probation; or (B) if the organization (or separately managed line of business) violated a condition of probation by engaging in *similar misconduct* (emphasis added by author) to that for which it was placed on probation.

While these sections do mention prior civil or administrative offenses, and violations of orders, they require separate instances of SIMILAR MISCONDUCT. This is potentially very different than the proposed expansion of violation of law to include any criminal or noncriminal violations.

Since the Sentencing Guidelines recognize that you can still have a violation when you have an effective program, it would be unfair for organizations to not receive credit for their program due to any civil compliance weakness. An organization could conceivably have an effective program to prevent and detect violations of the Foreign Corrupt Practices Act and still have an FCPA violation. Under the existing Guidelines, you would still be able to prove due diligence and gain the benefit of having a program. But

under the proposed amendments, you could lose that benefit if you did not also have a program for something as unrelated as appropriately training your groundskeepers to assure compliance with local regulations regarding interfering with wildfowl nesting areas. While this may be important, failure to conduct this type of training should not be an indictment of your compliance program, sufficient to affect the organization's sentencing for an FCPA violation.

Recommendation: Keep the status quo and do not expand the definition of "violation of law" to include noncriminal (including a regulation) offenses.

Risk Assessment:

The Fellows Program acknowledges that assessing risks for criminal violations is at least an implied part of the current guidelines, but has a concern about how "risk assessment" has become a formal requirement of an effective program to prevent and detect a violation of laws. This is especially true, if the concept of violation of laws would be expanded to include both criminal and noncriminal laws. §8B.2(c) states, "In implementing subsection (b), the organization shall conduct ongoing risk assessment and take appropriate steps to design, implement, or modify each step set forth in subsection (b) to reduce the risk of violations of law identified by the assessment."

The Fellows foresee two potential problems with the proposal: (1) scope, and (2) formality. Regarding scope, it would be extremely difficult to evaluate all laws, both criminal and noncriminal. The formality of the term "risk assessment" conjures up a very detailed and extensive analysis of every possible criminal and noncriminal risk. The Fellows would prefer the concept of "assessing the relevant risks" be used in place of the term risk assessment.

Recommendation: Eliminate §8B.2(c), and amend §8B.2.1(b)(1) to state, "The organization shall assess the relevant risks, then establish compliance standards and procedures to prevent and detect violations of law."

Confidentiality:

§8B.2.1(b)(5) states that the organization shall take reasonable steps: "(C) to have a system whereby the organization's employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms that allow for *anonymous reporting*." The Fellows Program commends the Sentencing Commission for recognizing the importance of anonymous reporting, but would encourage the Commission to follow the Sarbanes-Oxley Act of 2002 in its call for reporting which is either confidential or anonymous. §301 (m)(4) of the Sarbanes-Oxley Act of 2002, defines an audit committee's duty to include, "Complaints – Each audit committee shall establish procedures for ...(B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."

In this section of the Sarbanes-Oxley Act of 2002, Congress saw the wisdom in requiring either “confidential” or “anonymous” submissions. These terms may appear identical, but in reality could have a very different meaning. “Anonymous” reporting typically means that a company can not disclose the identity of reporting sources, because they do not know their identity. “Confidential” usually means that a company does know the identity of reporting sources, and tries to protect their identity. This could be done by removing all information from a report that would identify the reporting source. All of the remaining information would be available for review by other parties, both within and outside the organization.

It may be preferable to have “confidential” reporting because the person receiving the information (e.g. ombuds, ethics officer, human resources, legal, or compliance officer) can use the face to face conversations to establish a trusting relationship, address misconceptions and gather additional information. It is also much easier to have follow-up conversations with the reporting source when their identity is known. This type of program has effectively been implemented at major corporations like United Technologies and they have successfully protected the reporting source’s identity, even when sought through litigation.

Recommendation: To be consistent with the Sarbanes-Oxley Act of 2002, the Fellows would request that the Sentencing Commission change proposed §8B2.1(5)(C) to read “to have a system whereby the organization’s employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms that allow for *confidential*, anonymous reporting.

Managerial Oversight:

The Proposed Guidelines §8B2.1(b) (2) states, "The organizational leadership shall be knowledgeable about the content and operation of the program..." Given the importance of ethical leadership, the statement that "the organizational leadership shall be knowledgeable about the content and operation of the program" could be much stronger. Simply sending a report to the executive team once a year could be seen as satisfying that requirement.

Recommendation: §8B2.1(b)(2) language should be changed to: “The organizational leadership shall provide direction to and be knowledgeable of the content and operation of the program.”

Consistent Discipline:

Proposed §8B2.1 (b)(6) focuses on incentives and disciplinary measures. First, it is difficult to provide "incentives" for legal compliance. It does not make sense to most people to "reward" day to day legal or ethical conduct. Rather, this section should focus more on the messages sent by standards and procedures about what is rewarded and punished in the organization.

Recommendation: §8B2.1(b)(6) language should be changed to: "Compliance with the law ...shall be encouraged and supported consistently through standards and procedures that holds employees accountable for appropriate conduct and incorporates such accountability into regular promotion and compensation decisions. In addition, legal compliance should be enforced through appropriate disciplinary measures for engaging in violations of the law and for failing to take reasonable steps to prevent or detect violations of the law."

Internal Controls:

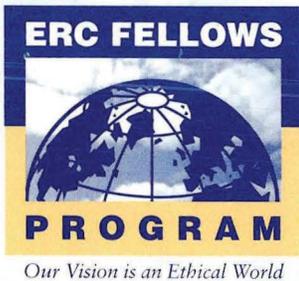
§8B2.1 Application note 1 defines compliance standards and procedures as "standards of conduct and internal control systems that are reasonably capable of reducing the likelihood of violations of law." The Fellows Program believes that effective internal controls can be an important part of a program to prevent and detect violations of law for large and small organizations. Instead of referring to "internal controls systems", the Commission should consider the more generic term of "internal controls" as a process. Many small organizations may not have adopted a formal internal control system (such as COSO), but still need effective internal controls (e.g. segregation of duties or requiring two signatures to authorize a check).

Recommendation: §8B2.1, Application Note 1, should change the words "internal controls systems" to "internal controls".

One final request would be that the United States Sentencing Commission work with the Department of Justice to make information available to the business community about what, if any, credit is given to organizations with an effective program to prevent and detect violations of law in charging decisions and criminal settlements. Most large corporations that have violations settle before trial. This information could be extremely helpful to ethics and compliance officers in demonstrating the positive impact their programs had with their discussions with the Department of Justice.

The ERC Fellows Program understands that the US Sentencing Commission is considering a public hearing on the proposed changes on March 17, 2004. The Fellows Program would be very happy to have a representative testify at that hearing.

Regards,
Mr. Stephen D. Potts, Esq.
Chairman
ERC Fellows Program



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Who Are the ERC Fellows?

Chairman

Stephen D. Potts, Esq.

Former Director, U.S. Office of Government Ethics

Vice-Chair

Carol R. Marshall

Former Director of Ethics and Compliance, Lockheed Martin Corporation

Convenor

Stuart C. Gilman, Ph.D.

President, Ethics Resource Center

Founding Chairman

Norman R. Augustine

Former Chairman, Lockheed Martin Corporation

Endowment

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Vice President, Corporate Compliance and
Regulatory Affairs
Archer Daniels Midland Company

Jacqueline Brevard

Chief Ethics Officer
Merck & Co., Inc.

Bill Smith

Ethics Operations
General Dynamics

Nigel Thompson

Exec. Dir., Economic and Development Strategy
Merck & Co., Inc.

Stephen I. Kasloff

Vice President, Ethics Officer
Guardsmark, LLC

Anne Marie Taylor

Associate Ethics Officer
Merck & Co., Inc.

Nancy Higgins

Vice President, Ethics and Business Conduct
Lockheed Martin Corporation



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Ethics Resource Center Fellows Program

1747 Pennsylvania Avenue, NW • Suite 400 • Washington, DC 20006
PH 202.737.2258 • FX 202.737.2227 • ethics@ethics.org • www.ethics.org

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Supporting Fellows

Bill Geiger
Group Vice President
Compliance & Corporate Counsel
AEGON USA Corporation

Kathryn Reimann
Chief Compliance Officer
American Express Company

Thomas McCormick
Director, Global Ethics & Compliance
Dow Chemical Company

Jeff Braun
Attorney, Office of General Counsel
General Motors Corporation

Thomas Gottschalk
General Counsel and Senior Vice President
General Motors Corporation

Patricia J. Ellis
Director, Business Ethics & Compliance
Raytheon Company

David LaJoie
Director, Ethics Program Development
Raytheon Company



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Fellows

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

Thomas Mayer
Director, Office of Business Practices
Caterpillar, Inc.

Allen Stewart
Director, Ethics and Compliance
Duke Energy Corporation

Deborah Severs
Chief Ethics Officer
Eaton Corporation

Sam Piazza
Director, Office of Business Practices
Hewlett Packard

Margaret Sperry
Senior Vice President and
Chief Compliance Officer
Massachusetts Mutual Life Insurance
Company

Robert Echols
Director, Global Compliance
Monsanto Company

Oliver Quinn
Department Vice President
Enterprise Ethics Office
Prudential Financial

R. Stephen Ayers
Director of Corporate Contracts
Science Applications International Corporation

Jo Pease
Corporate Ethics and Compliance Officer
Shell Oil - U.S.

Dennis Jorgensen
Senior Vice President, Ethics, Business
Conduct & Administration
Tenet Healthcare Corporation

Earnie Broughton
Ethics Office Coordinator
USAA

Patrick Gnazzo
Vice President, Business Practices
United Technologies Corporation



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Invited Fellows

Michael G. Daigneault
Former President
Ethics Resource Center

Richard S. Shreve
Adjunct Professor of Business Ethics
Tuck School of Business, Dartmouth College

George G. Brenkert
Georgetown Business Ethics Institute
Georgetown University

Linda Treviño
Professor of Organizational Behavior
Pennsylvania State University

Bart Victor
Cal Turner Chair of Moral Leadership
The Owen Graduate School of Management
Vanderbilt University

Gary Weaver
Associate Professor of Management
University of Delaware

Patrick E. Murphy
Director, Institute for Ethical Business
Worldwide
University of Notre Dame

Frank Vogl
President
Vogl Communications

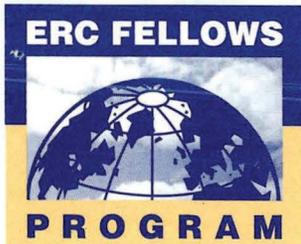
Paul Fiorelli
Professor of Legal Studies
Xavier University

Non-Profit Center Members

W. Michael Hoffman
Executive Director
Center for Business Ethics
Bentley College

Ed Petry
Executive Director
Ethics Officer Association

Rushworth Kidder
President
Institute for Global Ethics



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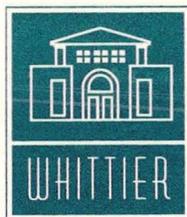
Government Office Liaisons

Paula J. Desio
Deputy General Counsel
United States Sentencing Commission

Barbara B. Hannigan
Ethics Counsel
Securities Exchange Commission

Jack Covaleski
Deputy Director for Agency Programs
U.S. Office of Government Ethics

Gaston Gianni
Inspector General
Federal Deposit Insurance Corporation



WHITTIER LAW SCHOOL
Faculty Offices

February 26, 2004

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

Dear Mr. Courlander,

I am writing to submit several brief comments on the Sentencing Commission's proposals for revisions to Chapter 8 of the federal sentencing guidelines which were published in the Federal Register edition of December 30, 2003. As a member of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines, it was my pleasure to have participated in the detailed review of Chapter 8 of the sentencing guidelines conducted by the Advisory Group over the past year and to have contributed to the recommendations of the Advisory Group which were delivered to the Sentencing Commission in the Advisory Group's report of October 7, 2003. To the extent that many of the Advisory Group's recommendations are reflected in the Sentencing Commission's proposed guideline changes, the Advisory Group's report amply describes the justifications for these changes. I fully support the Advisory Group's recommendations and statements of rationales for its proposed changes in the sentencing guidelines and write here only to comment on those aspects of the Sentencing Commission's proposals that concern issues not considered and addressed by the Advisory Group and its report.

These additional issues were raised in the Sentencing Commission's description of issues for comment in the portion of the above federal register notice dealing with organizational sentencing. Each of the issues for comment raised in this portion of the notice is addressed below.

Compliance Program Characterization in Cases of Unreasonable Reporting Delay

The first issue for comment concerns whether the guidelines' current bar to a three-point culpability score reduction for an effective compliance program should be retained for a convicted organization which unreasonably delays in reporting a detected offense. In essence, this current standard indicates that a

In service of justice and enterpriseSM

5535 Harbor Boulevard • Costa Mesa, CA 92626-1501
Tel. 714.444.4141 • Fax 714.444.1854

compliance program in an organization which unreasonably delays reporting should never be deemed an effective program for purposes of determining organizational culpability and the appropriate level of a corresponding sentence reduction.

I believe that, so long as the nature of an unreasonable delay is assessed carefully, the present standard characterizing a compliance program as deficient in these circumstances should be retained. It is important to realize in assessing the impact of this standard that a mere delay in reporting will not always preclude a finding of an effective program. Indeed, there are a wide variety of circumstances in which a substantial delay in reporting may be deemed reasonable and, consequently, not an adequate basis to preclude a finding that a program was generally effective.

For example, if there were substantial reasons that a company did not detect an offense for a long period -- such as unusually effective efforts by an individual offender to conceal his or her misconduct -- then a long delay in reporting would not be an unreasonable delay. Likewise, a delay necessary to complete a reasonable investigation of evidence of an offense should not make a resulting reporting delay unreasonable. About the only circumstance in which an organization's delay should be deemed unreasonable is where organizational officials have clear evidence which would convince a reasonable party that an offense has been committed and the officials fail over a substantial period to act on that information by reporting it to public authorities.

While this type of reporting delay may not be illegal of itself, it does indicate a lesser degree of public service and organizational responsibility than would prompt self-reporting of the misconduct. In the context of characterizing a compliance program, such a reporting failure by top organizational officials calls into question the degree of support of those officials for law compliance and for the just punishment those who engage in apparent misconduct in the course of organizational activities. Absent this support for law compliance and just punishment, it is unlikely that corporate officials have diligently pursued the sort of compliance program that will be generally effective in detecting and preventing organizational violations of law.

Even if a sentence reduction for its compliance program is not available to an organization following an unreasonable delay in reporting an offense, there are still ample incentives in the guidelines for offense reporting even after an initial period of delay. Organizational self-reporting, coupled with an exceptional degree of subsequent cooperation with public authorities, can justify an extensive sentence reduction under subsection (g) of § 8C2.5 of the sentencing guidelines.

In sum, where an unreasonable delay in reporting known misconduct is present, this delay suggests that corporate leaders do not possess the sort of strong law compliance values and support for law enforcement that are also needed to conduct an effective compliance program involving ongoing efforts to prevent illegal activities. Hence, no sentence reduction should be granted under the provisions of subsection (f) of § 8C2.5 which are primarily concerned with the adequacy of organizational actions taken prior to an offense to prevent illegal misconduct. However, even where such preventive actions are missing or of questionable quality, an organization can qualify for special sentence reductions even after an unreasonable delay in reporting where the organization finally takes the initiative, makes an offense report to public authorities, and cooperates in some particularly extensive or helpful way with subsequent investigations and prosecutions by public officials. This type of assistance -- so long as it entails significant aid to law enforcement efforts -- stands on its own as a basis for recognizing responsible organizational action and making corresponding reductions in recommended sentences.

Compliance Program Characterization Following Involvement of a High-Level Organizational Official in an Offense

The issues for comment section raises the question of whether the proposed presumption of inadequacy of a compliance program is appropriate where a high-level manager of an organization has participated in, condoned, or was willfully ignorant of a violation of law. This section also questions whether this type of presumption should apply in assessing compliance programs in small organizations where, because of the size of the organizations, high-level managers may frequently be in contact with and, hence, be involved in or condone illegal conduct undertaken by other organizational employees.

The proposed change to a presumption of inadequacy of a compliance program in these situations strikes the right balance between an outright bar to a favorable compliance program characterization in this type of situation and a standard that would overlook the implications of high level misconduct in characterizing a compliance program. The key issue with respect to the meaning of high level misconduct in determining the likely effectiveness of a compliance program is whether the presence of that misconduct indicates a lack of core values supporting law compliance in the organization at hand or a likelihood that persons holding those values would be intimidated in following through on them by seeking law compliance in the organization. In general, the presence of misconduct at high organization levels indicates a lack of such values or a high likelihood of the sort of intimidation that will undercut effective compliance efforts. Hence, it is appropriate to presume that a compliance program is ineffective when such misconduct is present.

However, there are circumstances where the misconduct of a particular high level party is isolated in some way from other corporate value setting functions and compliance program activities. If this is the situation, the presence of high-level misconduct in an organization would not indicate the likelihood of widespread disregard for law compliance or intimidation in carrying out law compliance tasks. Where an organization can make a convincing case that these sorts of circumstances isolating high-level misconduct from the general operation of the organization's compliance program are present, the organization should be able to avoid the normal implications of high-level misconduct and overcome the presumption of compliance program ineffectiveness that will otherwise preclude a recommended sentence reduction.

Enhancing the Sentencing Benefits of an Effective Compliance Program

The issues for comment section raises the question of whether the culpability score benefit for organizations with effective compliance programs should be increased from 3 to 4 culpability score points. I believe that this is a valuable change. The altered compliance program standards in the Commission's proposed guideline changes demand more of organizations in order for their programs to be considered to be effective compliance programs and it is appropriate to give greater benefits and rewards to organizations that undertake these greater efforts. Indeed, the Commission may wish to increase the benefit associated with an effective compliance program to a 5 point reduction in an organization's culpability score.

Along with these increases in the benefits that organizations receive for effective compliance programs meeting all of the tests stated in the revised sentencing guidelines, the Commission may wish to authorize a lesser degree of sentence reduction for organizations that have adopted compliance programs with most, but not all of the required features of an effective compliance program. Such a change would transform the present "all or nothing" system of compliance program rewards and incentives into a more graded approach with partial credit for meaningful, but less than complete compliance program efforts.

For example, the guidelines might authorize a 1 or 2 point reduction in an organization's culpability scope if the organization had, at the time an offense was committed, adopted a compliance program with most of the seven types of features addressed in the guidelines' standards for an effective compliance program, but which lacked a few of these features. Such a partial reward for a compliance program could be limited to circumstances where a convicted organization had adopted a

compliance program which was likely to have a substantial impact on law compliance, but which lacked a few of the required features necessary to qualify the program as a generally effective compliance program under the guidelines.

Incentives for Compliance Programs in Small and Mid-Size Organizations

The last issue raised for comment concerns the proper means to encourage the adoption of compliance programs by small and mid-size organizations. The commentary proposed to be included in Application Note 2(B)(ii) following new § 8B2.1 addresses the key considerations in encouraging small and mid-sized organizations to adopt meaningful compliance programs. This commentary correctly indicates that, for small organizations, an adequate compliance program must address the types of functional activities specified in the guidelines' tests for a generally effective compliance program, but may do so in the course of business activities conducted for other purposes and without the need for any special compliance organization or significant set of separate practices related to law compliance. If the leaders of a small organization regularly address law compliance in their directions to employees, regularly monitor whether those employees are complying with applicable law compliance instructions, and follow up affirmatively on evidence of specific incidents of illegal conduct with appropriate investigations and reforms, the leaders will have adopted an adequate compliance programs for a firm of their small size.

The general principle at work here is that operational methods and organizational structures devoted to law compliance in a small organization should be no more or less extensive than the measures that an organization of the same size generally devotes to other significant features of organizational performance. The same principle would suggest the types of methods and resources that a mid-size company should devote to law compliance. If, for example, mid-size companies in the same industry would typically devote a separate organizational unit (or even part of the time of a particular corporate employee) to securing the integrity and completeness of corporate financial reports or the quality of corporate products, corporate law compliance should receive similar attention with management methods and organizational units of similar scope and nature.

In general, however, small organizations will not need any compliance staff or organization and can adequately address compliance through systematic efforts within existing management structures and practices. In order to clarify this point and specify at what size an organization should be concerned about its lack of a separate compliance staff or compliance organization, it might be useful to include a specific size figure in the guidelines' commentary as a general threshold size

below which an organization would generally not be required to have a separate compliance officer or organization in order to have a generally effective compliance program. For example, a statement might be included at the end of Application Note 2(B)(ii) following new § 8B2.1 that: "In most organizations having 100 or fewer employees, an effective compliance organization can be implemented through management processes undertaken for other purposes and no separate compliance staff will be necessary."

I appreciate the chance to address these issues related to the Sentencing Commission's proposed changes in the organizational sentencing guidelines. If I can be of any further assistance, please do not hesitate to contact me by phone (714-444-4141 ex. 228) or email (rgruner@law.whittier.edu).

Sincerely,

Richard S. Gruner
Richard S. Gruner
Professor of Law

HCCA



**HEALTH CARE
COMPLIANCE
ASSOCIATION**

Association Office:
5780 Lincoln Drive
Suite 120
Minneapolis, MN 55436
phone: 888-580-8373
fax: 952-988-0146
www.hcca-info.org
info@hcca-info.org

OFFICERS

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President
Waco, TX

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First Vice President
Redmond, WA

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Second Vice President
San Francisco, CA

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Rapid City, SD

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Louisville, KY

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Costa Mesa, CA

Gregory J. Warner
Rochester, MN

CEO
Roy Snell

February 16, 2004

U.S. Sentencing Commission
One Columbus Circle, NE.
Suite 2-500
Washington, DC 20002-8002
Attention: Public Affairs

Dear Commissioners:

The Health Care Compliance Association (HCCA), established in 1996, is the only national, nonprofit organization dedicated solely to improving the quality of compliance. Its membership is made up of over 3,000 compliance professionals who oversee the compliance efforts of thousands of organizations both in and outside of health care. The HCCA has a rich history of facilitating the development and maintenance of compliance programs, providing a forum for understanding complicated regulatory environments, and collaborating with enforcement agencies to provide tools, resources, and educational opportunities for those involved with compliance. Its mission is to "champion ethical practice and compliance standards in the health care community and to provide the necessary resources for compliance professionals and others who share these principles."

HCCA Website: <http://www.hcca-info.org/>

The Executive Committee of the Health Care Compliance Association offers the following comments on the proposed changes to the US Sentencing Guidelines – See attached.

Sincerely,

Al Josephs
President
Health Care Compliance Association

HCCA



**HEALTH CARE
COMPLIANCE
ASSOCIATION**

Association Office:
5780 Lincoln Drive
Suite 120
Minneapolis, MN 55436
phone: 888-580-8373
fax: 952-988-0146
www.hcca-info.org
info@hcca-info.org

OFFICERS

Al W. Josephs, CHC
President
Waco, TX

Odell Guyton
First Vice President
Redmond, WA

Daniel Roach
Second Vice President
San Francisco, CA

Allison Maney
Treasurer
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Steven Ortuist, JD
Secretary
Phoenix, AZ

Alan Yuspeh
Immediate Past President
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DIRECTORS

Shawn Y. DeGroot, CHC
Rapid City, SD

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Salt Lake City, UT

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Sacramento, CA

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Philadelphia, PA

Britt Crewse
Durham, NC

John E. Steiner, Jr.
Cleveland, OH

Debbie Troklus, CHC
Louisville, KY

Sheryl Vacca, CHC
Costa Mesa, CA

Gregory J. Warner
Rochester, MN

CEO

Roy Snell

February 16, 2004

U.S. Sentencing Commission
One Columbus Circle, NE.
Suite 2-500
Washington, DC 20002-8002
Attention: Public Affairs

Subject: United States Sentencing Commission Proposed Changes

Dear Commissioners:

The purpose of this letter is to comment on the proposed changes to the Federal Sentencing Guidelines (Guidelines) relating to compliance programs. At the outset I would note that the Commission appears to be placing increased emphasis on the importance of compliance programs and the role of the compliance officer as a member of senior management. We completely support this effort. Moreover, we agree with the many changes proposed by the Commission to provide additional guidance and direction to organizations regarding compliance programs and to emphasize the need for compliance officers to have sufficient authority and resources to be able to perform effectively. While the board of directors of the Health Care Compliance Association supports virtually all of the proposed changes to the Guidelines, it does have concerns with two of the proposed changes. Those concerns are outlined below.

First, the proposed amendments suggest that the compliance officer of the organization is accountable for the effectiveness of the program. The proposed changes have added language to § 8B2.1(b)(2) which states that the high level person responsible for the program (the compliance officer) has the responsibility to "ensure the implementation and effectiveness of the program."

Our concern is that this amendment may not reflect the fact that compliance can only be achieved if the operating management of an organization (at all levels) performs the roles and responsibilities assigned to it through the compliance program. As a practical matter, the role of the compliance officer is to develop a compliance program and a structure for implementing the program. The compliance officer should then provide leadership and coordination of the program, as well as monitoring program performance and reporting to management and the board on program implementation.

Ultimately, however, the operating management of the organization must embrace, the program and assume accountability to ensure that the compliance program is effectively implemented. It is not realistic to hold the compliance officer alone responsible for the overall success or failure of the compliance program. If there are failures, the responsibility may reside with the compliance officer or may reside with any number of other leaders in an organization. The proposed amendments could be read as relieving management of the job of ensuring the organization is compliant. We believe that the guidelines should strengthen rather than weaken managements' accountability for the

organization's compliance efforts. For the reasons stated above, we would recommend that the proposed amendment be modified to read as follows:

“Specific individuals(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to coordinate the design, oversee the implementation, and evaluate and report to management and the board on the effectiveness of the program to prevent and detect violations of laws.”

Our second concern relates to the treatment of organizations which encounter trouble even though the organization had a compliance program in place. While the proposed changes are an improvement over the existing guidelines, it is our view that the proposed changes could do more to promote effective compliance programs.

As drafted, the proposed amendments create a rebuttable presumption that the compliance program was ineffective. However, we would propose a rebuttable presumption that the program is effective if it is the organization that discovers and brings the offense to the attention of the government. The rebuttable presumption of ineffectiveness creates a disincentive for organizations to thoroughly investigate and disclose wrongful conduct. Conversely, a rebuttable presumption that the program is effective (where the organization has uncovered and disclosed the wrongdoing) creates incentives to both investigate and disclose -- an approach that is more consistent with the overall emphasis on compliance in Chapter 8 of the Guidelines.

In summary, we support most of the proposed changes to the Guidelines and applaud the work of the Commission. The changes proposed by the Commission will help us strengthen organizational compliance programs and the role of the compliance officer. However, we would strongly encourage the Commission to revise the proposed Guidelines on the two very important points discussed above.

Sincerely,

Executive Committee
Health Care Compliance Association
5780 Lincoln Drive, Suite 120
Minneapolis, MN 55436

WRITTEN TESTIMONY OF DOV SEIDMAN,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
LRN

Let me begin my testimony by thanking the members of the Sentencing Commission and staff for giving me this opportunity. And let me also commend the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines for its insightful report and recommendations. We further commend the Commission for addressing in the proposed amendments the important issues raised by the Advisory Group.

We are in troubling times for the business community, and your work is greatly appreciated by it. Trust of American business is at an exceedingly low level, perhaps the lowest since the Great Depression. The actions of a few, spectacular malfeasants have sullied the reputation of business as a whole and exposed the need for greater vigilance, and greater penalties for failures of compliance and ethics.

As the Commission has recognized, though, simply creating penalties for those who do wrong is not enough. We must provide incentives for companies to do the right thing, and encourage their employees to do the right thing, even when it may not be the easy thing.

The proposed changes to the Organizational Sentencing Guidelines are a positive continuation of the work the Commission has done in the past to further compliance, and the Commission is to be commended for that work.

However, I believe the Commission would have a greater impact on organizational behavior if it added the requirement that organizations promote an internal culture that encourages a commitment to both the law, as it has in the past, and to ethics.

I make this statement based on over ten years working with hundreds of organizations, both large and small, on legal, compliance, and ethics issues. During this time, I and my colleagues at LRN have gained a better understanding of the relationship between ethics and compliance, and more broadly, the relationship between corporate cultures and compliance. We have also gained great insight into how organizations best communicate not only the legal and regulatory requirements of their business, but also respect for the law more broadly, as well as their values and standards. And we have had the opportunity to witness and participate in what we believe could well turn out to be a sea change in the approach to addressing these critical issues.

We are observing an emerging best practice in the development of effective compliance programs. In particular, we are observing that in communicating their values and providing employees with the knowledge and information they need to succeed and thrive, they are emphasizing both ethics and legal compliance. Indeed, attention to ethics

within organizations now takes many forms, from bringing to life codes of conduct through education and other means by which they are woven into the very fabric of the organization, to structuring education curricula in which law and the ethics are taught together. Or, put another way, they are designed to remind employees of what Justice Potter Stewart taught us: that there is a difference between that which you have a right to do and that which is right to do.

The goal of such programs is to not only comply with the law, but to instill in the organization's members an atmosphere of trust, a sense of mutual respect and benefit, and a commitment to doing the right thing, not simply the required thing.

If we look to the highly publicized ethical scandals that began to crescendo in 2001, we see that companies with "paper compliance programs," but no true ethical culture, collapse quickly as unethical conduct is revealed. The scandals that led to the recent reforms, while violating the law, were reflective of a broader ethical failure that was even more troubling than the actual legal violations.

Prosecutors frequently struggled to identify the appropriate laws and charges. The positive law had not kept up with the ability of highly proficient, yet ethically untethered individuals and organizations to find loopholes. Nearly all agreed, however, that the conduct was so egregious as to breach norms of ethical behavior. A collective cry arose that "there ought to be a law." That cry helped lead us to this hearing room today.

The aim of nearly all of the laws adopted in the wake of these scandals was to address the shortcomings extant in the positive law; namely, its failure to address conduct that was, while unethical, not necessarily illegal. At the federal level, both the legislative and executive branches have acted to redress those shortcomings.

This is consistent with past law, since the animating principles and foundational precepts of the rule of law originate from shared, common values. Businesses that embrace the letter and spirit behind the law inspire and uphold a higher standard of conduct in allegiance to these shared values. This higher standard considers the consequences of actions beyond their immediate outcome to consider the ultimate impact. This higher standard also acknowledges that everything is not relative and subject to equivocation and "clever pleading"; there are fundamental truths and values that should be adopted and championed simply because they are the right thing to do.

The judiciary, through the Commission, now has the opportunity to take its proper place beside its co-branches of government in ensuring ethics plays a key role in the lawful conduct of all organizations.

The Commission has, in its proposed changes to the Guidelines, taken the bold step of recognizing the vital role organizational culture plays in establishing and maintaining an effective compliance program. In that regard, the Commission has proposed that an organization must "(1) exercise due diligence to prevent and detect