12TH ANNUAL COMPLIANCE & ETHICS INSTITUTE
WASHINGTON, DC, OCTOBER 6-9, 2013

REMARKS OF HON. PATTI B. SARIS
CHAIR, U.S. SENTENCING COMMISSION
MONDAY, OCTOBER 7, 2013
8:30AM – 9:00AM

Good morning. I am delighted to join you this morning at your Annual Compliance & Ethics Institute. I am pleased to note that the audience today represents a broad array of industries and includes companies with household name recognition. As some of you may remember, in the early years of the Commission's efforts to develop organizational guidelines, some of the loudest and most adamant opposition to its efforts came from the business community. As a judge for 20 years, I have rarely had to apply the organizational guidelines. These cases generally come to me signed, sealed, and delivered by the parties. It is also not surprising that I don't often see organizational cases because there are generally 200 corporate cases per year, as compared to over 84,000 individual cases.

However, as chair, I have learned that in the years since their initial promulgation, the Organizational Guidelines have been seen as a success – a fact that can be attributed to the support for ethics and compliance programs from the business community. The Commission is very appreciative of your continued commitment to creating an ethical workplace that complies with the law.

This upcoming November, the Federal Sentencing Guidelines for Organizations will have been in existence for twenty-two years. As many of you know, the Commission was created amidst calls for general sentencing reform. In 1984, Congress passed the Sentencing Reform Act, a piece of bipartisan legislation, which sought to address unwarranted disparities in sentencing. I was working for Senator Kennedy at the time the legislation was being considered, although I was not there when it passed. The Act created the Commission, an independent agency in the judicial branch, and charged it with the responsibility for developing sentencing guidelines. We work in a bipartisan fashion. The Sentencing Commission has produced *two* sets of sentencing guidelines—one that applies to *individuals* who have been convicted of committing federal crimes, and the other that applies to all types of defendant *organizations*, including corporations, partnerships, trusts, unions, funds, non-profits, and governmental entities.

The Commission worked from its creation in 1984 until 1987 to produce the guidelines that apply to individuals, and, due to the complexity of the issues in this area, it took an additional *four years* to develop the guidelines that apply to organizations. In the fall of 1991, the Federal Sentencing Guidelines for Organizations were born.

When the Commission created the federal sentencing guidelines for organizations, it had multiple goals: not only to establish rules that punish organizational defendants more proportionally and uniformly, but also to create a system that encouraged good business practices and that prevented and deterred corporate criminal activity. The Commission's answer was to develop guidelines that serve as both a front-end and a back-end mechanism for dealing with corporate crime using the "carrot and stick" approach in the organizational guidelines.

On the front-end, the guidelines encourage companies to police themselves; that is, to establish their own internal systems for preventing and detecting criminal or unethical activity within the organization. On the back-end, the guidelines provide for serious financial penalties if a corporation is convicted of criminal conduct, but they also provide mitigating credits for convicted organizations that have in place the kinds of front-end systems that the guidelines encourage. In other words, generally speaking, an organization is less culpable if it has an effective compliance program in place and lower fines are imposed where there is self-policing.

It is a goal of the Commission that organizations would come to view this organizational guideline scheme as a powerful financial reason for instituting effective internal compliance programs that, in turn, would minimize the likelihood that the organization would run afoul of the law in the first instance. The guidelines make clear that, in addition to fully cooperating with any criminal investigation, an organization must exercise due diligence to prevent and detect criminal conduct, and otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Specifically, the guidelines emphasize the importance of a "tone from the top" and the need for internal corporate monitoring and auditing as a means of deterring organizational crime. A good compliance and ethics program can significantly reduce a company's exposure to criminal and civil liability, not to mention preventing the serious harms to innocent victims that can result from unchecked and widespread corporate misconduct.

Of course, the key question is does it work? Have the guidelines and all of your hard work made a difference?

Looking back over these past twenty-two years, I think it is clear that the transition from a world in which corporate criminality was mainly the concern of government authorities to a situation in which many companies themselves engage in internal, self-initiated, self-policing campaigns to root out unlawful and unethical behavior is well underway.

We see evidence of the growing importance of compliance programs almost every day through the work done by our fellow government agencies, work being done on an international scale, and through business literature and reports prepared by organizations such as the SCCE. Harvard Business School and other institutions are beginning to study the topic. Let me give you a few examples.

Just two years ago, the Ethics Resource Center released a report regarding *The Federal Sentencing Guidelines for Organizations at Twenty Years*. While making several suggestions for improvements, the report begins with how far we have come. In the Forward, the ERC notes that the "[e]vidence shows that the Guidelines have achieved significant success in reducing workplace misconduct by nurturing a vast compliance and ethics movement and enlisting business organizations in a self-policing effort to deter law-breaking at every level of their business." “The [Federal Sentencing Guidelines for Organizations] have achieved significant successes, notably the vigorous efforts by many U.S. companies and other organizations to adopt comprehensive compliance/ethics programs. The new rules led to the creation of a new profession of compliance/ethics professionals, who now number in the thousands, to develop and implement the new corporate programs.”

The ERC similarly touted the importance of effective compliance programs in its last *National Business Ethics Survey*. Again while the report showed some mixed data regarding the compliance efforts among companies, such as increased retaliation rates, it noted, as a preliminary matter, that employees in companies with effective meaningful codes of conduct and programs based on the Federal Sentencing Guidelines for Organizations witness fewer incidents of misconduct and are far more likely to report misconduct when observed. More specifically, the ERC demonstrated that "[t]he NBES data shows that a well-implemented program leads to a strong ethical culture. The more employees perceive that their company has implanted a strong program, the more likely they are to perceive that they work in a strong ethical culture," and their figures seem to prove this out:

- "Eighty-six percent of companies with a well-implemented ethics and compliance program also have a strong ethics culture."

- "Fewer than 25 percent of companies with little to no program have a strong culture that promotes integrity in the workplace."

We also see the importance of effective compliance programs in practice. As I am sure many of you know, the Department of Justice and the SEC recently released new guidance regarding the prosecution of cases under the Foreign

Corrupt Practices Act. This guidance discussed the fact that prosecutors must consider whether to bring such a prosecution, with one of the key factors being whether the company had an effective compliance and ethics programs based upon the seven minimum requirements in the guidelines.

We have already seen this guidance in action. Back in April, the SEC announced that it was entering a non-prosecution agreement with the Ralph Lauren Corporation in relation to an FCPA violation. This non-prosecution agreement was the first that the SEC has entered involving FCPA misconduct. So what persuaded the SEC not to prosecute? The SEC made its determination based upon the company's prompt reporting of the violations on its own initiative, the completeness of the information it provided, and its extensive, thorough, and real-time cooperation with the SEC's investigation. The SEC noted that the underlying misconduct came to light as a result of the company adopting measures to improve its worldwide internal controls and compliance efforts, including implementation of an FCPA compliance training program in Argentina.

So, in that case, having an effective compliance program worked on both fronts. It allowed for the prompt detection of ongoing misconduct and made for a more efficient and effective investigation, and also mitigated the penalties it was required to pay.

Similarly, I recently saw an article in *Compliance Week* regarding another company that faced significant troubles in the early 2000s, Tyco International. I remember seeing news reports about expensive shower curtains and birthday parties. The story described how Tyco has risen from its lowest points, and has now almost fully recovered from both its financial and reputational woes. I found it particularly noteworthy that the new leadership of the company largely credits the company's recovery on a renewed sense of dedication to developing and promoting strong and effective compliance and ethical business practices. In doing so, the new management emphasized that, while work in developing its program was expensive, it was well worth it.

Further evidence of the successes of your work can also be seen on a global scale where we are seeing the structure set forth in the guidelines being applied to newly developing standards around the world. For example, the Organisation for Economic Co-Operation and Development (OECD) published its ***Good Practice Guidance on Internal Controls, Ethics and Compliance*** back in 2010. Notably, that guidance included most of Federal Sentencing Guidelines 7 elements. We also see a similar focus on the importance of compliance programs in foreign laws, including laws and standards being considered or passed in the UK, Australia, New Zealand, Canada, France and Chile, just to name a few.

So, I think the important message for you is that all of your hard work is making a difference. The Commission has been extremely gratified to see the business world embracing the concept of compliance and ethics programs as set forth in chapter eight of the guidelines, and it has been exciting to witness the growth of the ethics and compliance field. They hire compliance professionals such as yourselves, who take seriously the important work of assessing risk, training employees, conducting audits, and avoiding problems.

While the Commission is not currently working on amendments to the Organizational Guidelines, some of the Commission's other work will be of interest to you. As many of you may be aware, the Commission has already begun a multi-year review of the fraud guideline at §2B1.1. While §2B1.1 is primarily applied to individuals, any changes to the fraud guideline will also have implications in the area of organizational sentencing. As you aware, the base offense level in organizational cases involving fraud is derived from the offense level determined under §2B1.1.

Additionally, fraud is no small matter in organizational cases. Last year, fraud cases were the second most common organizational offenses reported to the Commission, accounting for almost 14 percent of all organizational cases (and 10% of individual cases). As these organizational cases cover the gamut of fraud, including mail and wire fraud (54.2% of organization fraud cases), healthcare fraud (29.2% of organization fraud cases), and false statement cases (16.7% of organization fraud cases).

As part of the Commission's review, I am proud to say that we just recently held a Symposium on Economic Crime in New York City a few weeks ago, which was an invaluable first step in our review. The transcript from the event will be available in the next few weeks, and I would encourage you all to read it, but let me give you some of the highlights of the event.

First, we were thrilled to have had former Congressman Michael Oxley as our keynote speaker. As I am sure you know, Congressman Oxley is best-known for the creation and passage into law of the Sarbanes-Oxley Act of 2002. While Mr. Oxley did not specifically speak about the organizational guidelines, he gave us some incredible insight regarding some of things that were driving Congress at the time the Act was passed.

Of course, one of the big motivators was misconduct by a number of large corporations at the time, such as Enron, and, while the Sarbanes-Oxley Act certainly impacted criminal penalties for economic offenses, Mr. Oxley noted that the other lasting impact was increased monitoring and reporting requirements placed on companies, including the creation of a new accounting oversight board for publicly traded companies and increased penalties for mail and wire fraud offenses. These changes directly led to the guideline amendments that resulted in the stand-alone guideline – §8B2.1 – that sets forth the requirements of an effective compliance and ethics program.

The symposium also gave us an opportunity to publicly acknowledge that we have heard the criticisms of the fraud guideline, particularly in high loss cases like fraud on the market, and to discuss how to address them. We heard from the various stakeholders in the federal criminal justice system, including judges, prosecutors, defense attorneys, and probation officers. Not surprisingly, we learned that opinions differ on whether the guideline is completely broken or simply in need of fine-tuning, and confirmed that there are no easy solutions.

In particular, we heard comments that the guidelines place a disproportionate weight on "loss." We heard different views about what would be a better measure of culpability. Some urged the Commission to weigh the merits of using "gain" instead of "loss" to determine the severity of an offense, and that the victim enhancements should focus more qualitatively on the harms to the victims than the mere number of victims.

Of course, evaluating these comments and coming up with a workable guideline construct that addresses all of these concerns is no simple matter with as many as 300 statutes tied to the fraud guideline, including organizational fines. As such, we expect to continue our study of these issues during the current amendment cycle and into the next, and will continue to solicit public input on these complicated issues. We welcome your thoughts on how any changes to the fraud guideline could impact your compliance efforts. Keep this on your radar screen.

While fraud is currently one of the areas on the Commission's agenda, we are mindful that there may also be other areas for consideration in the Organizational Guidelines. For example, when the Commission originally promulgated Chapter Eight of the guidelines, it decided to exclude certain types of offenses from the guideline fine calculations, including environmental and food and drug offenses. It has become clear in the years since that these offenses comprise a large part of the organizational cases that we see. For at least the past ten years, environmental offenses have been among the most frequently reported types of offenses in organizational cases, and for the last two fiscal years, have been the most frequently reported offense type in organizational cases. Similarly, food and drug cases regularly result in some of the largest corporate fines each year. In light of this development, I wonder, both as a Commissioner and judge, whether the time may be ripe for the Commission to resume consideration of the organizational fine provisions as applied to environmental and food and drugs cases. I would welcome your input on this matter.

We have also heard your comments requesting the Commission's guidance on ways to improve the compliance and ethics program, such as describing appropriate incentives for employees.

While the tone starts at the top, many of the decisions that could enhance or hinder the effectiveness of a company's compliance program are made outside the boardroom. In this regard, a strong ethical culture starts at the top with a company's most senior leaders so that it can cascade through the entire organization.

I have recently heard an interesting phrase to describe this. If there is a "tone at the top," there must also be a "mood in the middle" and a "buzz at the bottom" that reflect and reinforce the tone at the top. The point being that the implementation of ethics in an organization is only as strong as its weakest link as it flows down into the organization. Too often, however, the behavior of middle managers remains unchanged, and undermines ethical messages and the creation of an ethical culture which is a corporate priority. If middle managers are not committed to the values and ethics, this is immediately apparent to the lower level employees.

This is where incentives may come into play. We are certainly aware that some of you have asked the Commission to provide some specific examples of what and how incentives should be used. The Commission has hesitated to do so given the variety of organizations and industries, with different structures and business models, to which the guidelines apply. The variety among companies means there are any numbers of ways that may be appropriate to promote and enforce the organization's compliance program. It is for this reason that the Commission has endeavored to keep the guidelines flexible. Again though, we understand this is an issue of great importance to you and welcome your thoughts and any specific ideas that might be included in the guidelines.

Finally, the Commission has also received some comment about the sentencing in antitrust cases. In particular, we have heard comments that the Commission should reconsider how the guidelines calculate fines in these cases, arguing that they are too low in light of a new study regarding the profits of cartels. As the number of antitrust cases grows – in fiscal year 2012, it was the fourth highest type of organizational cases, 7 of the top 10 fine amounts from last year involved antitrust cases – the

Commission recognizes that this may be another area that might warrant further review. And, we know this is of growing importance to your industry as well, I note that you have a breakout group later today on this very topic.

Let me conclude by commending you again on your work. The expansion of the use of the guidelines' seven minimal steps for an effective compliance and ethics program beyond the criminal justice arena is not only a success for the Commission but is a credit to all who have participated in the development of the organizational guidelines. Your work has helped usher in an unprecedented era, where more and more companies are seeking to develop effective systems.

And that's the real payoff: when a company assumes responsibility for monitoring and addressing the behavior of its agents, courts don't need to do so.

Thank You.