

PUBLIC HEARING HELD BY THE AD HOC ADVISORY GROUP
ON ORGANIZATIONAL SENTENCING GUIDELINES

PLENARY SESSION I

November 14, 2002

8:39 a.m.

Held at:

THURGOOD MARSHALL BUILDING

ONE COLUMBUS CIRCLE, N.E.

JUDICIAL CONFERENCE CENTER

WASHINGTON, D.C. 20002

1 P-L-E-N-A-R-Y S-E-S-S-I-O-N

2 MR. JONES: My name is Todd Jones, and
3 I have the privilege of chairing the Ad Hoc
4 Advisory Group on the Organizational Sentencing
5 Guidelines. It's an entity that the U.S.
6 Sentencing Commission constituted in February of
7 this year. We have been meeting pretty regularly
8 since March of this year. Events have overtaken
9 us, and we've been extremely busy.

10 Today's hearing is the culmination of
11 a lot of information gathered that we've done
12 over the last several months. The members of the
13 Ad Hoc Advisory Group are seated down front, and
14 I just want to run through a roster of their
15 names because they've done a lot of hard work,
16 giving of their time and their energies to
17 address this growing and important issue.

18 Richard Gruner, Jane Adams Nangle,
19 Paul Fiorelli, Michael Horowitz, Greg Wallance, Ed
20 Petry, Ron James, Eric Holder, Julie O'Sullivan,
21 Mary Beth Buchanan, Richard Bednar, Gary

1 Spratling, Win Swenson, Lisa Kuca, and Chuck
2 Howard and myself have all been working real hard
3 over the last several months. This morning we're
4 going to have two plenary sessions.

5 Let me explain a little bit about the
6 format of today's events. The agendas have been
7 disseminated. They're out front. We're going to
8 have two plenary sessions this morning consisting
9 of two panels of distinguished speakers who will
10 make statements and then be asked questions from
11 the members of the Advisory Group. Clock
12 management obviously is always important under
13 these circumstances. So while we want to have a
14 full discussion today, we may not be able to
15 accomplish all we want in the morning plenary
16 sessions. Hence, the afternoon breakout
17 sessions, and we will have four different
18 breakout sessions moderated by various members
19 from the Advisory Group. And it is our intention
20 that those sessions are more in depth and fuller
21 discussion and Q and A can take place.

1 Let me introduce this morning's panel,
2 go through some housekeeping matters, and then
3 begin. On the dives with us here, we're
4 privileged to have starting at the far end Jamie
5 Conrad, who is counsel for the American Chemistry
6 Council. Next to him is Dr. Stuart Gilman,
7 president of the Ethics Resource Center in
8 Washington, D.C. Next to Dr. Gilman is James
9 Cowdery, partner at Cowdery, Ecker & Murphy in
10 Hartford, Connecticut, a former federal
11 prosecutor and currently a white collar criminal
12 defense attorney. And right next to me is Steve
13 Priest, president of the Ethical Leadership Group
14 in Wilmette, Illinois.

15 A couple of housekeeping matters just
16 to answer questions that may be in the back of
17 your head. All of the testimony here today will
18 be transcribed, and I note that not only for the
19 benefit of the public members but also for the
20 speakers. We will be generating transcripts, and
21 each of the sessions do have court reporters

1 there. I would ask that people keep the record
2 in mind and give due deference to the court
3 reporter who has a tough job at times trying to
4 take everything down, so try not to speak over
5 each other. That information will eventually as
6 soon as it's generated be posted on the
7 Sentencing Commission's web site, as is all of
8 the information that we have gathered over the
9 last several months including written testimony
10 and statements by not only the speakers but
11 individuals who could not participate today. So
12 the web site -- the Sentencing Commission web
13 site is full of all of the information that we
14 have gathered.

15 We have determined that at some point
16 the public record and information gathering has
17 got to close, so on December 1st of this year,
18 those have you who have follow-up questions,
19 issues, want to make further comment, please feel
20 free to follow-up. Our process is we've had
21 several requests for public information. But on

1 December 1st of this year, it's our intention to
2 close the record and begin the hard work of
3 trying to determine what, if anything, needs to
4 be done with chapter eight.

5 Two more housekeeping issues, phones
6 and restrooms are outside. After the plenary
7 session this morning, number one, we're going to
8 have a 15-minute break. We'll have plenary
9 session number two that will run until noon, 90
10 minutes for lunch off site. We're not going to
11 host anything here, and then we will be back down
12 in the same area across the hallway in three
13 different rooms -- or four different rooms and in
14 this place for the afternoon breakout sessions
15 starting at 1:30 until 4:00.

16 And with that, our first speaker.
17 Keep in mind, gentlemen, that I am going to be
18 maintaining clock management today. It will be
19 Jamie Conrad, counsel for the American Chemistry
20 Council. Jamie? You can either stay seated if
21 you're more comfortable or you can take the

1 podium.

2 MR. CONRAD: Thank you, Todd and
3 members of the Advisory Group. Good morning.
4 I'm Jamie Conrad, bound to be confused with Jamie
5 Cowdery. Maybe I should be Jamie with the bow
6 tie or something like that. I'm a counsel with
7 the American Chemistry Council, which is a trade
8 association for the leading businesses in the
9 business of chemistry in the United States. Our
10 members are among the most highly-regulated
11 companies in the United States, and, as a result,
12 have developed among the most sophisticated
13 compliance management systems in the world. Some
14 of our members are Fortune 50 companies. Some of
15 them, one of them in particular, has 50 employees
16 and so it's -- from that perspective, both of
17 having very complicated and well-designed
18 compliance management systems but also the great
19 variability among our membership. Those are sort
20 of the two principles from which these comments
21 stem.

1 We've had fairly extensive progress in
2 May and then again in October, and I won't go
3 into all the details of those comments but to try
4 to hit about five or six of the principal points.
5 First is that we believe the guidelines should
6 focus on criminal conduct in the course -- in the
7 context of criminal sentencing. The Commission
8 is charged with promulgating detailed guidelines
9 prescribing the appropriate sentences for
10 offenders convicted of federal crimes, and the
11 courts use these guidelines to sentence those
12 offenders. The failure of an organization to
13 conform to the guidelines can have direct
14 implications in the criminal sentencing context,
15 particularly if those guidelines become the basis
16 for upward departures from the base fines.

17 Any suggested changes to the
18 guidelines must be evaluated in a very serious
19 criminal sentencing context in which those guidelines
20 were designed. We recognize that the guidelines have
21 inspired and served as the

1 template for the creation of effective compliance
2 management systems and that those programs have,
3 in turn, developed in some organizations to more
4 general codes or systems of corporate ethics.
5 It's important, though, we believe, to bear in
6 mind that that's for all of its value -- and it
7 is quite valuable. That it's essentially an
8 incidental or a secondary effect of the
9 sentencing guidelines, and that their real
10 fundamental purpose is to determine the fines
11 that organizations should have to pay. And, in
12 fact, those consequences are really the
13 fundamental results of the application of the
14 guidelines.

15 We don't believe that they should be
16 expanded to address general concepts of social
17 responsibility or corporate ethics. They're not
18 governed by criminal laws or directly relevant to
19 criminal sentencing. We're big believers in
20 corporate ethics programs. Fourteen of our
21 membership, slightly around ten percent of the

1 members, belong to the -- have people that belong
2 to the Ethics Officer's Association. Eight of
3 them are sponsoring party members. But we really
4 do believe that the purpose of this -- of the
5 Commission is to address the criminal conduct and
6 not promulgating ethical codes, and we think
7 that's particularly important given the lack of
8 sort of a consensus on what an ethical code ought
9 to prescribe in all of its details.

10 The second primary point is the
11 changes to the guidelines to be based on
12 objective evidence and demonstrable need for
13 changes. We're not aware of any data or evidence
14 in the public record showing deficiencies in the
15 guidelines that warrant correcting. To the
16 contrary as the Commission has noted, the
17 organizational guidelines have had a tremendous
18 impact on the implementation of compliance and
19 business ethics programs over the past ten years.
20 Thousands of organizations have invested
21 significant resources implementing systems

1 designed on the guidelines. Material changes
2 should only be considered after determining that
3 the guidelines are lacking in some fashion.

4 Now we assume that there's a certain
5 impetus to see changes in the guidelines as a
6 result of the corporate ethics controversies from
7 the last -- from this past summer of Enron and so
8 on and that something needs to be done. And we
9 respectfully urge the Advisory Group to proceed
10 slowly on that basis because a lot is being done.
11 The most sweeping changes to the federal securities
12 laws in the last 60 years have been enacted, and
13 we want to be careful. The pendulum is already
14 swinging pretty dramatically. Moreover, the fact
15 that there - that illegal or ethical conduct has
16 occurred in these organizations doesn't necessarily
17 mean that the guidelines were at fault or that the
18 guidelines need to be changed as a result. I
19 don't think we should also assume without some
20 evidence that ethics programs or increased

21

1 emphasis on ethics would have prevented those
2 violations, and, in fact, we think it would be an
3 interesting exercise to look at the businesses
4 that have been indicted or charged with
5 accounting and similar types of frauds to see
6 whether those companies had ethics programs and
7 if they did to determine why those ethics
8 programs didn't stop the apparent criminal
9 behavior that took place.

10 The third point is that the guidelines
11 need to remain flexible and practicable and
12 generally applicable to all organizations that
13 they apply to. At the moment, the guidelines
14 offer a tremendous degree of flexibility that
15 allow organizations of all sizes and type to
16 implement them. Proposed changes need to take
17 into account the fact that the vast majority of
18 American businesses are small- and medium-sized
19 companies. The Commission's own statistics from
20 the fiscal year 2000 show that 87 percent of
21 organizations sentenced under chapter 8 had fewer

1 than 200 employees and that approximately 65
2 percent of them had fewer than 50. Whatever
3 obstacles small- and medium-sized businesses face
4 to comply will not be simplified or
5 lessened by increasing the complexity of the
6 guidelines.

7 We also think that it would be quite
8 difficult to attempt to tailor the guidelines to
9 fit different types of small businesses because
10 of the tremendous heterogeneity of American
11 business depending on different sizes and
12 different lines of businesses. We also are
13 concerned that small firms should not be, in
14 essence, subjected to potentially greater
15 penalties because of their inability to adopt the
16 best practices developed by the fortune 500.

17 Our fourth point is that the
18 guidelines already provide significant guidance
19 in the design and implementation in auditing of
20 compliance systems and that it's not necessary
21 for them to provide additional detail in how that

1 ought to be done. We're not aware of any market
2 need or market failure in terms of the generation
3 of guidance into how to do compliance systems.
4 To the contrary, there's a plethora of sector
5 specific public, private, national, and
6 international guidance documents and standards on
7 compliance assurance, and we inventoried those in
8 the comments we filed in May. Moreover, I think
9 if the Commission were inclined to provide
10 additional detail on compliance programs that the
11 impact of that detail ought to be carefully
12 weighed because, as I mentioned, there's such a
13 diversity of guidance. And in some cases federal
14 regulations, the OSHA process safety management
15 rule, actually specifies elements of a compliance
16 program. Very careful thought has to be given to
17 how the guidance from the guidelines would
18 interact with and sort of interlace with the
19 other kinds of compliance guidance that exists.

20 Our fifth point is that the guidance
21 don't need -- ought not -- the guidelines are not

1 to provide additional detail on the subject of
2 corporate governance. As I eluded to earlier,
3 tremendous legislation has been passed -- has
4 been enacted through the Sarbanes-Oxley Act,
5 which corporate lawyers throughout the United
6 States are now attempting to commit to memory,
7 including myself. I -- and maybe I should just
8 say tangentially, we are aware that section 805A5
9 of the Sarbanes-Oxley Act directed the Commission
10 to ensure that the guidelines -- there's several
11 provisions in the guidelines in Sarbanes-Oxley
12 that relate to the guidelines, and, of course,
13 they're dispersed in different sections of the
14 statute and written in slightly different ways.
15 Section 805A5 requires the Commission to ensure
16 that the guidelines are sufficient to deter and
17 punish criminal conduct generically apart from
18 the section -- the parts that focused on fraud
19 and whatnot.

20 At least with respect to the elements
21 of the guidelines affecting -- establishing the

1 criteria for an effective compliance assurance
2 program, we believe you've already undertaken the
3 job that the statute calls for, and it doesn't
4 speak about any new or different initiatives. So
5 we think your -- that you've done what needs to
6 be done with respect to that mandate.

7 Coming back, though, to corporate
8 governance, there's a tremendous variety of SEC
9 regulations and stock exchange and NASDAQ
10 proposals that will then go before the SEC on the
11 subject that the audit committee of the board and
12 CEO and CFO certification, of whistleblower
13 protection. And the details and the scope of
14 these will in some cases not be known until almost
15 May, and then the implementation of that will
16 take several months thereafter. We think that
17 there's a tremendous potential for unintended
18 consequences if the guidelines attempt to specify
19 elements of corporate governance that then have
20 to be reconciled with the requirements coming out
21 of this recent legislation. And, in fact, it may

1 well be that because Congress has acted so
2 precipitously and particularly -- if you consider
3 until November, until the election date, we had
4 essentially one of the most stalemated political
5 environments that we've seen, and yet this
6 enormous statute has charged through Congress in
7 the space of a few weeks. And so it may well be
8 that Congress has addressed the concerns that
9 were raised to this Advisory Group initially having to
10 do with corporate governance.

11 Now less I appear to be uniformly
12 negative about the proposals outlined in the
13 requests for comments, I would like to emphasize
14 that we do strongly support one of the proposals
15 that was discussed in the request for comments,
16 and that's the notion that waiver of legal
17 privileges ought not to be required as a
18 condition for being recognized to have provided
19 cooperation or effective assistance to law
20 enforcement. Legal privileges are longstanding
21 and recognized elements of the rights of

1 individuals as well as organizations, and there's
2 been an unfortunate, in our view, erosion in the
3 area of prosecution of the validity of those
4 documents -- of those principles. And by their
5 requirement by SEC and EPA and others, the
6 parties waive them in order to be regarded as
7 cooperating. And it's important not just because
8 these are (inaudible) principles of law, but
9 because privileges promote the kind of internal
10 investigation and monitoring and analysis that we
11 think the Commission and this group ought to be
12 promoting. In other words, the fact that
13 corporations can't conduct internal discussions
14 and to document that without fear that those
15 documents will then be used, just as Jackson, I
16 guess, said, to kind of provide the thinking for
17 the other side, those -- the fact that that can
18 be done promotes, in our view, the kind of
19 self-evaluation and detective work that we
20 understand the guidelines to try to be -- to
21 support and so we really think that

1 recommendation is particularly important.

2 In conclusion and at the risk of
3 biting the hand that has fed me, I would
4 respectfully like to urge the Commission and the
5 Advisory Group in the future to publish notices
6 of these sorts of events in the federal register.
7 We're fully aware that the guide -- that the
8 Sentencing Commission is exempt from FOIA and the
9 Administrative Procedure Act (inaudible), but I
10 continue to be surprised by how many people have
11 no idea that this process is going on. I mean, I
12 called The Wall Street Law Firm where I used to
13 work to get a big binder on Sarbanes-Oxley and I
14 said, now, do you realize that the Commission is
15 looking at all this sort of Commission
16 governance. This is two weeks ago, and they said
17 no, who, no one, where -- you know, and I said,
18 well, you have to go to the Commission's web site
19 and then go to the "What's New" page and then
20 you'll see, oh, look, here's a little link. If
21 you go to that, that's an announcement that says

1 that the Commission is doing things. And so
2 really only those people who read the Trade Press
3 religiously are really aware of this, and I think
4 it's unfortunate because there's a lot of very
5 useful guidance that I think you could get from
6 the public that I'm concerned that you still
7 haven't gotten.

8 So that would be my final suggestion,
9 and I'll be happy to answer questions.

10 MR. JONES: Now the format this
11 morning is going to be, again, general members of
12 the public, save your questions until this
13 afternoon at the breakout sessions. But I would
14 call upon any members of the Advisory Group who
15 would like to ask a follow-up question to Mr.
16 Conrad regarding his remarks to just indicate
17 that you do have a question. Keep it in mind
18 that we're going to have a general Q and A at the
19 end of the first plenary session. Mary Beth?

20 MS. BUCHANAN: Mr. Conrad, you stated
21 that 87 percent of corporations charge -

1 THE REPORTER: Can you wait, please?

2 MS. BUCHANAN: With fewer than 200
3 employees --

4 THE REPORTER: Can you start over?

5 MS. BUCHANAN: Mr. Conrad, you stated
6 that 87 percent of the corporations charged have
7 fewer than 200 employees. I think that this is
8 evidence of the fact that we have a compliance
9 problem with smaller corporations. You've also
10 stated that these corporations can't adopt the
11 best practices of Fortune 500 companies. But
12 what can smaller corporations do, in your
13 opinion, to develop better compliance programs?

14 MR. CONRAD: That's an interesting
15 question. That's a profound question. I'm
16 not -- I'm not sure that there's a simple answer
17 to it to tell you the truth. If the current
18 guidelines aren't getting them there, I'm not
19 sure that revised ones would necessarily get them
20 there.

21 MS. BUCHANAN: Well, what is

1 preventing the corporations from developing
2 effective programs?

3 MR. CONRAD: I'm not sure -- I
4 don't -- I mean, I tend not to represent them, so
5 I don't really -- I mean, I think it might be
6 interesting to ask the Small Business
7 Administration, for example, which is -- which
8 does tend to look out and think about those -- or
9 the National Federation of Independent
10 Businesses. I mean, those are organizations
11 charged with kind of looking out for and speaking
12 for those organizations, and I think they may --
13 they may have useful things to say?

14 MS. O'SULLIVAN: My question is a
15 follow-up to that, which was what can we do to
16 help encourage small companies to develop
17 effective programs? And I assume your answer is
18 the same in that (inaudible)

19 MR. CONRAD: Uh-huh. Well, it did --
20 it did occur to me one, of the notions that I
21 hadn't seen thus far in the materials that the

1 Commission -- the advisory has indicated -- I
2 think clearly there's a sentiment that if the
3 current provisions regarding effective compliance
4 programs have had some benefit in promoting
5 compliance behavior, that sort of turning those
6 up might produce a sort of corresponding increase
7 in compliance. I think it's been understood thus
8 far that what that meant was to sort of say,
9 well, you had to do X, Y, and Z in order to get
10 so many steps of mitigation. What if you had to
11 do A, B, C, X, Y, and Z? Maybe that would
12 provide greater incentive.

13 Another way to think about it might be
14 to say to leave in place the current provisions
15 that sort of say do X, Y, and Z and you get so
16 much in a downward adjustment. Do A, B, and C
17 and you get even more downward adjustment. In
18 other words, if there were sort of more offered
19 in that regard without sort of raising the bar as
20 it will -- as you will, with what's currently
21 provided, potentially that could lead to a little

1 more attention being paid by folks to the
2 guidelines and perhaps more -- better compliance
3 management within smaller organizations.

4 MS. O'SULLIVAN: Can I ask one more
5 question? This goes to, I think, your principal
6 point, which I understood it to be something of a
7 jurisdiction question. Excuse me, I have a cold.
8 Your point seems to be that the Commission is
9 charged with constructing sentences for criminal
10 cases and that really values-based programs are
11 outside your purview. And just as a (inaudible),
12 I'd like to ask you, I mean, some -- I think
13 professor (inaudible) or one of these people
14 would argue that values-based programs or
15 ethics-based programs -- I don't want to get into
16 the definition of harass there. Actually are
17 necessary to promote legal components and that
18 absent a values-based program you're not going to
19 have the type of legal compliance that is within
20 the Commission's purview. Can you speak to that?

21 MR. CONRAD: I guess that -- I guess

1 the necessary correlate to that is either that --
2 since people -- people have been obeying the law
3 since the (inaudible). I guess that means
4 that they've always had values-based programs.
5 It was just never articulated to be such. I
6 mean, if they're essential and they were only
7 recently developed then they must not have --

8 MS. O'SULLIVAN: Well, I don't know if
9 historically that's actually true. In a
10 recent -- I know that (inaudible) Pitt wrote an
11 article 20 years ago about codes of corporate
12 conduct and how they were sweeping the country,
13 so, actually, I think historically they have --

14 MR. CONRAD: Right, but we -- I mean,
15 our view is clearly upper level management
16 commitment and a clear statement from upper
17 management that compliance is to be expected and
18 that non-compliance is never acceptable as a
19 means (inaudible), financial targets or others,
20 that sort of thing really is both indispense -
21

1 it's necessary and maybe not sufficient, but it's
2 certainly at least necessary. That sort of a
3 notion of a clear statement of an ethical
4 position by the senior management, I think, is
5 already in the guidelines. I think the question
6 for us really is to what extent -- consider that
7 the origin of the provisions about effective
8 corporate compliance programs was essentially to
9 say various people are going to get a bunch of
10 fines. Now there are some folks who have been
11 attempting to do more than the law requires as a
12 way of staying within the law. We recognize that
13 in some cases those organizations are
14 administered to run foul of the walk despite
15 their efforts, but we're going to give them some
16 degree of credit for having done that. And
17 that -- we think that that role, that element,
18 that function of the effective corporate
19 compliance program provisions needs to be -- to
20 be preserved.

21 MR. JONES: One more. Greg and

1 then -- Paul and then Greg.

2 MR. FIORELLI: Good morning. I was
3 looking at your written testimony, and you have a
4 comment that says that, "If it ain't broke, don't
5 fix it." I guess my question is, how do you know
6 if it's broke? Don't we need to conduct a review
7 like this to see from experts like yourself to
8 see if improvisations need any kind of refinement,
9 any kind of review, any kind of clarification or
10 modification? So do you have a problem with us
11 going through this process?

12 MR. CONRAD: No, not at all. I mean,
13 I think -- I think it's appropriate. I just
14 want -- the purpose of that comment really was
15 just to emphasize the need that -- for this
16 process to include or at least to reach out and
17 try to identify what in the way of empirical work
18 has been done on that issue rather than simply to
19 rely on statements from interested parties like
20 all of us as to sort of what our opinion is on
21 those things. But I think if there is empirical

1 evidence that the guidelines have or have not
2 been effective or that ethics programs are or are
3 not effective, I think that's entirely -- I mean,
4 that really is exactly what I think this group
5 ought to be doing.

6 MR. JONES: Greg, last question.

7 MR. WALLANCE: I was struck by your
8 concern about the possibility that revisions to
9 these guidelines, to criteria from an effective
10 compliance program, could conflict with
11 legislation and, I guess, the SRO, the emerging
12 SRO government standards. And really these
13 guidelines are ten years old, and to my mind
14 there's question as to whether or not the
15 legislation, the SRO government standards,
16 reflect the current perception of what's required
17 for a company to comply with the law when you
18 assure as best you can its employees and
19 (inaudible) are part of the law, so why shouldn't
20 we be examining whether the guidelines need to be
21 revised to reflect those standards?

1 MR. CONRAD: Oh, I -- that's exactly
2 what, I guess, I meant to say if I didn't make it
3 clear is -- is that the Commission ought to --
4 the Advisory Group ought to proceed by looking at
5 what Sarbanes-Oxley and the SCC and the SRO are
6 doing to make sure that what you do does, in
7 fact, track them so that there's essentially sort
8 of a unified set of standards one needs to
9 follow.

10 MR. WALLANCE: If I could just have one
11 follow-up? For example, the SRO government
12 standards put a great deal of emphasis on
13 independence of -- at least having some
14 independent members of the board, independence in
15 the auditing committees. The guidelines as
16 they're currently written really don't stress
17 that -- they don't put emphasis on that kind of
18 governance, so then why shouldn't the guidelines
19 be revised to stress the kind of permanence that
20 the SROs are implementing right now?

21 MR. CONRAD: Well, I think they should

1 with the -- I guess the proviso that all of these
2 Sarbanes-Oxley and the SRO documents are directed
3 to publicly traded listed companies which are a
4 certain size. And I guess the question is
5 considering that the majority of organizations
6 that the guidelines were applied to are not
7 public companies, is it reasonable to expect that
8 they'll all have a similar sort of corporate
9 governance structure with a board of directors
10 that includes an audit committee and so on. I
11 mean, if you've got a company with a board of
12 three, I guess under the statute the board of
13 three becomes the audit committee. But I -- that
14 would be -- that would be the only proviso.

15 MR. JONES: Well, we're off to a good
16 start. There's a -- I appreciate you going first
17 here, Jamie.

18 MR. CONRAD: Usually I'm --

19 MR. JONES: It's all Lynn's fault.
20 The questions initially from Mary Beth Buchanan
21 and Julie O'Sullivan address the smaller to

1 medium-sized businesses and we're going to skip
2 over and go right into that issue. James Cowdery
3 was invited to come and address some of the
4 issues with particular emphasis on small to
5 medium-sized businesses which statistically have
6 been the parties involved with chapter eight
7 actually being sentenced. And with that said,
8 James, the mike is yours.

9 MR. COWDERY: Thank you, Todd. I'm
10 going to remain seated. I appreciate the
11 opportunity to testify this morning. I think one
12 of the things I've just seen is that the question
13 and answer format is probably a lot more
14 interesting than any speech I could make this
15 morning. So I'm going to make my prepared
16 remarks short and allow some time for question
17 and answer.

18 My practice consists mostly of
19 representing small businesses, small
20 corporations, small LLCs. And when I say
21 "small," I mean small, fewer than 50 people,

1 sometimes fewer -- often fewer than ten people,
2 and I'm not alone. When I made the mistake of
3 talking to Chuck Howard and ended up getting
4 invited here, I sent an e-mail out to friends in
5 Connecticut who practice in white collar criminal
6 defense, and their experiences are very similar
7 to mine. Most of them represent little
8 companies, so I asked the probation officer to
9 run me a printout of all the companies that have
10 been sentenced in Connecticut since 1991, bearing
11 in mind that, you know, a fair number of those
12 probably -- the early ones weren't guideline
13 sentences. There were 44, and while I didn't do
14 a scientific survey, I recognized about, I don't
15 know, a third to a half of the cases. The rest
16 of them I checked the web sites, and it appears
17 that four of the 44 companies were publicly-held
18 companies. The great majority of the rest of
19 them were under 50, and, as far as I could tell,
20 all of the rest were under 200.

21 So this -- this is the field in which

1 I work. My feeling, if I can cut to the
2 conclusion and then take some questions, is
3 probably small businesses are better off if the
4 guidelines are not changed. I say that in the
5 sum of trepidation because I think there's some
6 things about the guidelines that are problematic,
7 but my concern echoes that of my brother Jamie,
8 which is that unintended consequences can come up
9 and bite you in ways that you couldn't have
10 anticipated and didn't anticipate. And I'm
11 afraid that will happen here. What I see in my
12 very pedestrian world is I see a person at the
13 end of the day standing in front of a judge and
14 usually he's got two hats on. One hat says
15 "individual" and one hat says, you know,
16 "individual, Inc." And this person is a person
17 who for whatever reason couldn't work something
18 out along the way, and I'm happy to say most of
19 the time I can work something out. But every now
20 and then you go to trial and you lose and you end
21 up in front of a judge and you've got to apply

1 all this stuff. It's extremely onerous when you
2 find yourself in that position with somebody who
3 with his company has engaged in criminal conduct
4 and now has to be sentenced.

5 So while there is clearly a
6 substantial social policy component to what the
7 Commission does, there's also the component of
8 making a framework within which a judge has to
9 impose a just sentence, and I think that can
10 happen now but just -- just by the skin of our
11 teeth, and I'm concerned frankly that
12 something -- a change designed to reflect the
13 behavior of a Fortune 50 company or a Fortune 500
14 company, all with the best of intentions, could
15 rebound in a way that isn't anticipated to make
16 it even more difficult for that small business
17 man standing in front of a judge at the end of a
18 day to be able to get a fair sentence. So my
19 thought from the small business point of view is
20 that it's probably better to leave it alone.

21 In my summary of testimony, I went

1 through the various aspects that I think the
2 guidelines do provide some flexibilities, some
3 reasonable allowances now. Rather than proffer
4 all that again, I think I'll conclude because I
5 have a sense there may be some questions.

6 MR. JAMES: Hi, thanks for your
7 comments. When you commented, it sounds like you
8 cited cases that had actually gone to trial and
9 where people were (inaudible) had been convicted.
10 But in your experience, I assume you work with
11 organizations, small businesses that have put in
12 place some sort of effort to get a compliance
13 effort going. Can you describe what a best
14 practice smaller business might look like that
15 you work with in contrast that with someone who's
16 paid no attention? And what are some of the
17 differences in the organizations?

18 MR. COWDERY: I'll try. I think you
19 have three shades of the spectrum. You have the
20 small business that has not put in any kind of
21 written plan, much less any implementation of a

1 written plan. That's a significant percentage.
2 I couldn't put a number on it, but it's a lot.
3 Then you have another significant percentage that
4 has put in a written plan in the drawer, that
5 hasn't followed up on it, and that's -- of the
6 people who have put in a written plan, most of
7 them fall into that category. There are really
8 very few small businesses in my experience, and
9 by this I mean fewer than 50 people, that engage
10 in auditing practices or have a ombudsman or have
11 a hot line or do those things. Most small
12 businesses, I think, evolve because somebody
13 knows how to make something or sell something or
14 do something, and that's -- that's how they get
15 started and they grow, but they continue to grow
16 around that mind set. And so all of those things
17 tend to gravitate around lawyers, and those small
18 businesses don't have an in-house counsel. The
19 ones that do have an in-house counsel, the
20 in-house counsel is running around doing a lot of
21 different things. And these -- these kinds of

1 practices and audits and so forth tend to be
2 driven by lawyers or at least inspired by
3 lawyers.

4 MS. BUCHANAN: I have such a list of
5 questions for you.

6 MR. COWDERY: I can't wait.

7 MS. BUCHANAN: First off, I guess one
8 thing that -- where do I start? In reading
9 through your testimony, I noted that a lot of the
10 carrots that are applicable to the larger
11 corporations really aren't paying the bulk for
12 smaller corporations.

13 MR. COWDERY: Yes.

14 MS. BUCHANAN: In part because the CEO
15 is generally involved and the like. Is there any
16 way to make those carrots be -- in terms of the
17 structure and the balance, is there any way to
18 make this such that small companies have
19 incentive to do this? And I guess the follow-up
20 to that is, why do you think -- I understand that
21 the small companies are very concerned with their

1 business and are thinking -- probably not
2 expecting to be indicted, which I think is
3 probably the foundation of this. But you also
4 point that maybe they're not doing it because
5 they don't know about the problem. There is a
6 lack of awareness, and is there anything we can
7 do about that?

8 MR. COWDERY: I think a lot don't know
9 about the guidelines. Probably most don't know
10 about the guidelines. Often I find when I get
11 involved in one of these investigations, which is
12 invariably too late, they don't even know about
13 the offense conducted and all of the rules and
14 regulations surrounding that.

15 You're correct. I do think that most
16 of the carrots aren't available to small
17 businesses. I don't think there is anything you
18 can do to make them available to small businesses
19 because I think the very nature of small
20 businesses where the operation and management of
21 the company tends to surround a very small

1 nucleus of high level people. It's -- it's going
2 to be very difficult to craft anything that is
3 literally coherent, and I think you will run into
4 firestone of opposition from the prosecution if
5 you start to allow carrots where high level
6 people have been involved and not carrying out a
7 compliance program if they have one or engaging
8 in criminal conduct if they have one. I thought
9 it through, and it was useful for me to do it in
10 writing the summary of testimony, but I don't
11 really see an easy way.

12 MS. BUCHANAN: I mean, for instance,
13 your discussion in your prepared testimony
14 indicated that often times there's a double
15 whammy --

16 THE REPORTER: Just wait a minute.

17 MS. BUCHANAN: I'm sorry. A lot of
18 times there's a double whammy --

19 THE REPORTER: Wait a minute.

20 MR. COWDERY: It's a microphone thing.

21 MS. BUCHANAN: In your prepared

1 testimony, for example, you indicated that
2 there's often this double whammy. People are
3 assessed points because of the level of the --
4 the high level involvement in the offense and
5 they also can't get effective compliance credit
6 because of the level of function created. You
7 know, would it be possible to eliminate that
8 double whammy, for example, of small businesses?
9 Or you also mentioned that in terms of collateral
10 consequences are particularly meaningful for
11 small businesses and you said that there's no
12 departure to that. Should there be? I mean, I'm
13 not (inaudible) this, but I'm sort of trying to
14 stipulate some sense of what it is that you do to
15 make the guidelines more meaningful for small
16 companies?

17 MR. COWDERY: Again, I have to say I
18 don't know. I'm sort of left with the sense of
19 beware of the Commission bearing gifts because I
20 think that -- I think for every one thing that
21 might help them, they'll be two or three that

1 don't help them. I mean, my experience quite
2 frankly is these things never change for the
3 better from my perspective. So anyway I think
4 there's some other questions.

5 MS. KUCA: My question is sort of
6 weaved in with Julie's, which are in your
7 research when you were preparing your written
8 statement and in your experience as a
9 practitioner, how often do you see these small
10 companies being indicted and the individual who
11 owns the companies? So you're looking at dual
12 indictments of the company and the individual.
13 And can you expand a little about your
14 experiences with that, whether one is safe and
15 the other is not or -- and then the survival of
16 the companies after the indictment. How many of
17 these end up out of business?

18 MR. COWDERY: That's a great question.
19 Most of the time you don't end up in the dreaded
20 sentencing hearing with no agreement. Most of
21 the time something can be worked out. When you

1 end up in that situation of a wide open field,
2 nothing but a judge and some guidelines and a
3 defendant in a corporation, it's usually not a
4 good thing. I think in my experience the times
5 that it has happened has been where the
6 corporation has gone to trial, and the
7 corporation has gone to trial because its
8 president or owner is also going to trial. In
9 those instances where it's happened, and there
10 haven't be many in my practice, there will be one
11 case the small business did not survive. In one
12 case, a small business did survive. In two cases
13 the small business did survive. Most of the time
14 there is a fine imposed on both the owner of the
15 company and the business. There is a provision
16 in the guidelines -- it's 8C3.5. That allows for
17 there to be an offset, and I was able to argue
18 that and the judge provided some relief on that
19 basis but not a dollar-for-dollar relief as it
20 happened.

21 So one of the problems that you have

1 in that scenario is many of these companies are
2 involved in regulated conduct, and as a result of
3 the conviction you can have exclusion or
4 debarment problems which are sometimes very
5 difficult to survive depending on the kind of
6 business your company is in. So there are a lot
7 of things that work together to make it very
8 difficult for a corporation to come out of one --
9 a small business to come out of one of these
10 things alive, and only part of that has to do
11 with the guidelines. But if the fine is really
12 more than the company could possibly pay, that is
13 a very substantial contributing factor to the
14 company's demise.

15 MS. KUCA: Just a follow-up question
16 also sort of teeing off of other comments. We've
17 talked about lack of awareness. If you could say
18 with regard to companies not or small companies
19 not imposing compliance programs or having these
20 sort of three different areas of compliance
21 programs and nothing at all to a paper program,

1 which -- do you think it's more lack of
2 awareness, lack of budget, lack of human
3 resources to implement, or is it equally a
4 combination of all of those?

5 MR. COWDERY: I think it's a
6 combination of all. I just don't think the
7 orientation of the small business is around any
8 of this stuff. I think a large number of them
9 are not aware of this in any kind of specific
10 way. I think there probably are some that are
11 aware that there are these sentencing guidelines
12 and, therefore, you need to hire a law firm to
13 put together a plan, but then they don't follow
14 up on it because unless you have constant
15 involvement of counsel or auditors, it does -- it
16 tends to gather dust.

17 MR. SPRATLING: I was surprised at the
18 conclusion of your oral remarks that small
19 businesses are better off (inaudible) because
20 they seem more expansive than your written
21 remarks which said you wouldn't like the change

1 if they resulted in the erosion of some of the
2 allowances. And following up on what Julie said,
3 I wonder if there are some changes that benefit
4 small corporations as well as large corporations.
5 I mean, you also said in answer to Julie that the
6 reason you've never seen these things change for
7 better, which accounts for your further
8 conclusion of oral remarks, but I'm thinking
9 particularly -- I'm thinking particularly about
10 your concern that small businesses cannot qualify
11 for an effective compliance program because of
12 the rebuttal presumption (inaudible).

13 You say that on account of representing
14 small businesses. You may or may not know that
15 the same complaint comes from representatives of
16 large businesses. And, in fact, the same
17 complaint comes from the antitrust section in
18 the American Bar Association that represents obviously
19 the large businesses. And the reason is because
20 in your case the rebuttal presumption is that --
21 and you have a problem because by nature of the

1 corporate structure, the small closed nature and
2 the operation of the company in other types -- in
3 other types of cases with a large corporation,
4 some complain that will always be the case. That
5 is, high level people will always be involved
6 because of the nature of the offense.

7 (Inaudible). So my question is, do
8 you -- can you see a change in the guidelines
9 that would benefit small corporations as well as
10 large corporations with respect to that
11 rebuttable presumption? Is there something that
12 might be done? We've heard some other
13 suggestions, and I don't want to put other
14 people's suggestions before you. But isn't that
15 a way that a small corporation could be helped,
16 as well as possibly a large corporation?

17 MR. COWDERY: I don't think so, and I
18 think the reason that my comments maybe distilled
19 down a little more this morning than in my
20 written testimony is I just thought about it some
21 more. I think two things, Gary, that will make

1 it very difficult for that to happen. Number one
2 is the position of the government. I just think,
3 for the most part, if you're in a situation where
4 the government is opposing credit for a
5 compliance program, you're probably not going to
6 get it unless you've got a very compelling
7 showing. And I think that, in turn, is going to
8 boil down to whether you self-reported it and
9 self-reported it early. I think if you get in
10 early and self-report, everything will work out.
11 You'll probably get substantial credit for
12 cooperation, and the government is going to be
13 much more inclined to find that your compliance
14 program such as it was worked.

15 But I think the converse is also true.
16 If you don't self-report and you find yourself
17 being in the responsive position rather than
18 proactive, I don't think you're going to get it.
19 Because I think the government is going to say
20 no, and I think the judge is going to, for the
21 most part, follow with the government on it.

1 MR. SWENSON: One of the things I
2 think we grapple with is how do small companies
3 achieve compliance? What's the process by which
4 they do that? Mr. Conrad said, and I think this
5 is something that most observers in the
6 compliance field would agree with, that tone at
7 the top is critical. If you are the CEO of a
8 company that is a company with a thousand
9 employees, the way in which you might "patch"
10 communicate that tone would probably be more
11 formal, would you not agree, than if your company
12 is the people sitting at the table who you
13 see every day?

14 MR. COWDERY: Sure.

15 MR. SWENSON: Is that a fair --

16 MR. COWDERY: Oh, absolutely.

17 MR. SWENSON: So if that's fair,
18 really what a large company would need to do to
19 to (inaudible) top message would be we'd need to
20 have specific instructions for management to
21 place around the world so we can understand what

1 our CEO is talking about in training and so forth
2 because our organization is inaudible. But in
3 a smaller organization, that's more easily
4 accomplished by just simply on personal
5 interaction every day. There really are those
6 differences.

7 What would prevent the Sentencing
8 Commission in whatever changes it may have if it
9 made any continuing sort of -- or trying to
10 articulate those differences? And just before
11 you answer, I guess, you mentioned one difference
12 the guidelines already make between larger and
13 smaller companies that's defining offset for
14 closely held corporations. The probation section
15 has a provision that says generally if the
16 company doesn't have a compliance program, it
17 ought a probation be ordered to propose one, but
18 that doesn't apply to the companies with
19 employees fewer than 50. There's an aggravator
20 for high level involvement, but it kicks up
21 according to the size of the organization. Would

1 that same kind of sort of line drawn be possible
2 as a way of in a sense recognizing that the ways
3 in which small companies could achieve compliance
4 can be far less formal than the ways in which
5 larger companies do?

6 MR. COWDERY: I guess the answer to
7 your question is yes, sort of. I think that a
8 corporation can -- the guidelines already make a
9 recognition that there's a different level of
10 formality that applies to smaller businesses as
11 opposed to larger businesses. I think the
12 problem you run into, however, with the points
13 you're raising are the what are now called the
14 rebuttal presumptions and the problems that arise
15 when a high level person is involved. And I
16 think those are fairly fundamental concepts, and
17 that's what I can't really find a way around
18 dealing with the small businesses or a large
19 business. I completely agree that the tone set
20 at the top of the organization is critical to the
21 organization's pattern of compliance or

1 noncompliance. That's undisputably true in small
2 businesses.

3 But the next question is, if there is
4 a breakdown or problem there, what -- where do
5 you go then? And I'm afraid once that happens,
6 getting credit for a compliance program over the
7 objection of the government when somebody, either
8 an owner or president or a vice president, was
9 involved and at the enter of the wrongful
10 conduct. I don't see how that's going to happen.

11 MR. JONES: Last question.

12 MR. HOWARD: First let me say I make
13 no apologies for promising your appearance.

14 MR. COWDERY: It's all your fault.

15 MR. HOWARD: But secondly is I read
16 your paper and prepared remarks. You were saying
17 although they may be meager, there are some ways
18 that courts can help protect small businesses,
19 principally revolving around the ability to pay
20 restitution orders, but your observation is
21 courts are not doing that. Is there anything

1 that we can or should do from your perspective to
2 help encourage a more refined determination on
3 that point?

4 MR. COWDERY: Well, I thought about
5 that and I thought about making one modest
6 suggestion and decided against it on the theory
7 that it's better to leave them alone, but right
8 now this -- the ability to pay business and the
9 restitution business, if you're out practicing is
10 really tending towards awarding full pay for
11 everything. I mean, the restitution statute
12 initially was a discretionary statute. It
13 required the court to consider the defendant's
14 ability to pay and so forth. And courts for a
15 while did that and over the last decade have
16 really stopped doing that under the discretionary
17 statute, and then Congress put in a mandatory
18 restitution. And I believe courts, and I know
19 probation officers, have really sort of gotten in
20 the habit of just putting down the full number.
21 And I think courts are less focused on ability to

1 pay issues than maybe they have been in the past.
2 I'm worried that that is going to spill over into
3 ability to pay a fine.

4 To answer your question, Chuck, I
5 think that one thing -- the language of the
6 guideline says "may," and there's a court that
7 contrasted the corporate guideline to the
8 individual guideline and said, well, this one
9 says "may" and the other one says "should." When
10 I went back and looked at those guidelines, I
11 didn't see the distinction that the court saw.
12 If the guidelines said ordinarily should, that
13 would perhaps tell the court that this is
14 something that you ordinarily should do rather
15 than, you know, you might do it but you really
16 might not do it too. But that would be a change,
17 and I'm not sure I'd want to advocate any
18 changes.

19 MR. JONES: The clock is ticking and
20 we need to move onto the next speaker, and the
21 next in the key is Dr. Stuart Gilman, president

1 of the Ethics Resource Center.

2 MR. GILMAN: It's a great honor to be
3 here today. Many old friends and hopefully some
4 new friends too talk about what I consider a
5 critical issue. I have submitted not only formal
6 comments but also formal testimony because one of
7 your colleagues asked me to address three
8 specific areas, which I'm going to try to drill
9 into a bit today. But I really wanted to
10 emphasize that from my point of view where a
11 person stands on any given issue sort of depends
12 on where he or she sits. And as I understand it,
13 we are the only independent, not-for-profit
14 organization that's been asked to testify before
15 you. And I thought it was at least worthwhile
16 mentioning that ERC, although I'm relatively new
17 to it and so I cannot claim credit for doing any
18 of these things, has had a long and storied
19 history in this area, including publishing the
20 first government wide U.S. code of conduct in
21 1980s, in 1985 helping General Dynamics set up

1 the first formal organizational ethics office in
2 any corporation, in 1985 advising the president's
3 Blue Ribbon Commission on defense management that
4 ultimately led to the DII, and I could go on,
5 including some of the motivation for the
6 guidelines themselves that came out of research
7 that had been done at the Ethics Resource Center.
8 And we continue to do research in this area, and
9 I have some concerns that I will raise that have
10 been presented in previous presentations. Simply
11 to raise them as questions for you and, again,
12 they're outside of the bounds of my general
13 testimony.

14 First of all, in terms of small
15 businesses, I would argue you don't have a legal
16 question. I think you really have a publicity
17 question. One symptom of that is a
18 year-and-a-half ago, I gave a speech for the
19 Small Business Administration in which the
20 General Counsel and the Inspector General came up
21 to me afterward and said that I had no idea there

1 were corporate sentencing guidelines. We talk
2 often times to ourselves. It's a closed
3 community, and we assume other governmental
4 entities. They provide 20 percent of the funding
5 for small businesses in the United States, and no
6 one in the organization had the foggiest idea
7 that this was in play. That's a publicity issue
8 I would argue respectively. It doesn't take away
9 some of other concerns, but I would suggest on
10 the frond end it's far more easy to prevent these
11 sorts of issues rather than to adjudicate them on
12 the other end.

13 And, second of all, I urge you to take
14 a slightly different perspective in terms of
15 viewing this merely as a legal issue having
16 worked in the government at the U.S. Office of
17 Government Ethics for almost 15 years.
18 Inevitably when people got into trouble, it's
19 because someone gave them the advice or basically
20 the individual asked the question, all I want to
21 know is it against the law. That is the sort of

1 thin ice that people slip into. The metaphor
2 I've often times given with very senior leaders
3 many times not taking my advice, including Mr.
4 Espy, the former Secretary of Agriculture, is one
5 of my prime examples of how to get into trouble
6 the easy way, was, well, there's nothing
7 absolutely against the law about that. Perhaps
8 no one would notice if I did it, and I think that
9 there is a cultural issue that you need to
10 address because I think that, in fact, sentencing
11 guidelines, in effect, have an impact on the
12 culture of corporate corporations in the United
13 States. And I think it is a very, very important
14 role to play and you have a very important role
15 to play today.

16 I'm going to address three very
17 specific issue areas that I've been asked to
18 really focus in on. The role of the leader, the
19 role of the board of directors, and the problem,
20 the creation of an ethical culture within an
21 organization. And I'll apologize because this

1 afternoon -- I guess on the good news side, I
2 will have to travel to New York City, but my able
3 partner in crime here -- I guess non-crime, Pat
4 Harned, who's our managing director for programs
5 will be here this afternoon.

6 But we're giving the Stanley Pace
7 award to an outstanding executive of a private
8 company. Ira Lippman of Guardsmark, who makes
9 not only a model citizen in the ethics community
10 but drills down in an organization in which
11 ethics is emphasized at every step and every
12 turn. It's widely recognized as a company that
13 has an ethical culture that has been driven from
14 the top without the kind of mandates that
15 publicly-held companies have. And so it gets me
16 very easily into what is the role of the leader
17 and some of the questions you basically have
18 asked of us.

19 Much conversation regarding
20 organizational leadership is centered on business
21 scandals, the most appropriate way to avoid

1 similar circumstances. It is critical to note
2 that Enron had a fully compliant ethics program.
3 I would argue compliant on paper and not in
4 reality. You're going to blow the whistle, you
5 call Ken Lay (phonetic). The example I gave, I
6 was at the War College last week with a group of
7 very senior officers. It's, like, sort of I'll
8 call the Secretary of Defense and explain to them
9 why we have a problem here. It doesn't work. It
10 never was designed to work, and I think we all
11 recognize that. And I think that's part of the
12 debate, part of the conversation we're having
13 here today.

14 Everyone knows, and, by the way, there
15 is research to back this up, that successful
16 ethics initiatives require much more than legal
17 compliance. They have to be in a culture where
18 that legality makes sense to the individual
19 employee. And I'm going to try and explain some
20 of those kinds of issues I hope in a way that
21 makes sense for the issues that you're trying to

1 deal with.

2 Right now you're one of the two voices
3 to which the corporate business community is
4 paying attention. Sarbanes-Oxley is one of the
5 previous panelists mentioned, and I will testify
6 to this. I think it is a mess. It was driven
7 through Congress and winds up much like a camel,
8 something that was put together by a committee
9 and looks like it and will take years to sort
10 out, I think, on the legal scene. It's an
11 opportunity, though, I would suggest for the
12 Sentencing Commission because as the second
13 voice, I urge you to think about the minimum and
14 rather think about how these guidelines can
15 affect corporate culture. Where Sarbanes-Oxley
16 requires executive leadership to attest to the
17 integrity of their organization's financial
18 reporting around overall operations, it begs a
19 fundamental question that you have an opportunity
20 to address. An effective system of monitoring an
21 oversight of the business conduct of

1 organizations is described in chapter eight and
2 some of the recommendation -- recommended changes
3 assumes a culture of integrity. Executives
4 seldom have full knowledge that the data that
5 they're attesting to and reporting are valid.
6 What they're validating is that their employees
7 have acted ethically when conducting their
8 business. That is dependent upon a culture that
9 promotes high standards and rewards good people
10 for doing the right things.

11 The business community, I would argue,
12 is actually looking to the sentencing guidelines
13 for guidance outside the morass of
14 Sarbanes-Oxley. They don't want it sort of left
15 to the lawyers to argue over the next five years
16 in terms of meaning of that legislation because
17 it is contradictory both internally and
18 externally. I've been to a number of reviews at
19 various law firms. Sarbanes-Oxley has created a
20 wonderful cottage industry, by the way, and there
21 are a lot of people doing that. The point

1 basically at the end of the day is, what are we
2 doing for that corporate culture. How are we
3 making it better?

4 Leaders, in fact, have to set the tone
5 for organizational integrity at the top. We have
6 done the research. Many of you are familiar with
7 it. Those of you who are not, I urge you to go
8 to our web site free of charge. We provide
9 research all the time. In this case "Moral
10 Person, Moral Manager" done through our fellows
11 program, which supports the notion that being
12 perceived as an ethical role model is more than
13 simply being an ethical person. You have to be
14 out front there, and there are ways, I think,
15 that the corporate sentencing guidelines can urge
16 corporate leaders to take that role, to take
17 ethics seriously even in small businesses. It is
18 not too much to basically talk about integrity in
19 meetings. Ira Lippman has made a model of that,
20 and I would suggest respectfully that there is
21 much research, not a lack of research. There is

1 much research to support this. It's not in the
2 legal community. It's in the business ethics
3 community. I think it's very solid. I think
4 it's interesting, and I think it's persuasive.

5 Second of all, in terms of leadership
6 you must understand the cascade effect of this.
7 Senior leadership impacts on supervisors, and
8 supervisors impact on employees. In research
9 independently funded through the Office of
10 Government Ethics in 2000, the research found
11 that supervisory attention to ethics has a strong
12 relationship to program outcomes. They basically
13 view the corporate leader or the organizational
14 leader as creating the culture, but it's the
15 supervisor that directs the behavior. And
16 there's a direct cascade effect that is
17 measurable and demonstrable, and the point
18 basically is that leadership is critical. And
19 holding leadership accountable, I think, is a
20 critical element in terms of the responsibility
21 that you all have here today.

1 Second, an unanticipated finding of
2 the study is that supervisors tend to have a more
3 positive perception of the cultural factors and
4 outcomes than do non-supervisors. Supervisors
5 really believe that corporate culture affects
6 them. Most people in the line don't see that
7 impact, but in effect directs their behavior.
8 Thus leadership changes culture, but individual
9 employee behavior is most immediately impacted by
10 the employee's immediate supervisor. ERC fellows
11 research provides supporting evidence on this in
12 a variety of different ways, and I don't want to
13 drill down too formally in that. You'll find
14 that in my testimony and as well as in the
15 documents we have provided.

16 What we are concerned about in terms
17 of corporate leadership is that ethics offices
18 and ethics officers are in effect migrating down
19 the chain of command in many organizations. We
20 think that's a dangerous trend, and the reason
21 is, I would suggest, the lack fundamentally of

1 the efficacy of the guidelines in terms of the
2 immediate corporate impact. It's interest -- and
3 they've gotten old. They need to be refreshed,
4 but part of it is that, well, we don't see a lot
5 of people punished under this and, therefore,
6 what we're going to do is we'll put it down one
7 or two chains. We'll make the ethics officer
8 report second in line to the second vice
9 president of HR. The impact of that from my
10 point of view is deadening. The ethics officer
11 from my -- again, from the ERCs point of view
12 plays a role as a transmission link between
13 supervisors and managers and the senior
14 leadership, and, in many cases, by the way, to
15 the board. The board of directors can and does
16 play a critical role for this.

17 One additional reason for the
18 migration downward of ethics officers is the
19 failure of the current language in chapter eight
20 to specify to whom the officer should report.
21 Subsequently, many ethics officers have lost

1 saliency in their organizations. Although the
2 guidelines state that there should be high level
3 personnel responsible for an effective program.
4 The ERC believes the language is too vague. It
5 is our position that the ethics officer must have
6 direct and unfettered access to the highest
7 authorities within an organization, including the
8 CEO, COO, and CFO and appropriate members or
9 committees of the board. One way to characterize
10 this level of access to see the ethics officer is
11 a direct report of both the COO and the board.
12 Unless you think that's impossible, American
13 Express does that right now. There's not an
14 ideal model. There is a model that is in play.

15 What is the role of the board? Boards
16 must take an active role in shaking the ethical
17 culture of the organizations they serve. The
18 board of director sets the tone of the company as
19 a whole, and the board must oversee the design of
20 the ethics program itself and accept
21 accountability for its eventual success. And,

1 again, I'm coming from the federal government
2 where, in effect, there are designated agency
3 ethics officials appointed in every department
4 and agency in government. But the Ethics in
5 Government Act of 1978 specifically states that
6 ultimately the responsibility for the ethics
7 program is that of the head of the agency. They
8 cannot delegate that responsibility. They can
9 delegate the functions, but the responsibility
10 rebounds back to them, and I think that it's
11 critical that we recognize that in the board's
12 role.

13 Recognize the urgency of expanding
14 compliance programs beyond satisfying simply
15 legal and regulatory minimums. If all they can
16 do is tell you exactly what the law is rather
17 than if you're not careful you're going to step
18 over the line, you need to be concerned about
19 this. I'm not generalizing about legal
20 counselors, but often times in the rush
21 day-to-day how difficult it is to say -- for

1 someone who basically says is it the law, and you
2 say no, it's not against the law and you never
3 have a chance to say another word. Compliance
4 officer, I think, need to have a stronger voice.
5 Remove communication barriers between the top of
6 leadership and the ethics officer levels.

7 ERC recommends to you to go passed
8 simple benchmarking of current industry standards
9 and compliance with current law regulation.

10 Remind boards that they're responsible for
11 meeting fiduciary obligations to employees,
12 shareholders, and ultimately to society as a
13 whole. That's what a publicly-held company
14 means. That's why we created it. Require that
15 boards be obliged to establish objectives for
16 ethical conduct of CEOs. The irony is that's far
17 more common in Europe than it is in the United
18 States, and I think that it's a tragedy. Require
19 the board design a performance review and
20 compensation system for the CEO and other high
21 level personnel to ensure that the ethical

1 culture of the organization is maintained. And
2 this kind of makes me -- it kind of brings me to
3 my last point in terms of ethical culture.

4 Encouraging ethical culture. The
5 question is, should you? And the answer is yes.
6 I mean, I can't believe that anyone has answered
7 no to that, but perhaps from a very narrow point
8 of view it would make sense to someone. The idea
9 that you would say that we don't want to create
10 an ethical culture, especially after this past
11 year, seems outrageous to me both on a personal
12 level and as someone who both is a citizen of the
13 United States and who has profound investments in
14 publicly-traded companies throughout this country
15 and throughout the world.

16 You should require organizations to
17 make systemic and sustained efforts to create a
18 culture that fosters ethical business practices
19 and ethical employee behavior. Ensure the focus
20 on the intent of legal and regulatory
21 requirements and avoid mere technical compliance

1 that could potentially circumvent the intent or
2 spirit of the law regulation. Ethical business
3 practices and ethical employee behaviors are
4 shaped by perceived organizational expectations
5 and the observation of those actions that are
6 modeled in terms of whether they're punished or
7 rewarded. There are many companies represented
8 in this room and many companies and corporations
9 throughout the world that I've worked with that
10 have very good, very fine systems, and they don't
11 simply look at legal compliance.

12 The organization's efforts to create
13 an ethical business culture should be observable,
14 measurable, and open to audit. Absolutely
15 reasonable standards. We encourage a climate
16 where employees can report, observe misconduct,
17 and appropriately raise and voice their ethics
18 concerns. And this is essential. Employees are
19 often unwilling to report misconduct and report
20 ethical concerns because they fear retaliation.
21 They believe no action will be

1 taken under compliance. The solution is to place
2 greater emphasis on that ethical culture.
3 Encourage reporting by ensuring that reports are
4 valued, acted on, and result in appropriate
5 responses and provide positive consequences for
6 employees making those reports.

7 Finally, in summary, legal compliance
8 ought to be only a minimum standard. I think if
9 it's the only standard, it is more dangerous than
10 having no standard at all. To be very honest,
11 I've seen it in practice, and I think the
12 nightmares are certainly consequent there. The
13 federal sentencing guidelines for organizations
14 should encourage organizations to reach higher,
15 evolving towards the highest standards and
16 seeking the minimum rather than seeking the
17 minimum that society will tolerate. Where we
18 experience a crisis of trust and confidence
19 today, in part, is the belief that many (inaudible)
20 regarding the value of ethics in corporations.
21 Skating on the fine line of (inaudible)

1 and turning one's back on higher ethical
2 principles I don't think is the responsibility of
3 this board nor of the sentencing guidelines.
4 Public confidence in our institutions is too
5 dear. It costs too much to pay for it through
6 ethical minimalism. The bar must be raised and
7 the suggestion and recommendations we have
8 presented here today seek to urge you to do just
9 that.

10 The dilemma -- and I've worked with
11 colleagues in the legal profession for years.
12 The dilemma is always unintended consequences,
13 but that's the excuse for absolutely doing
14 nothing. I would suggest you take a slightly
15 higher standard, and I will quote and take, I
16 hope, no offense if I quote from Deuteronomy.
17 When Moses is complaining to God about how
18 difficult all of this is, God speaks to Moses and
19 says, "It is not beyond your strength or beyond
20 your reach. It is not in heavens through that
21 you need to wonder who will go to heaven for us

1 and bring it down to us so we shall have it. Nor
2 is it beyond the seas so that you need to wonder
3 who will cross the seas for us and bring it back
4 to us so that we can hear and keep it. No, the
5 word is near to you. It is in your mouth. It is
6 in your heart and you can do it." Thank you.
7 I'll be glad to answer any questions.

8 MR. JONES: I think in fairness to the
9 other speakers because the last set of speakers
10 are going to hit on similar themes with respect
11 to ethics and leadership given the comments,
12 we're going to go right to Professor Paine and
13 then to Steve Priest and have some time for the
14 members of the group to ask any of those three
15 individuals because I do believe that their
16 themes are similar. I want to provide them with
17 an opportunity to make their statement on the
18 record here, so Professor Paine.

19 MS. PAINE: Thank you very much. I
20 will follow the model of sort of an informal
21 discussion of some of the points that were in my

1 written comments, and then I hope we'll have some
2 time for some questions and interchange. Can
3 everybody hear?

4 UNIDENTIFIED SPEAKER: Uh-huh.

5 MS. PAINE: Thank you very much for
6 inviting me here today. I'm actually going to
7 make four suggestions about the guidelines. I
8 guess I come from an environment where change is
9 by definition good in itself, so in terms of
10 where we all sit on the desirability of change
11 it's a very interesting background question here.
12 I should -- before I get to those suggestions,
13 though, I should probably tell you where they
14 come from and they grow out of the research that
15 I've been doing over the last two decades. My
16 research has not actually focused on compliance
17 and ethics programs per se. My focus has been on
18 the question, a broad question, which is how do
19 you build a responsible company and by
20 "responsible," I mean a company that conducts its
21 business in a way that's responsible vis-a-vis

1 its core stake holders and the broader community.
2 And within that broader question, of course,
3 ethics programs, compliance programs come in as
4 an element in some organizations.

5 I've pursued this research really
6 along three different tracks. The first is an
7 exploration of what you might call moral
8 dilemmas, ethical dilemmas. This is how people
9 think about and how we should deal with questions
10 where there are no clear answers, where you have
11 competing values, where maybe you have new issues
12 brought up in technology, or changing social
13 morals or whatever that are really unsettled
14 moral questions. That's not so relevant to what
15 we're discussing here today.

16 The second line of research does bear
17 more directly on what we're discussing and that
18 is the origins of misconduct in organizations.
19 And my research has focused on large
20 organizations, and it is focused on the kinds of
21 misconduct that are typically found in those

1 organizations. Why focus on some large
2 organizations? Many of our students will become
3 leaders of publicly-held corporations and so that
4 is part of the reason that that has been my
5 focus.

6 The third line of research has looked
7 at companies that try to position themselves as
8 responsible companies, that their leadership
9 wants to build a responsible company. They've
10 tried to do it, and they've -- so I've tried to
11 look at, well, how they do it. So those three
12 lines sort of feed together into this broader
13 question of how you build a responsible
14 organization.

15 And looking at those three lines of
16 research, I come back to sort of three categories
17 of things that are absolutely critical. I won't
18 go into the details which would take a lot of
19 time, but let me just give you the headline
20 categories because under each one there are a lot
21 of important things. The first category is the

1 quality of leadership, which has already been
2 mentioned here, the skills, the capabilities of
3 the leaders, whether they actually exemplify the
4 standards and values they espouse, but in
5 addition their real understanding of the role of
6 the company in a broader society. Their
7 understanding as a company, as a collective
8 effort, and as a very complex system of
9 activities. So quality leadership then is a
10 broad category.

11 The second category is the
12 organizational design. How is the organization
13 structure? How are its processes designed, and
14 are those processes linked to these broader
15 responsibilities that we're talking about? If
16 you go into some organizations, you find that
17 they've got lots of processes, but they're only
18 focused on one thing. The organization as a
19 whole does not have the capability to be
20 responsible because it's poorly designed. It may
21 be a question of structure. It may be a question

1 of process. It may be a question of
2 accountability and controls. It could be
3 anything.

4 The third category is decision making,
5 that is, what are the frameworks and analytics
6 that people in the organization use to make
7 decisions? Do those frame works actually
8 incorporate consistency with law? When a
9 proposal comes up to, let's say, the leadership
10 team and they're deciding should we do this,
11 should we devote resources to that, does the
12 question -- is this consistent with law? Is this
13 consistent with our values? What is the effect
14 on our stake holders? Are those questions
15 answered in the course of the organization's
16 decision making. So those are sort of the broad
17 background things that I've been looking at. And
18 what grows out of that in relation to the
19 sentencing guidelines are really four
20 suggestions, and I say "suggestions" because I
21 know you have many, many things to consider in

1 this process. But from my point of view, my
2 first comment would be to resist the temptation
3 to provide ever more detail guidelines on how to
4 communicate, how to structure, how to audit,
5 monitor, and so on.

6 In my experience, many, many people
7 want very highly detailed guidance, and, in fact,
8 they will follow it. However, just because it
9 satisfies the guidelines doesn't mean they will
10 actually be effective in the organizational
11 context in which they are working. The better
12 approach, I believe, is to provide the broad
13 general functional specifications that you've
14 tended to provide and for organizations to work
15 out what those mean in the context of their legal
16 environment, their regulatory environment, their
17 own standards, the industry and the structure of
18 the organization which needs to ducktail with
19 that.

20 Fundamentally I found that there
21 really is no single blueprint for building a

1 responsible organization. There are many ways to
2 do it. Just as there's no single blueprint for
3 building a comfortable and well-functioning
4 house. But there are certain things a house has
5 to do in order to be functioning --
6 well-functioning and comfortable. So as I've
7 said, I think specifying the functions, setting
8 standards, communicating, evaluating and so on is
9 absolutely our target. The key thing is that
10 that organization has got to create a context in
11 which every employee has the opportunity, the
12 knowledge, the ability, and the desire to do what
13 is responsible. So that's my first suggestion.

14 The second suggestion comes back to
15 this question of effectiveness. I think that's a
16 crucial issue, and the guidelines currently
17 acknowledge that by requiring that programs be
18 effective. But it's in a way surprising if you
19 come from a management background that there's no
20 actual requirement that a company demonstrate the
21 effectiveness of its program when it applies for

1 the benefits. That is, the program is presumed
2 to be effective if it has the elements laid out
3 in the guidelines. My suggestion would be to
4 consider requiring companies to present their own
5 evidence of effectiveness of when they apply for
6 the benefits being offered to them. This would
7 also seem a necessary correlate to the design
8 flexibility that I think is important. The
9 flexibility in the design of the program should
10 be justified by its effectiveness. And while
11 there are no, as far as I'm aware, currently
12 existing contested and widely accepted models for
13 evaluating effectiveness, I believe that this is
14 an important area, and there are many experiments
15 going on right now.

16 The Sentencing Commission would have
17 an opportunity here to stimulate innovation and
18 to stimulate work so that perhaps eventually
19 there will be some framework for all of us as
20 citizens to understand and evaluate whether a
21 company as a whole is a responsible company. So

1 that will be my second suggestion.

2 People will ask about method -- well,
3 I won't go into that. That will take a long
4 time.

5 My third suggestion really is to board
6 level oversight, and here I would suggest that
7 assigned responsibility for the companies'
8 compliance and ethics efforts should be assigned
9 to someone, some independent directors of the
10 board. Now whether or not a special committee is
11 required I think should be left up to the board,
12 whether it could be the responsibility of an
13 existing committee. This is also quite possible
14 depending on the organization. This suggestion
15 really grows out of the need for checks and
16 balances at all levels of the organization and
17 not just the middle levels, and I think the only
18 way that anyone will have the clout to address
19 any misconduct arising at higher levels of the
20 organization is going to have to have the support
21 of the board of directors.

1 More over, as many people have already
2 pointed out, probably the single most important
3 factor -- although it's not alone sufficient, the
4 single most important factor is probably the
5 quality of leadership. And if there is
6 misconduct at the top and it's not dealt with,
7 that's going to set -- that does set the tone for
8 the entire organization. So without good
9 measures of the effectiveness, which relates to
10 the second point, certainly there has to be some
11 support from the board for the continuing
12 vitality of these efforts.

13 Now I know we've had some problems
14 with boards, right? Plato asked, "Who guides the
15 guardians?" He didn't answer it, and I don't
16 answer it either. I mean, I think fundamentally
17 all of us are our own compliance officers, you
18 know, in the final analysis. So I don't know
19 where to go beyond that, but the board is
20 responsible for the inaudible of the overall
21 organization. It has the fiduciary duty, as I

1 pointed out, to the shareholders and to the
2 corporation so that would seem appropriate and
3 would also contribute to the overall
4 effectiveness of these programs.

5 Finally, my last suggestion is --
6 concerns the centrality of the performance
7 assessment and compensation systems to the
8 effective functioning of any organization. One
9 thing that I was struck with as I looked at cases
10 of organizational misconduct is the power of the
11 performance measurement and management systems
12 and compensation systems in corporations. And
13 the truth be told when push comes to shove, those
14 are the driving forces of the organization. And
15 given that and assuming that actually legal
16 compliance high standards are important in
17 companies, I think the Commission should consider
18 requiring ethics-related in the evaluation award
19 and compensation of individual's business units
20 in the corporation as a whole as a part of what
21 is required.

1 This relates back to the discussion
2 that was going on a bit earlier about high level
3 misconduct. I think that unless a company can
4 show that it has actually considered the
5 individual's compliance with company standards
6 and with laws adherence to those standards and
7 laws -- even with the performance evaluation and
8 promotions process, it's very difficult to figure
9 out why the company should be given credit for a
10 compliance -- an effective program.

11 So those are my four suggestions, and
12 I'm happy to answer any questions or to begin a
13 discussion about any of these.

14 MR. JONES: Before we begin the Q and
15 A, we want to hear from Steve Priest, president
16 of Ethical Leadership Group, who it's my
17 understanding will continue the statement and
18 maybe expand upon a couple points. Then we'll
19 open it up for how ever much time we need. I see
20 a lot of writing going on. I know that there are
21 questions, and all the panelists will be

1 available for questions when Mr. Priest finishes.

2 MR. PRIEST: Thank you. Thank you for
3 having me here. I've been told that you can
4 read, so I won't read my testimony, and also I'm
5 hoping, though, you can't tell time. I was told
6 never to go after two attorneys and two Ph.D. but
7 alas here I am.

8 We know how important all of this is
9 in the United States. I spent much of the last
10 three months meeting with executives in Latin
11 America, Europe, Asia, and I have to tell you
12 their perceptions. I mean, the first perception
13 is a little bit glee, you know, that, oh, you
14 Americans who are so proud of your ethics and so
15 proud of your corporate governance systems, you
16 are the ones who have had these multi-billion
17 dollars scandals, not us. Now of course they're
18 pleasantly ignoring some of the facts that
19 happened in their economies, but there is a sense
20 of glee. Underneath the glee, digging deeper is
21 a real sense of disappointment that we are

1 supposed to be the standard setters of global
2 governance of good ethical practices and that we
3 have let the people around the world who are
4 trying to reform their economies and their
5 system -- we have let them down. So your job is
6 doubly important, not just for our economy but
7 for the global economy.

8 I'm going to make several points. The
9 first one is fairly speculative. I hadn't
10 thought of it until I studied the sentencing
11 guidelines and even until after I had these
12 conversations with executives around the world,
13 and that is that the guidelines in some parts
14 talk about an effective program to prevent and
15 protect violations of the law and other parts
16 talk about criminal conduct. I think a modest
17 suggestion, but a speculative one, is changing
18 the entire scope of the guidelines from criminal
19 conduct -- or, actually, making it more
20 consistent (inaudible) an effective system to
21 prevent and detect violations of the law rather

1 than focusing solely on criminal conduct might be
2 of benefit to all of us in this field. That's
3 the speculative suggestion.

4 On the firmer ground, I want to talk a
5 little bit about culture and about what makes an
6 effective program to detect and prevent
7 violations of the law. This ground is based on
8 ten years of consulting experience mainly with
9 Fortune 500 companies. Although, I have run a
10 micro business, an under ten employee company.
11 Even if you stretch all of our people, we're
12 under ten employees. So I have a lot of sympathy
13 and admiration for the flexibility in the
14 guidelines as written now. Three years -- for
15 three years before that I ran a think tank in
16 ethics. Before that I had a divinity degree, but
17 I will not quote Deuteronomy. My -- any of us --
18 I also have been a father for 17 years and a son
19 for 42 years, and families are organizations too.
20 Any of us who have been members of families,
21 small organizations, or medium-sized

1 organizations or huge Fortune 500 companies know
2 if you strip everything away there are only three
3 things that any organization needs to do foster
4 good conduct. The first is to clearly
5 communicate standards, clearly communicate
6 standards that promote good conduct. The second
7 is to have a culture, an environment, or a
8 context in which living up to those standards is
9 possible and, yes indeed, even rewarded because
10 the third thing we have to do is have
11 consequences, positive consequences, for
12 behaviors that live up to those standards and
13 negative consequences for behaviors that don't
14 live up to those standards.

15 The sentencing guidelines currently
16 address the first and third quite effectively.
17 They talk about clear standards, and they talk
18 about consequences for inappropriate action.
19 They don't talk about culture or environment or
20 context. I would love -- I would love the
21 sentencing guidelines to address that clearly,

1 even before the present scandals with the list of
2 villains that grows longer and longer. I
3 would -- there's no ethics and compliance officer
4 in the world who would deny the critical
5 importance of culture. A code versus culture,
6 the culture wins. Training versus culture, the
7 culture wins. A hot line versus culture, the
8 culture wins. And yet the term culture is
9 divisive I've noticed in talking about this, and
10 people in the judicial system are loathe to
11 start talking about culture because it's so
12 ambiguous. And it is a bit tricky. We've worked
13 with clients who have very effective cultures
14 that are very high trust and high empowerment
15 cultures, and we've worked with clients who have
16 very effective programs, and they have very high
17 rule based, high enforcement cultures. Two very
18 difficult kinds of cultures. Both are
19 sufficient. Both set up an environment where
20 people do live up to the law.

21 So I would like to suggest a more -- a

1 modest way to achieve the cultural progress we
2 all desire, and that is to require, suggest,
3 cajole that since we're talking about an
4 effective program to detect and prevent
5 violations of the law anyway, just make an
6 assessment of that program and requirement of it.
7 It seems like common sense.

8 If we have to have a program, we
9 should be assessing to see if we have a program,
10 but yet you have to parse -- no matter how you
11 sort of parse the current guidelines, there is no
12 requirement for organizations to monitor how
13 effective their program is, to assess how
14 effective their program is. And here I don't use
15 the word audit, and I don't think that --
16 following up with Lynn Sharp Pain's comments, I
17 don't think we should be over specific here. I
18 mean, organizations depending on their size might
19 say employee survey is good and they might say
20 bench marking with other companies is good and
21 they might say a suggestion box is good. There

1 are a number of ways where organizations can
2 monitor the effectiveness of their program. But
3 simply requiring it unleashes what American
4 business is great at. We're great at creativity.
5 We're great at innovation. We're great at
6 bench marking, and it leaves flexibility or the
7 desired flexibility, I think, for the smaller
8 organizations.

9 I especially don't think you should
10 mention, you know, things like you need to have
11 an outside audit or you need to involve outside
12 attorneys or consultants or auditors. Again,
13 undue burden for smaller organizations, and, by
14 the way, the -- we've done most of our work with
15 large organizations. Much of the smaller ones --
16 we've had wonderful experience with a client who
17 is trying -- they're very dependent on their
18 supply chain, a lot of smaller companies, and
19 they have spent a lot of time and a lot of money
20 nurturing the supply chain trying to communicate
21 the sentencing guidelines to them. The first

1 challenge as Stu mentioned is that very few small
2 organizations know about the guidelines. But
3 I've got to tell you, even after explaining it to
4 them, there's a heavy resistance because they
5 think that this is going to impose a bureaucracy.
6 They think it's going to stifle their innovation.
7 They think it's going to be an added expense.
8 They don't believe that there's anything in it
9 for them, that it's too heavy in rules and
10 regulations and doesn't -- doesn't recognize what
11 is the pivotal aspect of a small organization
12 which is the culture and the tone at the top, the
13 informal communications that comes from a CEO.

14 My last point is through our work with
15 many organizations, the reporting relationship
16 between the ethics and compliance officer, the
17 person charged with that responsibility, and what
18 in our experience is an independent committee of
19 the board of directors where the organization has
20 a board of directors is the critical element.
21 Reporting to a CEO is nice, but more critical is

1 having the independent -- the relationship with
2 the independent committee of the board. It gets
3 the board involved. This way you don't need to
4 define board chart or the board of -- if they're
5 being reported to is going to be involved, and
6 organizations tend not to -- they tend to put
7 good people in a position where they're going to
8 be reporting to the board of directors, so you
9 finesse that issue of the quality of person who
10 is in that role.

11 It's an important job. There's a lot
12 of heat, smoke, and light about corporate ethics
13 and corporate responsibility in 2002 in America.
14 If history is any guide, in a few years the
15 American public and hence Congress will have
16 forgotten all about it, so it's your actions and
17 the decisions you make that will have a lasting
18 impact on corporate practices and so I thank you
19 for doing that.

20 MR. JONES: Now given the
21 distinguished panel, we're not doing too bad on

1 time here. It has been raised -- I will
2 identify -- I know there's lots of questions. I
3 saw lots of note taking, and the first question
4 with no follow up will be to Mr. Petry who has
5 not had a chance to ask any questions yet today.
6 So Ed Petry.

7 MR. PETRY: Thank you, Todd. And this
8 is a question to the entire panel. I think every
9 single one of you have mentioned the importance
10 of tone at the top. And certainly beyond this
11 panel it's mentioned in nearly every -- the
12 legislation, the inaudible requirements. Most
13 of you have also referred to whether or not you
14 think the guidelines should or should not include
15 some language on the responsibility of the board.
16 However, I'm asking a slightly different
17 question, and that is do you believe the
18 guidelines should be modified in some way to
19 specify the responsibility of senior management
20 more than is currently specified in the
21 guidelines?

1 MR. GILMAN: Can I take a -- I'll try
2 this again. Yes, and let me at least put it into
3 context. One of the things that I've seen in
4 terms of European compliance systems is, in fact,
5 the serious attention that is paid to ethics.
6 Once it is absolutely clear that no matter how
7 the organization deals with the ethics problems,
8 issues, guidelines, compliance systems in place
9 that ultimately the CEO or senior management or
10 someone is responsible for that. They can't
11 simply, you know, say, well, I have delegated and
12 so, you know, that's not my responsibility. I
13 think clearly identifying that is a reasonable
14 step. I think it's a reasonable step for all
15 organizations because certainly in small
16 organizations it's usually the CEO, the senior
17 leader, who's making those decisions. And so I
18 think clarifying what I think is implicit in the
19 guidelines right now I think would be very
20 helpful.

21 MR. JONES: Any other response from --

1 MS. PAINE: I want to take a slightly
2 different -- I can see two different ways you
3 might go here. One is to specify
4 responsibilities of senior management. The
5 alternative would be to make ethics and
6 compliance related criteria pertinent to the
7 evaluation and compensation of management at all
8 levels, and I think that -- do we reserve the
9 right to think further about our answers?

10 My first reaction is to favor the
11 second approach over the first just, again, on
12 the grounds of flexibility of what -- how the
13 responsibilities might be allocated in a given
14 organization and that the board is going to be
15 evaluating and compensating the CEO and so the
16 thought process that goes into what are the
17 responsibilities, what are the measures of
18 effectiveness, and so on would seem to require a
19 sensitivity to specific organization. So it
20 would be a way to accomplish that goal but under
21 a broader umbrella.

1 MR. JONES: Richard Bednar.

2 MR. BEDNAR: Thank you. I'm
3 interested in hearing some suggestions about
4 metrics, metrics that a CEO or board may use in
5 assessing the effectiveness of this program.
6 This is an issue that a number of companies
7 struggle with. Some try to look to a number of
8 key tone? actions following its company vis-a-vis
9 the industry, somewhat to criminal complaints,
10 incidents of debarment. They use employee
11 surveys to see what the perception is among
12 employees, but I'd like the advice of our
13 distinguished panel on what they believe are the
14 most effective approaches to assessing the
15 effectiveness of the program.

16 MR. PRIEST: With the qualifier this
17 is for large organizations --

18 MR. BEDNAR: Yes.

19 MR. PRIEST: And with the assumption
20 that metric means numbers, and one of the reasons
21 we use assessment of program as a phrase is more

1 pertinent than audit is because there are many
2 kinds of measurements of an effective program
3 that go beyond numeric metrics. But those two
4 kind of provisos with the three areas we look at
5 that have numeric metrics that have proven to be
6 very valuable for the companies that are -- that
7 have done these things. The first one is
8 employee surveys, and when you ask employees, you
9 know, can you report violations without fear of
10 retaliation, how many -- have you observed this
11 kind of conduct? What have you done when you
12 observed it? Do you have the kind of culture
13 where you can bring up concerns? Do you feel
14 pressure ever to violate company standards?
15 These kind of -- these kind of metrics,
16 especially over time, show clear directional
17 progress and hold sort of divisions of
18 organizations accountable. You know, when you've
19 got 49 divisions that are -- that are giving an
20 80 percent mark on employees who know the
21 standards and you have one division where they're

1 giving a 40 percent mark, you can do something in
2 that division. You invite that divisional CEO in
3 to talk to corporate headquarters, to the audit
4 committee, and say can you tell us why you've got
5 this number. That's not a very pleasant
6 experience. Most of them would rather not be
7 there.

8 So the employee survey metric has been
9 enormously valuable. The call line or help line
10 statistic, which we've done the research on and
11 was quoted in several other testimonies, is
12 another very useful metric that measures not
13 just, you know, the paper part of the program but
14 whether employees know about this mechanism and
15 trust it. The third part is the mechanism you
16 suggested, trying to quantify the legal actions
17 taken. I think that's the complete answer.

18 MR. GILMAN: Very quickly, I think
19 some of this echoes to Steve. I think we're well
20 on our way to developing metrics, but I don't
21 want to take away from the qualitative elements.

1 We do on a regular basis for several large
2 multi-national organizations internal surveys.
3 What's been very useful is we also benchmark that
4 against the national and business ethics survey
5 which we do biannually because it at least gives
6 some comparative framework because you wind up
7 often times within an organization having a
8 danger of an echo chamber. You know, things
9 aren't progressing but they're not really going
10 back and you assume things are okay, and I think
11 there is some danger in that. But I also
12 understand, Dick, that your organization DII is
13 looking to what I think is very useful, and that
14 is beginning to norm some of these results.

15 The problem, for example, with a
16 whistleblower hot line is that if you get nine
17 calls a year or 9,000, you can explain one either
18 way. But if you can norm that in terms of type
19 and size of company and then begins talking about
20 within a standard deviation, what ought that to
21 look like, at least there's some warning bells.

1 That, of course, is for a very large
2 organizations. I think there are very quickly
3 coming about some very interesting metrics for
4 small organizations to get in and do a litmus
5 test in terms of focus groups of small
6 organizations. And I would with one proviso, I
7 think that Steve is absolutely right. We don't
8 want to create business in the audit community,
9 but I think there is a danger with only doing
10 internal assessment. And I don't -- and I don't
11 want to exclude it, but I think that there is
12 some value to having some independent outsider
13 look at that assessment so that you don't create
14 an echo chamber effect in terms of measures.
15 It's a difficult question, but I think it's one
16 that is critical and worthwhile and I think we're
17 moving toward that.

18 MR. JONES: Lynn.

19 MS. PAINE: I would just make one
20 small point, and it -- this implicates the
21 question of whether the Commission's mandate is

1 just criminal misbehavior or whether this is
2 broader mandate responsible corporate behavior.
3 One of the developments that I have stated, along
4 with all of my fellow panelists and I'm sure many
5 in the audience, is that companies are beginning
6 to try to create metrics linked to their
7 standards of conduct. So go, for example, where
8 there shall -- going through each principle and
9 saying all right, if we successfully do this,
10 what will be the indicators of our having done it
11 and then trying to pull out of that what they
12 call key performance indicators and using that as
13 a way of evaluating whether or not they're
14 actually living up to the standards they espouse.

15 MR. CONRAD: Just real quickly, I
16 think I'd like to echo the comment about
17 normalization because a lot of these metrics
18 really can be as much a function of the size of
19 the organization as whether its -- how well
20 compliance is occurring. The other is the
21 important proviso around numbers of types of

1 legal actions because there really is kind of an
2 irreducible externality to that in the sense that
3 they're driven into -- some are to greater
4 extents by predilections and prosecutors and
5 other kinds of essentially random factors, and
6 there could be companies that are just as
7 noncompliant and just haven't been caught for
8 whatever reason. I don't say that from personal
9 experience.

10 UNIDENTIFIED SPEAKER: That was the
11 optimistic view.

12 MR. FIORELLI: First of all, I'd like
13 to thank all the panelists, and I think that you
14 for me have done a very good job of showing kind
15 of the extremes as to what can or perhaps should
16 be done. You know, look at Mr. Conrad's written
17 testimony talking about the sentencing guidelines
18 and what the United States Sentencing Commission
19 should be doing in a situation and what's
20 appropriate for it to do. Is it just crime
21 control or punishment or that we look at some of

1 our -- what Stu was talking about creating
2 ethical culture. I'm wondering if there is --
3 first of all, I'm wondering about the probation
4 officer that is reviewing a case to see is this
5 an ethical corporation and how she or he makes
6 that decision and recommendation to the judge. I
7 have problems with that and am troubled by that.
8 If you have any commentary or specific language
9 that you could submit to us that we could
10 consider incorporating into the guidelines, I
11 certainly would appreciate that.

12 But the second point, is there
13 possibly a middle ground? If we have guidelines
14 that specifically state that here are seven,
15 eight, nine, five minimal requirements of what we
16 design to be an effective program that detect
17 violations, is it possible to include perhaps
18 within the commentary of the guidelines which are
19 not necessarily binding but could talk about
20 things like and we encourage this -- Stu Gilman
21 said we encourage organizations to do more than

1 the minimum. We encourage them to have
2 ethical -- you know, to be ethical organizations.
3 And, again, this may not have the force of law,
4 but it would tend to nurture and encourage and
5 nudge organizations in that direction.

6 So it's really kind of a two-part
7 question. Is that a workable and middle ground,
8 and if it is, would that kind of language -- with
9 the organizations you deal with, would that give
10 them any additional -- would that give them any
11 additional support or encouragement or is it just
12 additional language?

13 MR. PRIEST: I have an MBA from the
14 University of Chicago, so markets rule. And in
15 this regard, the markets have far outpaced the
16 sentencing guidelines at least in 2002. The main
17 incentive for organizations to do the right thing
18 isn't the possibility of an increased penalty.
19 It's because they don't want to be executed in
20 the court of public opinion. Anything positive
21 in the commentary is, I think -- will be of

1 long-term value when the markets become
2 overinflated again and this little episode in our
3 corporate history is forgotten. So I -- I think
4 it's maybe not a necessary item now, but a
5 helpful one.

6 MR. GILMAN: If I can, I don't think
7 it's unhealthy to think of this as a risk
8 management strategy. I not only want to agree
9 with Steve, but really echo this. I think it's
10 really healthy to have the footnotes because
11 people actually read them when crises come. It's
12 like what do you really mean by that. It's --
13 and I think it is critically important, but the
14 one piece I don't want to lose in all of this
15 because I've worked with parole officers, if you
16 put in there that there should be some
17 demonstrable proof, assessment -- I don't care
18 what language you use, but these are really in
19 place. There is not really a check box. In
20 working with parole officers, the tendency is do
21 they have a code of conduct and nook in the wall.

1 Yes, that's -- check. Don't ask where it came
2 from or why. It could have gotten out of the
3 local magazine or whatever. It actually makes no
4 difference whatsoever.

5 Having some language in there about
6 what substantively we mean in that area and
7 giving them the obligation to say assess it, is
8 it real, is it substantive. And I'm willing --
9 and I absolutely agree, by the way. I don't want
10 detailed guidance in this. I mean, it will be a
11 nightmare. But at least giving some positive
12 responsibility to those individuals to say that
13 there's more than simply checking the boxes as a
14 parole officer I think is really critical.

15 MR. JONES: Michael Horowitz.

16 MR. HOROWITZ: I want to go back to
17 all the business questions we asked at the
18 beginning, and Mr. Cowdery and Mr. Conrad had a
19 (inaudible) and focus questions that lasted with
20 three speakers. Are small businesses trying to
21 put in place compliance programs, ethics

1 programs, values programs? If they are doing
2 that, what kind of steps are they or should they
3 be taking and how do those differ from what
4 larger institutions are putting into place?

5 MR. PRIEST: Our experience is,
6 basically, they are not. This is not a
7 scientific -- it's not based on any scientific
8 research, but each -- but recounting our
9 experience with this large manufacturer and their
10 supply chain, this is a pretty good example of
11 middle American small companies. And ten percent
12 of them had programs that you would say were, you
13 know, an effective compliance program and a few
14 more maybe had pieces of papers their lawyers did
15 years ago in a drawer. But most of them were
16 doing business and thought, you know, we're a
17 good small company and we're good at what we do
18 and of course nothing like that is ever going to
19 happen here and if it does we'll deal with it
20 when it comes.

21 I don't know. I really don't know

1 what we collectively can do to communicate these
2 standards better. I think it's more than just a
3 communications challenge. I think it's more than
4 just a challenge that they look to owners.
5 There's something -- there's something else.

6 MR. GILMAN: I guess my experience is
7 slightly different than Steve's. I've had the
8 opportunity to address several chambers of
9 commerce, by the way, which I think were very
10 good vehicles, and they were absolutely
11 fascinated by this idea. And I think that, in
12 fact, although you can read the guidelines as
13 fairly onerous, in fact, they're fairly liberal
14 in terms of small companies. And what they
15 basically want is a sign that in effect you take
16 this issue seriously. I mean, I know there's
17 more depth to that, and I've been actually very
18 pleased. When you sort of expose people because,
19 it's like -- it's not that you have to hire a
20 lawyer because you don't have to hire a lawyer to
21 write a code of conduct. I'm sorry. You don't.

1 I mean, obviously if you were looking for legal
2 protection -- I'm sorry for taking business away
3 from colleagues. But, in fact, that can be done
4 internally and probably ought to be done
5 internally. From my point of view, I think in
6 terms of having traction it really ought to be
7 done within the organization. I think there are
8 good ways of doing it.

9 I really think that it's start -- I
10 agree with Steve in one sense. It's not
11 publicity alone, but I think that if we could get
12 an effective way out there, that this is a -- and
13 not only an affirmative obligation in one sense,
14 but a really good positive way of putting your
15 business up front both out of danger but sort of
16 leading edge in this particular area. I think
17 there's a great deal of traction and, again,
18 attraction to small businesses. And it's
19 interesting.

20 I'm going out to West Virginia. I
21 won't use that as an absolute model to address 80

1 small businesses who were absolutely fascinated
2 that this was required and wanted to talk about
3 what could they do internally. I think it's a
4 good dialogue and a good beginning to a dialogue
5 that I think is critically important. And, in
6 fairness, the Commission has been focused on
7 large companies for the last ten years. It's a
8 good thing to begin talking about, let's
9 publicize it and let's make it attractive to
10 those small companies to sort of take those
11 initial steps. I don't know if that's helping
12 Michael or not, but that's my experience.

13 MS. PAINE: Let me just add one thing.
14 Your question highlights for me this distinction
15 between the compliance program and the compliant
16 company. And even though I have been studying
17 mostly publicly-traded companies, one of the
18 things that comes across very clearly is that
19 many of the companies started as small companies.
20 And the culture that was set by the individuals
21 at the beginning had tremendous impact on how the

1 organization evolves. And the organizations that
2 tend to become responsible large companies
3 started out as responsible small companies with
4 leaders who made it a value -- was a value of the
5 organization that we would adhere to law. That's
6 a core value in the organization. So as I'm
7 listening to this, I'm trying to figure out how
8 can you take that observation and turn that into
9 something that is useable when it comes to
10 assessing that company's efforts in terms of
11 legal compliance.

12 MR. JONES: Last question. Lisa Kuca.

13 MS. KUCA: I have a question to the
14 panelists that spoke, the last three. In my
15 experience when you start talking to companies,
16 regardless of the size, about legal and
17 regulatory compliance, there's a lot of
18 enthusiasm in the beginning and then when they
19 really see what it entails through an economic
20 standpoint and from the totality of it, from the
21 human resources that are going to be necessary to

1 do it, the response comes back, let's do the
2 least we need to get by. And I'm curious what
3 your experiences are when you're trying to
4 encourage an ethics-based program or ethics
5 integrated into the legal inaudible, legal and
6 regulatory compliance piece. What are the
7 drivers? What is actually making these companies
8 shift from just the red letter of the law to the
9 more ethics-based because I'm not seeing any
10 interest at all out there in wanting to tackle
11 that.

12 MS. PAINE: I'll take a shot at that.
13 I was surprised by the opening of your question
14 about the initial enthusiasm. I've never
15 encountered the initial enthusiasm. Maybe later.
16 Especially when it comes to legal compliance.
17 The enthusiasm, to the extent there is
18 enthusiasm, comes from the notion of creating a
19 great company, creating a company that's really
20 excellent. And a company that's really excellent
21 has a set of values, and those values have

1 typically involved doing the right thing, being a
2 good citizen. Being a good citizen means obeying
3 the law, and then for reasons not only risk
4 management, organizational functioning, market
5 positioning, civic positioning, companies will
6 embark on ensuring that the company lives up to
7 these values. Legal compliance is sort of a
8 subset. I've never seen anybody want to start
9 out with, yeah, give me all of those rules so
10 that we can comply with them.

11 MR. GILMAN: Yeah, I want to echo
12 that. I mean, our experience has been that
13 usually there are two types of companies that
14 come to us, ones that are in really deep trouble
15 and that presents its own set of problems, ones
16 that basically want to simply be in compliance
17 and ones that simply want general information
18 about it. And all of them ultimately start with
19 the position they want to protect their name.

20 I really hate -- when it comes down to
21 it, you know, what can we do to protect our

1 reputation. There is a great Warren Buffet quote
2 that it takes 20 years to develop a reputation
3 and five minutes to destroy it, and I think that
4 the current climate is really addressed there.
5 And ironically, I think you're far more able to
6 get to the legal compliance by starting with the
7 values base side. And there's some companies who
8 will throw up their hands and say I'm not
9 interested in that, we don't do that kind of
10 thing. But by around large, those are the
11 companies that are in trouble anyhow and all they
12 want to do is give us this sort of wallpaper
13 around us to protect us.

14 Those companies -- and there are many
15 of them. I really want to emphasize that many of
16 them not only in the U.S. but globally. And
17 Steve and I have not, but we can compare notes in
18 terms of experiences. I just got back from Dubai
19 of all places which basically at a conference on
20 corporate governance where the major focal point
21 was integrity in the transition of family-owned

1 businesses to publicly-traded businesses and the
2 essence of integrity in terms of those kinds of
3 issues. And they've started out now with a law
4 because it doesn't exist, but what are the kind
5 of values that we have to have in order to make
6 this viable so that we're part of that global
7 marketplace and then we'll backtrack and worry
8 about the laws.

9 And that's why I think that when
10 someone talks about ethical culture, it sounds
11 like an abstraction. It sounds like you're --
12 it's intangible, but I guess the point that I
13 would make is, in fact, the sentencing guidelines
14 has the ability -- and this is bad English. To
15 make the absolutely intangible tangible. The
16 intangibleness tangible, and I think that one of
17 the pieces about this is that the values piece
18 really get you to the law. It's very
19 difficult -- one person comes and says all I'm
20 interested in is legal compliance to get them to
21 the values. That's been our experience

1 generally.

2 MR. PRIEST: Three quick points. One,
3 the cost of a decent compliance program or an
4 effective one is extraordinarily low. It's a
5 rounding error on the income statements of the
6 Fortune 1000. Second, any company that has to
7 think about whether the cost benefit is worth it
8 isn't going to have an effective program anyway
9 because the principle -- the commitment isn't
10 there to do the right thing from the beginning as
11 Ms. Sharp Paine described. And, thirdly, we
12 asked them to talk to other companies who have --
13 you know, to do a very fast and dirty
14 bench marking and find out the benefits from them.
15 And when they -- when these other companies say,
16 you know, for a very small investment not only
17 have we reduced our exposure legally but we
18 increased employee productivity and moral but our
19 customers feel better about us, but our PR, our
20 reputation is better, and we go through the
21 lists. The NGOs who were beating on us before

1 are beating on us a little less. The list of
2 benefits are pretty darn high for the small costs
3 that are accrued.

4 MR. JONES: I want to thank our
5 morning plenary session. Excellent information
6 and Q and A. We're going to be in recess for
7 five minutes to switch over to the next panel and
8 try to stay on track. Thank you.

9 (Plenary Session I recessed 10:40 a.m.)

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