

**PROCEEDINGS OF THE SECOND SYMPOSIUM  
ON CRIME AND PUNISHMENT IN THE UNITED STATES**

**Corporate Crime in America:  
Strengthening the  
“Good Citizen” Corporation**

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**SEPTEMBER 7-8, 1995  
WASHINGTON, D.C.**

# Corporate Crime in America: Strengthening the “Good Citizen” Corporation

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**Richard P. Conaboy**  
*Chairman*

**Michael S. Gelacak**  
*Vice Chairman*

**A. David Mazzone**  
*Vice Chairman*

**Wayne A. Budd**  
*Commissioner*

**Julie E. Carnes**  
*Commissioner*

**Michael Goldsmith**  
*Commissioner*

**Deanell R. Tacha**  
*Commissioner*

**Mary Frances Harkenrider**  
*Ex-officio*

**Edward F. Reilly, Jr.**  
*Ex-officio*



## INTRODUCTION

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The Sentencing Commission sponsored this second symposium on crime and punishment in furtherance of its various authorities to collect and disseminate information on sound sentencing policies and practices (*see* 28 U.S.C. §§ 991-98). The event was co-chaired by Commissioners Wayne A. Budd and Michael Goldsmith.

The organizational sentencing guidelines became effective on November 1, 1991. With a general focus on the organizational guidelines’ policy of tying potential penalties for criminal offenses to the quality of corporate self-policing efforts, the symposium addressed the following issues:

1. corporate experiences in developing “effective” compliance programs;
2. whether the government can (or should) do more to foster “good corporate citizenship”;
3. whether and when compliance practices should be protected from disclosure;
4. new models and proposals for evolving compliance standards;
5. the role of ethics, incentives, and private inspectors general in achieving compliance;
6. whether and how overlapping enforcement schemes can be coordinated more effectively; and
7. the views and experiences of the enforcement community on compliance and related “good corporate citizenship” issues.

The first day began with a welcoming address from Judge Richard P. Conaboy, Chairman of the Sentencing Commission, who stated that at the core of the organizational guidelines is the notion that “people committed to high ethical standards and carefully considered policies can, in fact, reduce corporate crime.” He added that he hoped the symposium would “provide a window” on the way in which corporations, industry groups, and

government enforcement personnel are responding to the organizational sentencing guidelines' emphasis on compliance programs and other crime-detering measures.

Two presentations followed that provided participants an overview of the organizational guidelines' operation and goals. L. Russell Burress, the Sentencing Commission's Principal Training Advisor, and Julie R. O'Sullivan, Associate Professor, Georgetown University Law Center, discussed the operation of the organizational guidelines' culpability score and other guideline features that combine to provide structured sentencing for organizations. Win Swenson, the Commission's Deputy General Counsel, then outlined the "carrot and stick" philosophy that underlies the organizational guidelines. This philosophy strongly encourages the establishment and maintenance of effective compliance plans to prevent and detect wrongdoing by providing for substantially reduced penalties for companies that have undertaken these actions but have nevertheless sustained a criminal conviction.

The program next turned to the first of 11 topical panels, each led by a moderator who laid out the issues to be addressed by the panel, facilitated the transition and interaction between the speakers, and relayed questions submitted by the audience. (Panel moderators were Jeffrey M. Kaplan of Arkin, Schaffer & Supino, and Commissioner Wayne A. Budd, Mary E. Didier, Marguerite A. Driessen, Donald A. Purdy, and Win Swenson of the Sentencing Commission). The first panel, consisting of Kenneth D. Martin of Sundstrand Corporation, Herbert L. Thornhill of the Bank of Tokyo, and John A. Meyers formerly of Tenet Healthcare Corporation, discussed experiences with compliance programs in the defense and general manufacturing, financial services, and health care industries, respectively.

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The next panel discussed the sharing of "best practices" information within four associations formed in large part for this information-sharing purpose. Members on the panel were Howrey & Simon attorney Alan R. Yuspeh, the coordinator of the Defense Industry Initiative on Business Ethics and Conduct, W. Michael Hoffman of the Ethics Officer Association, Thomas Furtado of United Technologies representing the Ombudsman's Association, and Anne L. Gill from Sprint who described the Telecommunications Industry Compliance Practices Forum.

The first day’s luncheon keynote address was given by Senator Edward M. Kennedy (D-Mass.), one of the principal architects of the Sentencing Reform Act that created the Sentencing Commission. Senator Kennedy discussed how the organizational guidelines brought greater rationality to federal enforcement of corporate crime. This system, he said, had been characterized by “law without order,” with penalties largely dependent on the views of individual judges. He emphasized that corporate crime is not “an overblown, anti-business invention of career-hungry prosecutors, regulators, and politicians,” but is “both serious and distressingly common.” In this regard, he praised the “serious commitment to compliance” that some companies are making.

Senator Kennedy added that government enforcement personnel must attempt to understand better what an effective compliance plan entails, and to coordinate criminal, civil, and administrative penalties to make federal policy more effective. He recommended that small businesses be given a fair opportunity to develop effective compliance plans as well.

The first afternoon panel presented the results of empirical research on compliance practices – cataloging what compliance practices companies are undertaking and shedding light on the differences between what companies believe they are doing and what employees actually perceive. The first three panelists presented results from Commission-sponsored studies: Andrew R. Apel of the Minnesota Association for Applied Corporate Ethics presented preliminary results from a national study of compliance practices; William S. Laufer of the Wharton School of Business presented the preliminary results of a study of small business compliance practices; and Edward S. Petry of the Center for Business Ethics presented preliminary results from a study of compliance practices in “compliance aware” companies. The remaining two panelists were Rebecca Goodell of Howery & Simon, and Mark Pastin of the Council of Ethical Organizations. These two panelists described, respectively, the Ethics Resource Center’s survey of ethics practices and employee perceptions, and the Council of Ethical Organizations’s study of organizational factors and their effect on compliance.

The first day’s program concluded with two breakout sessions. One breakout session was devoted to new models and proposals for compliance standards. Edward A. Dauer, President of the National Center for Preventive Law, discussed his organization’s efforts to develop standards for corporate compliance. James T. Banks, Director of Governmental and Environmental Affairs for WMX Technologies, Inc., presented the compliance plan designed by the Advisory Working Group on Environmental Sanctions. Christopher L. Bell, a member of the U.S. delegation to the Organization for International Standardization’s international environmental standards initiative (“ISO 14000”), discussed the development and implications of environmental quality standards in the global arena.

The second breakout session began with a presentation by Commission Staff Assistant Mary E. Didier on the flexibility of the guidelines’ approach to defining “effective” compliance strategies. Ronald Goldstock of Kroll Associates then discussed the value of using an “Independent Private Sector Inspector General” in fostering effective, credible compliance programs within organizations. Gary Edwards of the Ethics Resource Center discussed the principal causes of serious misconduct in organizations. He emphasized that a particularly problematic root cause of corporate misconduct involves employees who come to believe

mistakenly that management expects them to cut legal corners.

The second day of the symposium began with a panel presenting empirical data on organizational cases. Commission Research Associate John Scalia, Jr., discussed cases sentenced to date under the guidelines, and Kirk S. Jordan of Compliance Systems Legal Group discussed criteria in consent decrees.

The next two panels examined the interaction between the enforcement community and those subject to enforcement. The first of these panels consisted of Eleanor Hill, the Inspector General at the Defense Department, William B. Lytton of Lockheed Martin Corporation, and David N. Yellen of Hofstra University Law School. Ms. Hill discussed the successes of the Defense Department's Voluntary Disclosure Program. Mr. Lytton discussed the seeming lack of coordination in federal enforcement and noted that overlapping enforcement policies can send inconsistent or even conflicting messages to organizations. Professor Yellen explored the ways in which inconsistent policies can undercut strong compliance and suggested possible reforms.

The next panel was comprised of senior Justice Department officials who detailed their approaches to enforcement, especially with respect to compliance programs. Panelists were: Robert S. Litt, Deputy Assistant Attorney General in the Criminal Division, Ronald A. Sarachan, Chief of the Environmental Crimes Section of the Environment and Natural Resources Division, Gary R. Spratling, Deputy Assistant Attorney General in the Antitrust Division, and Eugene M. Thirolf, Director of the Office of Consumer Litigation in the Civil Division. The panel was moderated by Commissioner Wayne A. Budd, formerly Associate Attorney General of the United States.

The luncheon keynote address on the second day was given by Stephen L. Hammerman, Vice Chairman of the Board of Merrill Lynch & Company, Inc. Mr. Hammerman said that the securities industry generally believes that good compliance is "good business," noting that an attack on a corporation's reputation in the securities industry will cause an important lack of confidence both in the company and the capital markets. In his view, however, management must set the tone for how employees are to behave. He emphasized that while the general counsel should participate in correcting any wrongdoing, the highest executive in the business unit "bears the primary responsibility for taking compliance action and [for reacting] if one of their people does not adhere to good compliance standards." Mr. Hammerman stated that an effective compliance program requires a consistent and sincere effort at education that involves the active participation of senior officials.

The first afternoon panel updated the status of legal privileges and their relationship to compliance practices. Commissioner Michael Goldsmith of the Sentencing Commission discussed the relationship of privilege to the organizational guidelines' carrot and stick features. After canvassing current law, Commissioner Goldsmith observed that the compliance practices contemplated by the guidelines do pose some disclosure and liability risks. He discussed the possible implications of these risks and ways practitioners may respond to them. Patricia Bangert, Deputy Attorney General for National Resources in Colorado, discussed recently enacted legislation in Colorado designed to respond to these risks – at least in the environmental area – by 1) giving privileged status to self-evaluative audits that companies perform

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Joseph E. Murphy of Bell Atlantic recommended that government enforcement officials learn more about the practicalities of establishing compliance and ethics programs. He stressed the need for more incentives from government to reward innovative, compliance-supporting corporate actions. He expressed concern, for example, that voluntary disclosure can cause companies more negative consequences than positive.

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The Commission will continue to monitor sentencing practices for organizational defendants, amend the guidelines as experience warrants, and encourage organizational guideline training. In addition, the Commission will communicate with the private sector, business and law schools, and other interested parties to promote a more ethical, law-abiding corporate culture, and will work with law enforcement on issues concerning consistent, effective enforcement policies.

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*Chairman Richard P. Conaboy and Senator Edward M. Kennedy, flanked by symposium chairs Commissioner Wayne A. Budd (front left) and Commissioner Michael Goldsmith (front right), pause briefly following Senator Kennedy's keynote address to a capacity crowd. In the background, Senator Kennedy's Chief Counsel Ronald Weich (back left) and symposium coordinator Win Swenson, the Commission's Deputy General Counsel (back right), look on.*

*Photo ©1995 by MH Photography .*



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*Day One*

# **Welcome and Conference Overview**

**Judge Richard P. Conaboy, *Chairman, U.S. Sentencing Commission***



## WELCOME AND CONFERENCE OVERVIEW

CHAIRMAN CONABOY: We want to call this meeting to order, please. I have been a judge a long time and I often wish at an event like this I had a gavel. I have never used a gavel in my life, even though you see judges use it on television all the time, but I guess with a big crowd, you could use it.

Judge Mazzone mentioned to me this morning what a different appearing crowd we have this morning compared to the last symposium. Our last symposium was about drugs and violence. In that audience, you saw a variety of people including recovering drug addicts, police and law enforcement officials, and people in dungarees, pony tails, sweat suits, and every other type of garment that you can think of. Here today, we have all of you dressed in finery looking like we could have a wedding reception. And still, we're talking about the same thing, criminal conduct and control of crime in this country.

I am Judge Richard Conaboy, Chairman of the United States Sentencing Commission. It's my duty to welcome you here this morning and to open this program and begin what we hope will be a fruitful couple of days in discussing matters that have a significant impact on our entire country. So, in fact, I do welcome you to the Sentencing Commission's national Symposium on Corporate Crime in America: Strengthening what we call the "Good Citizen" Corporation.

I am delighted that we have such a diverse and distinguished group on hand for this very important event. It's my belief that you, as attendees of this symposium, are participating in something that's quite historic. Corporate crime is a problem in this country, a very distinct problem that undermines the public's health and safety, its financial security, and its confidence in the free market system.

Still, while corporate crime has proved persistent in many ways, new understandings are emerging to suggest that this is a problem we don't simply have to accept. These new understandings show that each of you here today, whether you work inside a company, whether you advise corporate clients or whether you teach or enforce the law, each one of you can advance the practices and policies that will make corporate crime less likely to occur and hopefully more easy to detect.

This idea, that people committed to high ethical standards and carefully considered policies can, in fact, reduce corporate crime is at the core of the Sentencing Commission's organizational guidelines, and it's the energizing force behind this symposium.

Because an understanding of the Sentencing Commission's statutorily prescribed mission is important to understanding why we have this symposium, I want to talk to you a little bit about three aspects of the Commission. When Congress created the Sentencing Commission in 1984, it assigned to this body a variety of responsibilities.

Foremost among these was the duty to develop what are called presumptively mandatory sentencing laws, which we call guidelines, for use in sentencing procedures in all of the United States federal courts. The Commission developed a comprehensive system of guidelines



to govern the sentencing of individuals in 1987. These guidelines were considered at the time to be evolutionary and, indeed, we continue to refine them to ensure that they work as effectively and as fairly as possible.

For example, the Commission is now engaged in a very extensive review of these individual guidelines to make sure that their effectiveness and their use is not undermined by undue complexity and rigidity.

In 1991, about four years after the individual guidelines were promulgated, the Commission issued a detailed set of guidelines to govern sentencing of corporations and other organizations accused of criminal conduct. As most of you know, these guidelines broke ground by codifying into law incentives for organizations to take crime-detering actions; especially and of particular importance over these next two days at this symposium, organizations were encouraged to establish rigorous, effective internal compliance programs.

In addition to the critical task of writing guidelines, a second responsibility that Congress assigned to the Commission was to foster research to inform the formulation of sentencing policy. This area of Commission activity will be reflected later this morning, as you see in your program, in what I expect will be an informative panel discussion of empirical research that the Commission has sponsored on corporate compliance practices.

A final Commission responsibility is the directive Congress gave the Commission to serve as a clearinghouse or a disseminator of information that can advance our collective understanding of effective responses to crime. Congress believed that the Commission's systematic collection and sharing of information on sentencing and on human behavior as it relates to crime can enhance society's ability to combat this social ill. It is to this goal particularly that this symposium is, indeed, dedicated.

As I mentioned earlier, the organizational sentencing guidelines' emphasis on compliance programs and other crime-detering measures that companies can undertake reflects a new policy approach. At the same time, because the guidelines stress preventive corporate measures, it may be a long time, if ever, before the sentencing cases give us much of a handle on how the approach is working. After all, sentencing cases are limited to the times when preventive efforts have obviously broken down or were never undertaken at all, so it's difficult to use the case law to determine how well the preventive programs are working.

Through this symposium, however, we can begin to gain a common understanding of how this new policy should be functioning and hopefully is functioning. The symposium, we hope, will provide a window on how corporations, industry groups, and government enforcement personnel are responding to that policy. We can learn what appears to be working, where the gaps in our knowledge are, and what challenges remain ahead. Finally, we can examine whether the various governmental policies that apply in this area can be improved and how that can be done.

Before moving on to what you can see in the program is a very full agenda, let me conclude on a somewhat personal note. I was not the Commission's Chairman, nor were a number of the current Commissioners on the Commission when the organizational guidelines

were first promulgated. However, my years on the federal bench overseeing cases of all kinds have given me a distinct perspective on the nature and the insidiousness of the misconduct that can occur within businesses and especially within big business.

Often, corporate crime appears to be the result of a failure to establish values and modes of conduct that are based on clear, ethical, and moral standards. We have not come here to preach to anybody about what their moral standards should be, but it would be foolhardy not to recognize that the kind of programs that we're talking about with you today must be based on clear ethical and moral standards or they have no chance of success.

As I mentioned before, corporate crime poses a threat to our nation's well-being on many levels. We think, therefore, that it is significant that the organizational sentencing guidelines go beyond those for individuals by mitigating penalties for corporate actions that really amount to taking a stand against corporate crime, and establishing those high ethical and moral standards.

Company policies can make a difference in corporate crime. The guidelines recognize this fact and, we hope, provide the corporations a chance to develop programs that will stave off or prevent crime.

The guidelines can only do so much, however, and it is our hope that the business community will not shrink from what we see as an important opportunity and obligation. The whole world looks up to the American free enterprise system and those in corporate life benefit most directly from that system.

As a consequence, those of you here today from the business community are in a position to do more than the bare minimum in taking a stand against crime. You must take on the obligation to lead this effort, to be in the forefront, not only by working to ensure that your companies' employees follow the law but by embracing and placing at the very top of your companies' priorities the basic good citizenship values that make law abidance possible.

The next two days will not resolve all of these difficult issues, but by sharing ideas and by talking about them, I believe that each of you can take something important from this symposium and apply it in your own life and your corporate life to make a difference.

For that reason, I salute all of you for taking time to participate in this significant event and I ask all of you to feel free to participate to the fullest extent of your desires in all of the programs that will take place in the next two days. As I indicated to you, the basis of this program is to listen and to learn from each other.

Finally, I want to extend my thanks, especially to the Commissioners and our employees and staff members who have essentially put this conference together and have taken the burden of developing such a fine program. Win Swenson and Andy Purdy led the staff work, and I extend my thanks to them and the thanks of the entire Commission.

And Commissioners Wayne Budd and Michael Goldsmith, who are here on the podium with me, are the Commissioners who developed the program. I extend to them not only congratulations on what initially appears to be a very successful turnout and conference but the

gratitude of the other members of the Commission for taking on this burden.

Finally, my last task this morning, in addition to welcoming all of you and extending my hopes for a successful conference is to introduce Commissioner Budd. He will take over the rest of the program.

Commissioner Budd is a distinguished lawyer from Boston. We learned that the other night when we went up to Boston to a meeting of several hundred judges and we went out to a Boston Red Sox game. Even though the Red Sox played a wonderful game, the biggest reception at the ballpark that night wasn't for President Bush, who was there, but it was for Commissioner Wayne Budd, so we felt very happy to be seated with him.

He is a distinguished lawyer and has had a distinguished career as the United States Attorney in Massachusetts, as Associate Attorney General here in Washington, and in a variety of other capacities in his legal, social, and professional community. We are lucky to have him on the Commission with us. He will be directing, with Commissioner Goldsmith, the rest of this program, and I am happy to introduce Commissioner Budd.

COMMISSIONER BUDD: Thank you very much, Judge Conaboy. Ladies and gentlemen, we have a very ambitious agenda. If anything, we erred on the side of being perhaps too comprehensive, but we're going to need your cooperation. We are going to try our very best to stay on schedule. You will find that the introductions of the speakers will be brief, but you have their backgrounds in the materials before you. We are going to start promptly after breaks. We will need your cooperation there, of course.

A very important part of what we're doing here, as Chairman Conaboy pointed out, is soliciting feedback. We want your views. You will find that there are feedback forms at the back of your proceedings notebooks and these will be collected at the end of the conference tomorrow. We will do a report on these forms and they will be sent to you in the post-symposium proceedings book.

With regard to questions and answers, again, we hope to establish throughout the course of this conference a dialogue and we need and want the benefit of your questions. Hence, you will find monitors moving throughout the hall this morning and throughout the course of our conference in the next day or two collecting your question cards.

We are not going to have questions for the first two presenters because the time frame will be short, but they will be here throughout the course of the proceedings. So please feel free to ask them questions as you see them moving about the audience and about the conference.

*Day One*

# **How the Organizational Guidelines Work: An Overview**

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**L. Russell Burrell**, *Principal Training Advisor, U.S. Sentencing Commission*

**Julie R. O'Sullivan**, *Associate Professor, Georgetown University Law Center*

*Moderator:* **Commissioner Wayne A. Budd**, *U.S. Sentencing Commission*



## HOW THE ORGANIZATIONAL GUIDELINES WORK: AN OVERVIEW

COMMISSIONER BUDD: Now, let's move to the formal part of our program and get things rolling. We thought it was important to offer you a quick grounding on how the guidelines actually work so that you have something of a context for thinking about the presentations that will follow. We are very fortunate to have two excellent presenters. I am going to keep with my own words and make their biographies very brief. Again, you have them before you.

Russell "Rusty" Burress is the first of our presenters this morning. He has been with the Commission for ten years, and during that time he has trained thousands of people in the federal court family, as well as in the legal community. Indeed, he is considered to be a national figure in the criminal justice system.

The other presenter, and she will be starting with Rusty in just a moment, is Julie O'Sullivan. Ms. O'Sullivan is an associate professor at Georgetown Law School where she has been for about a year. Prior to that she held several very important positions, not the least of which was serving as a law clerk for Associate Justice Sandra Day O'Connor of the United States Supreme Court.

With that, I'm going to turn the program over to Rusty and I think you're going to very much enjoy this presentation. Rusty Burress.

MR. BURRESS: The Sentencing Commission believes that an organization that has developed and has maintained an effective compliance program, that is a program that will detect and hopefully prevent violations of law, that a corporation that has done that is a good corporate citizen. Because of being a good corporate citizen, you are going to find out over the next couple of days, I believe, that there are a number of benefits to being a good corporate citizen.

One is that if this program prevented the violation of law, then, of course, your organization will not face a criminal conviction and will not face the penalties that go along with a criminal conviction. But even if there has been a criminal conviction, the guidelines still recognize and the Sentencing Commission still recognizes the good corporate citizen and the efforts the good corporate citizen has made in establishing and maintaining this effective compliance program. The way they recognize that is in lesser fines being called for under the guidelines for the organization.

So what Julie and I are going to do is to talk with you about how the guidelines are applied and how the guidelines recognize in their application this effective compliance program and call for lesser guideline fines because of this effective compliance program.

Now also, as we're looking at guideline application, we will point out other areas that are mitigating areas or factors that, if they're present in your organization, can result in lesser guideline fines. While we're looking at these mitigating factors that will reduce the guideline fines, we will also point out to you some aggravating factors, some factors that will increase the guideline fines if those factors are present.

We don't anticipate anyone being a guideline application expert in 30 minutes of

discussion of guideline application, but hopefully, if you do leave here, if you ever look at our guidelines in any detail, you will at least have some insight as to what is going on in the guidelines.

Now, I have been talking about guideline fines, how we will calculate a guideline fine, and I have mentioned these aggravating and mitigating characteristics under guideline application. But there is really sort of a distinction between, say, the organization's culpability and the organization's responsibility under the guidelines and under the statute, and, Julie, what is that distinction and exactly what is the applicability of the organizational guidelines to an organization?

MS. O'SULLIVAN: Let me start with the basics. The organizational guidelines can be found in Chapter Eight of your Guidelines Manuals. The Commission has xeroxed it for you. Chapter Eight is in the last section of your booklet, so the entirety of the organizational guidelines is available for you. What we're going to do is just go through and generally sketch out the high points.

Now, Chapter Eight applies to organizations, and organizations are defined as persons who are not individuals. That means they're not living, breathing human beings. Chapter Eight will apply to corporations, unincorporated associations, partnerships, pension funds, and unions. It will apply to basically every organization you can think of.

Say you have an organizational defendant. If there is an individual employee who is also convicted, what will apply to that individual are Chapters One through Seven, which are the individual guidelines. They will be dealt with separately.

Now, just to be very basic so everybody's on the same page, the organizational guidelines do not change the standard for the imposition of criminal liability. Generally speaking, corporations can be vicariously liable for the actions of their agents or employees within the scope of their employment and for the benefit of the corporation. The guidelines don't change that.

What the guidelines *do* do is structure the judge's discretion in assessing sentence after the organization has been convicted. Congress, by statute, set forth the maximum penalty that can be imposed on an organization for a particular count. What the guidelines do is tell the judges what narrow fine range within that larger statutory maximum they must choose, and in most cases, the judge is required under the guidelines to impose the fine on the corporation within the range mandated by the guidelines, absent extraordinary circumstances.

And if the individual guidelines are any precedent, then what will happen is in most cases, the fine imposed on an organization will be within the range dictated by the guidelines. We are going to tell you how it is that you arrive at the guidelines range. Rusty, do you want to start that off?

MR. BURRESS: Okay. I want to introduce you to some of the general principles of the organizational guidelines in Chapter Eight. We are going to be using some overheads here, but in your Section One tab you have all these materials that we're using as overheads, so these

are in your materials.

We're looking at the one that has the typewritten page number one at the bottom, the general principles that the Commission has in these organizational guidelines back in Chapter Eight of the guidelines manual. The first general principle is to remedy the harm. The Commission says if the offense has resulted in some harm, let's remedy that harm. Generally, that is going to occur by an order of restitution. There's going to be a victim in the offense. There's going to be a monetary loss, perhaps, and there's going to be an order of restitution to make the victim whole once again. Generally, that's how remedying the harm will occur.

You may also have remedying the harm occur through, say, a remedial order, to go in and remedy the harm that has occurred, have the organization do something that will remedy the harm or to lessen the likelihood of future harm or risk of harm from this offense that has occurred.

You also can have a community service order, ordering the organization to do some type of community service that will remedy the harm. So there are a variety of ways including an order of notice to victims that can be achieved under a guideline sentence that will try to remedy the harm in an offense.

MS. O'SULLIVAN: You may want to note that it may be called remedying the harm, but a restitution order of, say, \$10 million, is going to seem awfully punitive to some organizations. So it is in theory remedying the harm, but it may hurt.

MR. BURRESS: Now, we see where the Commission goes in to penalize the organization – where the punishment occurs in guideline sentencing – is under the second general principle here: the second general principle being “penalize the organization through fines.” That's where the penalty occurs. And we say fines based on the seriousness of the offense and the culpability of the organization, and we're going to come back to that in a little bit and see exactly how those fines are calculated. That's where we intend to spend most of our time up here with you over the next few minutes.

I will make the note that in those instances, and I dare say that none of your organizations that are represented here today would be one of these instances, but in those instances where the organization is determined to be a criminal purpose organization, that is, an organization that's operating primarily through criminal means or primarily for a criminal purpose, then the guidelines say that the fine imposed on such an organization should be sufficient to divest this organization of their net assets.

In other words, try and put them out of business if, indeed, it's a criminal purpose organization, but I don't think we're going to be dealing with that and that's why we're going to focus with you people on how fine range calculations will occur for your types of organizations.

The third principle is the use of probation to implement another sanction or to prevent future criminal conduct. Again, probation is not given as the punishment as such, but oftentimes probation will be given in order to carry out some other aspect of a sentence. If the court orders restitution or the court orders a remedial order or a fine has been ordered and those things



haven't been immediately done, then quite likely there will be an order of probation so the organization will be under the jurisdiction of the court in carrying out these requirements of the court's order. So we have probation that is done primarily for that.

Now, one note to you, because we are going to try to encourage you, if you do not have an effective compliance program, to come up with one: if an organization comes into federal court having been convicted of an offense and that organization does not have an effective compliance program at the time of sentencing and the organization has 50 or more employees, then the guidelines require that the organization be placed on probation to come up with an effective compliance program. So it's a sure ticket to get placed on probation if you do not have an effective compliance program when coming into court.

Now, what we would like to do is go back here and focus on this second general principle, which is penalizing the organization through fines, and we say fines based on the seriousness of the offense and the culpability of the organization. Julie has come up with what I think is a very descriptive overhead here that shows exactly what this fine calculation is all about. Julie, do you want to explain to us how this fine will be established?

MS. O'SULLIVAN: I should note that some sections of Chapter Eight apply to every federal felony and Class A misdemeanor. The restitution provisions and the probation provisions apply to every federal felony and Class A misdemeanor. The fine provisions, however, apply only to certain federal offenses, and those offenses are specified in your Guidelines Manual.

Basically speaking, the fine calculation provisions do cover about 85 percent of federal cases. Notable exceptions to the application of the fine provisions are environmental offenses, national defense export violations, and food and drug violations. You need to make sure that the criminal violation that you're dealing with is covered by the fine calculation provisions.

Let's proceed to how you figure out the fine range within which a judge, absent extraordinary circumstances, must sentence the criminal defendant to a fine. Conceptually, the fine range is the product of the seriousness of the offense and the culpability of the organization. Now, the seriousness of the offense is represented by a base fine. The base fine can be computed in a number of different ways, but in most cases, the base fine is the loss caused by the offense.

Assume you have a federal contracting fraud and the government is out \$10 million as a result of that violation. That's going to be your base fine. The Sentencing Commission has determined that that, in their view, represents the seriousness of the offense. So you've got a base fine, say, of \$10 million.

You want to end up with a range, so you're going to multiply the base fine by a minimum multiplier to end up with the bottom of the range and a maximum multiplier to give you the top of the range. For example, your range could be \$20 to \$40 million at the end. How do you know what multipliers to apply?

The Commission has isolated certain factual circumstances that it believes are relevant

to determining the culpability of a corporation. It has assessed points that relate to those factors. One goes through the factors, figures out whether they're applicable in the organization's case, adds up the points – say five points for this, three points for that. You end up with what's called a culpability score, for example ten points.

You look on a chart which we've given you on page nine of your handout. We won't go through it independently, but there's a chart that basically tells you for a culpability score of ten, you're going to have a minimum multiplier of two and a maximum multiplier of four. You apply the multipliers to your base fine. Conceptually you are multiplying culpability by seriousness.

In our example, you have a base fine of \$10 million times a minimum multiplier of two and a maximum multiplier of four, and you end up with a fine range of \$20 to \$40 million, within which the judge, absent extraordinary circumstances, must sentence the defendant.

Now, there are certain grounds upon which a court can depart from that range, but again, given the individual guidelines experience, that's not going to happen very often.

You should also be aware that in certain circumstances, the judge can sentence outside the range if the fine range would essentially jeopardize the continuing viability of the corporation, that is, if the fine is too large. But in most cases the organization is going to end up paying a fine within the fine range yielded by the formula.

We are going to be concentrating on the culpability score because it is in this area that the organization can do the most right now to affect any future liability it may have, most notably by instituting an effective program for detection and prevention of criminal conduct. An effective program will give you credits that are going to make a very large difference in this culpability equation. Rusty, do you want to go on?

MR. BURRESS: Because Julie has a good example as to the dollar impact that these culpability points will have on an organization, let's just quickly look at these culpability factors, and we are going to come back and look at a couple of them in detail that are somewhat difficult, perhaps.

But for culpability calculations, just the mathematics of it, everyone starts with five culpability points. That's the starting point. Then there are factors, aggravating factors that may increase this culpability score from five points going up, and it potentially can go up as high as 17 points. And the mitigating factors that are subtracted from these five points that could run the culpability score down. It could potentially take you down to like a minus three. So these factors are going to decide what the multipliers are going to be.

Now, you start with five points and then these following are aggravating characteristics, that if they're present in the offense, the Commission says, this organization is more blameworthy than an organization that didn't have these characteristics. The first is the level of authority and the size of the organization. Basically, the Commission says, if you have someone who is in the hierarchy of an organization and that person was involved in the offense or somehow tolerated this offense occurring, then that organization is more culpable. And then if you have

an individual in the hierarchy, depending on where they are in the hierarchy and the size of this organization, these two things in conjunction will increase the culpability points anywhere from one up to five additional culpability points. In other words, you could go from five up to a ten in some instances based on that factor alone.

The next factor is the prior history, prior history meaning did this organization have a previous criminal adjudication, civil or administrative adjudication for similar conduct, because if they did, this organization is more culpable than an organization that didn't have this prior record. And so that will increase the culpability points by one or two, primarily based on the recency of this prior adjudication.

This federal offense that the organization is coming into federal court for – is that somehow a violation of a court order or an injunction, or were they on probation and they violated a condition of probation by committing this offense? If so, it's a more culpable organization and that organization will pick up one or two additional culpability points.

And then obstruction of justice. Did somehow this organization obstruct the investigation or the prosecution of this offense? And if that's the case, three culpability points are picked up for that characteristic. I'm sure that it will be mentioned further on in the program, but this is sort of what they refer to as the “stick.” In other words, this is where you are going to get punished, the organization gets punished for these characteristics.

But there's also the “carrot,” and that's what these next couple of characteristics are, the mitigating characteristics, one being the effective program to prevent and detect violations of law that we've been mentioning already. That subtracts three culpability points, and we're going to talk a lot more about that over the next couple of days.

And then the final characteristic, the organization reporting the offense, cooperating with the authorities in the investigation and accepting responsibility, which often translates into a plea of guilty. Those things can reduce it by five additional culpability points.

So I mentioned you could get the culpability points high and you could get them low, depending on these aggravating or mitigating characteristics. Now Julie, do you want to give us an example, a dollars-and-cents example as to where this culpability may lead?

MS. O'SULLIVAN: This overhead is intended to give you a fairly graphic example of how much these factors can matter to an organization. This is my case of a \$10 million contracting fraud. The base fine is \$10 million because that's the loss that the government incurred here.

These represent three different assumptions. Assumption one, is ten or more points. Let's say you start, again, with your base of five. Say this particular organization also obstructed justice and acted in violation of a prior order. So they have another three points for obstruction, and two points for violation of an order. That's an additional five points. They end up with ten points for their culpability score.

That translates into multipliers that are going to give you a fine range of \$20 to \$40

million. Now, you have to recognize that this is in addition to restitution. This is just the punitive aspect. The organization would have been subject to a \$10 million restitution order on top of this.

Case two: assume you start off with a base of five and there are no mitigating or aggravating factors. This organization in this circumstance is going to pay a fine of between \$10 and \$20 million.

Case three: you start off with a base of five points. Say you've got an effective compliance program. That's going to give you a credit of three points. Say, too, you cooperate and accept responsibility. Your culpability score will be zero. The organization's fine is going to be between \$0.5 and \$2 million. You can see what an enormous difference ten points makes.

What I want to also emphasize is that a culpability score of zero is possible. A score of zero is attainable, especially if one has in place, at this point in time, an effective program to prevent and detect criminal violations, because that will give you an automatic three point credit.

MR. BURRESS: Time is growing short, but we do want to just go back and look at a couple of these culpability factors in just a little bit of detail here over just the next couple of minutes so you're aware as to what these overheads in your materials actually mean. Going back to the first one we're looking at, the level of authority and size of an organization. Again, the level of organization is going to drive, to some degree, what this culpability point assessment will be.

This is assuming in this scenario here, that you have 10,000 employees in the company. If the person who committed the offense or tolerated this offense is, say, the CEO of this company, that's going to be five additional culpability points.

But in the same organization, if the person who is involved in the offense or tolerated the offense was, say, a sales manager, someone who wasn't in a policy making position or in control of the organization but had substantial discretionary authority in this position, then you're going to get two culpability points for that individual.

But now if you have an individual who's not involved, say, in the hierarchy of the organization, say just a sales representative, there will be no culpability point increase in that situation. So the effect on the culpability score by the level of authority is quite significant.

The size of the organization is significant, too. Assuming we have the CEO in each of these scenarios but the size of the organization varies, and we have, say, 10,000 employees. We just saw how that would give us five additional culpability points. But if the organization is smaller, say 200 employees, that would give three additional culpability points. Or a very small organization, say with 25 employees, that would get one additional culpability point. So those two things work in conjunction, both the level of authority and the size of the organization.

MS. O'SULLIVAN: When you're focusing on this factor, you should be aware that the guidelines do not only examine the level of authority of persons actually involved in the offense.

They’re also examining the level of authority of those persons who tolerated, condoned, or turned a blind eye to the offense, and the pervasiveness of that willful blindness within the organization.

So if a sales representative is the person that actually committed the offense, but persons at higher levels of authority basically condoned it or tolerated it, the organization is going to be assessed more points.

MR. BURRESS: On page seven of your materials we list for you the minimum requirements for having an effective compliance program. In other words, if you want these three culpability points removed, you have to meet the minimum requirements for an effective compliance program.

That means that’s what you have to do to get the three culpability points removed. However, you may find that your organization will benefit more by having more than the minimum requirements. Maybe going beyond the minimum requirements is what you need to prevent the violations from occurring. It is certainly better to have no fine than to have a reduced fine.

The final characteristic that we want to look at, and I’ll let Julie speak to, is the self-reporting, cooperation, and acceptance of responsibility where you can get a lot of culpability points removed.

MS. O’SULLIVAN: This is another area where the organization can get a lot of credit. You can get five points for self-reporting, but self-reporting is a fairly onerous requirement. You need to act prior to an imminent threat of disclosure of the violation or to a governmental investigation. So before you get the subpoena, and within a reasonable time of finding out about the violation, you must report it to the government. You must also cooperate with the investigation, and there’s a lot of discussion as to exactly what cooperation entails, and you must accept responsibility, which usually translates into pleading guilty.

You have to do all those things to get five points. To get two points, you just need to cooperate and to accept responsibility, meaning plead guilty. To get one point, you need to accept responsibility.

You should be aware that there is a certain dove-tailing between these credits. For example, you are more likely to be in a position to claim these points for self-reporting if you have an effective program in place. If you have an effective program in place, presumably the organization will have detected the offense in advance of a governmental investigation and will be in a position to remedy and report it at that point.

MR. BURRESS: We are going to be with you all for today and tomorrow, so if you have any questions in particular, please feel free to talk to us. We look forward to spending time with you during the course of the symposium and thank you all for coming.

*Day One*

**The Organizational Guidelines’  
“Carrot and Stick” Philosophy, and  
Their Focus on “Effective” Compliance**

*Win Swenson, Deputy General Counsel/Legislative Counsel, U.S. Sentencing  
Commission*



**THE ORGANIZATIONAL GUIDELINES’ “CARROT AND STICK” PHILOSOPHY,  
AND THEIR FOCUS ON “EFFECTIVE” COMPLIANCE**

COMMISSIONER GOLDSMITH: Good morning. My name is Michael Goldsmith. I am a member of the U.S. Sentencing Commission. The next panel is concerned with “The Organizational Guidelines’ ‘Carrot and Stick’ Philosophy, and Their Focus on ‘Effective’ Compliance.” The panel moderator is Win Swenson, who is Deputy General Counsel at the Commission.

Win was responsible for the staff group that developed the basis for the organizational guidelines. He has written several works on the guidelines, including a treatise on organizational sentencing and a series of law review articles on guidelines and guidelines implementation. He continues to oversee our staff group charged with studying organizational sentencing. Win?

MR. SWENSON:

I. *INTRODUCTION*

- A. The previous presentation (Burress and O’Sullivan) summarized key features of the organizational guidelines. Implicit in these guideline features is a “carrot and stick” structure: companies that 1) fail to take certain actions (*e.g.*, establish strong compliance programs, voluntarily disclose misconduct, fully cooperate in the investigation of the misconduct) and 2) have attributes indicating greater institutional culpability for misconduct (*e.g.*, had senior corporate officials involved in the offense, or had employees obstruct justice) face stiff penalties in the event of a violation. Companies that take the prescribed steps, and do not evince attributes of greater institutional culpability, will avoid onerous penalties should a violation happen to occur.
- B. In this presentation, I will attempt to set the stage for those that follow by examining three questions:
- 1) What is the origin of the Commission’s “carrot and stick” corporate sentencing philosophy – and, relatedly, how does this philosophy contrast with prior practice?
  - 2) What were the Sentencing Commission’s objectives in establishing the carrot and stick approach?
  - 3) How does an understanding of these Sentencing Commission objectives help one understand the definition of a guideline-qualifying compliance program – *i.e.*, “an effective program to prevent and detect violations of law?”
- II. *Question One: What Is the Origin of the Commission’s “Carrot and Stick” Corporate Sentencing Philosophy, and How Does this Philosophy Contrast*



*with Prior Practice?*

- A. Prior to the guidelines the practice of sentencing corporations lacked a coherent, consistent rationale.
- 1) Court decisions demonstrated that judges truly were struggling to find meaningful ways to sanction corporations.<sup>3</sup>
  - 2) Scholars also disagreed about how best to respond to corporate violations.<sup>4</sup>

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<sup>3</sup> See, e.g., *United States v. Allegheny Bottling Co.*, 695 F. Supp. 856 (E.D. Va. 1988) (corporation sentenced to a three-year, suspended term of “imprisonment”); *rev’d in relevant part*, 870 F.2d 656 (4th Cir. 1989) (tbl.). See also *United States v. Missouri Valley Constr. Co.*, 741 F.2d 1542 (8th Cir. 1984) (vacating a condition of probation that required corporate defendants to contribute money to a charitable organization); *United States v. John Scher Presents, Inc.*, 746 F.2d 959 (3d Cir. 1984) (vacating condition of probation that corporate defendants use promotional business to raise money for charities designated by the probation office); *United States v. Wright Contracting Co.*, 728 F.2d 648 (4th Cir. 1984) (vacating sentence of probation that imposed charitable contributions); *United States v. Mitsubishi Int’l Corp.*, 677 F.2d 785 (9th Cir. 1982) (upholding a sentence requiring three companies to lend high-level executives’ service to charity for one year without compensation and to pay contributions to the same charity); *United States v. Arthur*, 602 F.2d 660 (4th Cir.) (upholding requirement that white collar defendant accept full-time employment without salary in a charitable organization as part of probation), *cert. denied*, 444 U.S. 992 (1979); *United States v. Clovis Retail Liquor Dealers Trade Ass’n*, 540 F.2d 1389 (10th Cir. 1976) (vacating sentence of probation that included financial contribution to county alcoholism council); *United States v. Nutri-Triumph, Inc.*, 500 F.2d 594 (9th Cir. 1974) (upholding condition of probation requiring company not to engage in the distribution of pornographic material); *United States v. Danilow Pastry Co.*, 563 F. Supp. 1159 (S.D.N.Y. 1983) (requiring bakery companies to donate fresh baked goods to specified charitable organizations).

<sup>4</sup> See, e.g., KIP SCHLEGEL, *JUST DESERTS FOR CORPORATE CRIMINALS* (1990) (endorsing the application of the “just deserts” theory, which mandates that the punishment reflect the seriousness of the offense, to corporate crime); Michael K. Block & Joseph G. Sidak, *The Cost of Antitrust Deterrence: Why Not Hang a Price Fixer Now and Then?*, 68 GEO. L.J. 1131 (1980) (arguing that threatening antitrust violators “with exorbitant economic penalties that have only a minimal probability of being enforced” is not the optimal solution); John C. Coffee, Jr., *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions*, 17 AM. CRIM. L. REV. 419 (1980) (arguing that “fines are an inefficient means by which to deter organizational crimes”); Brent Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1141 (1983) (arguing that the punishment for corporate criminals should not be limited to fines); Richard A. Posner, *Optimal*

- 3) Empirical research of corporate sentencing practices conducted by the Sentencing Commission showed that corporate sentencing was in disarray. First, the Commission found that nearly identical cases were treated differently. Thus, there was evidence of disparity in corporate sentencing. Second, while some fines appeared quite high, the average fines were meaninglessly low. By that I mean that fines appeared to be, on average, *less than* the cost corporations had to pay to obey the law.<sup>5</sup> This seemed to raise the specter that corporate crime did in fact “pay,” as some had historically claimed.
- B. Because the government’s approach to corporate crime enforcement was managed by so many distinct entities and personalities,<sup>6</sup> it was difficult to make out what the government’s policy *was* in all this. One thing clear was that the government’s corporate crime enforcement policy often got mired in litigation. In very simple terms, you might say that the prevailing system was characterized by “speed trap enforcement” and a “circle the wagons” corporate response.
- 1) By “speed trap enforcement” I mean that the government’s *policy* toward corporate crime often seemed reducible to that of the many state police forces out on the national highways. State police departments accept the fact that in all of the millions of miles of national highway there are only so many trees, grassy knolls, and dips in the road in which they can hide the limited number of patrol cars they have. So, they pick the best spots, turn on the best radar equipment they can requisition, and wait for unwary lawbreakers that happen by those spots. One can argue that the government engaged in a similar policy toward corporate lawbreakers – substantial resources were put into *catching* corporate lawbreakers, but little effort was put into

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*Sentences for White-Collar Criminals*, 17 AM. CRIM. L. REV. 409 (1980) (arguing that a sufficiently large fine for white-collar crime is socially preferable to imprisonment); Andrew von Hirsch, *Desert and White-Collar Criminality: A Response to Dr. Braithwaite*, 73 J. CRIM. L. & CRIMINOLOGY 1164 (1982) (arguing that “white-collar crimes should have a pyramidal structure of seriousness similar to that of ordinary crimes”).

<sup>5</sup> See Mark A. Cohen et al., *Report on Sentencing of Organizations in the Federal Courts, 1984-1987*, in U.S. Sentencing Commission Discussion Materials on Organizational Sanctions at 7-11, 21 (tbl. 9). See also Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines For Corporations: Their Development, Theoretical Underpinnings, and Some thoughts About Their Future*, 71 WASH. U. L.Q. 205, 215 (1993).

<sup>6</sup> See generally MARSHALL B. CLINARD ET AL., U.S. DEP’T OF JUSTICE, *ILLEGAL CORPORATE BEHAVIOR* 37 (1979) (stating that the regulatory agencies responsible for enforcement do not adequately coordinate their activities).

providing a meaningful *response* to these violators. And, just as with speed traps, the enforcement community simply accepted the fact that for every one they nabbed, many more went sailing by somewhere else.<sup>7</sup>

- 2) This rather bare-bones enforcement policy toward corporate crime, in turn, fostered a “circle the wagons” response by many transgressing corporations. This was because companies often perceived little incentive to respond any other way.
  - (a) First, corporate decisionmakers could not know what penalties they would be facing because corporate penalties – just like fines from speeding tickets among the many jurisdictions around the country – were not imposed in any predictable way; they depended mostly on where the transgression occurred and the unpredictable proclivities of individual prosecutors and judges.
  - (b) Second, there was no guarantee that a company’s cooperation with the authorities or its demonstration of extenuating facts – such as significant compliance efforts – would better the company’s predicament. It was easy for companies to rationalize in this environment that the safest response was: “circle the wagons” and fight back – that is, litigate – for all your worth.
- C. Meanwhile – and surprisingly given the state of things – many representatives of the business community argued that the Commission should ignore corporate sentencing altogether and leave the prevailing system as it was. They cited evidence that Congress’s creation of the Sentencing Commission was motivated more by concerns over the sentencing of individuals than of corporations.
- D. Given the lack of coherence in prevailing corporate sentencing practices and what most commissioners concluded was a broad, but definite, mandate from Congress to improve sentencing practices where they could,<sup>8</sup> the Commission decided to plow forward.
- E. However, concluding that current corporate sentencing was in need of improvement begged an even more important question: could the Commission fashion a corporate sentencing policy that was any better? The Commission ultimately concluded that the answer was yes, but it is critical to recognize that this was

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<sup>7</sup> *See id.* at 35-36 (discussing limitations of enforcement efforts).

<sup>8</sup> *See Nagel & Swenson, supra* note 3, at 214.

not a foregone conclusion.<sup>9</sup>

- 1) The Commission's early forays into the development of organizational guidelines reflected little of the carrot and stick philosophy the Commission ultimately came to adopt.
  - 2) For example, the first model the Commission considered – a so-called “optimal penalties” approach – relied on a formula to produce what theory said should be perfectly calibrated fines. The theory was that these perfectly calibrated fines would, in turn, bring about perfectly efficient crime-avoiding responses by corporations. Under the approach, fines were to be set according to this formula: the optimal fine = monetized harm (*i.e.*, loss) ÷ probability of conviction.
  - 3) This approach was really an idealized version of the pre-existing, “speed trap” approach to corporate crime enforcement. It assumed that government policy need be little more than a commitment to catch *some* corporate wrongdoers and fine them. Fines for the unlucky corporations that were caught would then be set in inverse relationship to the likelihood of being caught, and corporate managers – carefully, coldly scrutinizing these perfectly calibrated fines and concluding that crime could not pay – would rationally choose, instead, to spend resources obeying the law.
  - 4) As it did with a variety of approaches over the next few years, the Commission rejected this approach and moved on. Overall, the process of developing organizational guidelines spanned five years, produced numerous official and informal drafts and generated mountains of public comment.
- F. Ultimately the “carrot and stick” approach seemed to emerge from the Commission's acceptance of three facts:
- 1) Fact One: *Vicarious liability means not all corporate defendants are alike* – The Commission came to recognize that the doctrine of vicarious criminal liability for corporations operates in such a way that very different kinds of corporations can be convicted of crimes; from companies whose managers did everything reasonably possible to prevent and uncover wrongdoing, but whose employees broke the law

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<sup>9</sup> For detailed discussions of the history of how the organizational guidelines were developed, see Nolan Ezra Clark, *Corporate Sentencing Guidelines: Drafting History*, in COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES: PREVENTING CRIMINAL AND CIVIL LIABILITY §§ 2:01-2:06 (Jeffrey M. Kaplan et al. eds., 1994). *See also* Nagel & Swenson, *supra* note 3, at 217-51.

anyway, to companies whose managers encouraged or directed the wrongdoing.

- 2) Fact Two: *Responsible corporate actions can foster crime control* – The second key fact the Commission came to embrace was that actions by corporate managers can significantly reduce the likelihood and impact of corporate crime. Voluntary disclosure and cooperation by a company mean, for example, that harms caused by the company *will* be rectified and individuals within the company *will* be identified and held accountable. Similarly, strong corporate compliance efforts hold out the promise of fewer violations in the first instance and greater detection and remediation of offenses when they occur.
- 3) Fact Three: *Mandatory guidelines can create incentives* - Finally, the Commission recognized that because guideline penalties are essentially mandatory and therefore predictable, penalties tied to how well a corporate defendant had undertaken specified crime-controlling actions would create incentives for companies to *take* those actions. With a guideline system, corporate managers would *know* – unlike the situation in the pre-guideline era – that their “good citizen” actions would make a difference in terms of the company’s exposure to penalties. Good citizen actions, low penalties. Failure to take such actions, high penalties – “carrot and stick.”

III. *Question Two: What Were the Sentencing Commission’s Objectives in Establishing the Carrot and Stick Approach?*

- A. The Commission had three principal and related objectives in structuring the organizational guidelines as it did.
  - 1) Objective One: *Define a model for good corporate citizenship* - The first objective was to define a model for corporate action that would exemplify “good corporate citizenship” with respect to the narrow issue of law abidance.<sup>10</sup>
  - 2) Objective Two: *Use the model to make corporate sentencing fair* - The second objective was to incorporate this model into the guidelines so that corporate sentencing would be more fair. Penalties would go up and down depending on objective, defined criteria that would reflect

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<sup>10</sup> The Commission, for example, did not try to draft a broad model for corporate social responsibility. Cf. Edward Petry, *Should the Government Create a Corporate Model for Social Responsibility?*, 4 CENTER FOR BUS. ETHICS NEWS (Bentley C., Waltham, Mass.), Summer 1995, at 3.

a corporation's true culpability for criminal conduct.

- 3) Objective Three: *Use the model to create incentives for companies to take crime controlling actions* - The third objective was to create the incentives for good corporate citizenship that I mentioned before – incentives for corporations to undertake crime-controlling measures that, in turn, satisfy the Commission's model of good corporate citizenship.
- 4) This final objective marks a significant departure from the “speed trap” enforcement policy of the past. Under the new approach, the enforcement policy is something *more* than just “lie and wait” and impose a fine. The new policy is interactive. Companies take actions to join the fight against corporate crime and government responds by significantly limiting potential penalties for the companies that do. Limited government enforcement resources are augmented by the potentially highly effective efforts of companies themselves.

IV. *Question Three: How Does Understanding this Last Objective – i.e., the Goal to Have Companies Themselves Undertake Effective, Crime – Controlling Actions – Help One Understand the Definition of Qualifying Compliance Program under the Guidelines?*

- A. An understanding of this objective makes clear what the Commission had in mind in defining an “effective” compliance program under the guidelines: the Commission wanted companies to use some reasonable degree of diligence and ingenuity *to devise compliance programs that actually work*. Put another way, the often-cited seven steps in the definition of an “effective” compliance program should not be viewed as a superficial check-list requiring little analysis or thought.
- B. The actual guidelines definition of an “effective program to prevent and detect violations of law” support this interpretation. To begin with the “seven steps” are only one part of a four-part definition.<sup>11</sup>
  - 1) The definition begins with a paragraph of general criteria that includes what might be called the definition's baseline requirement: a qualifying compliance program is one that has been “designed, implemented,

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<sup>11</sup> For further discussion of the definition, see Winthrop M. Swenson, *An Effective Program to Prevent and Detect Violations of Law*, in COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES: PREVENTING CRIMINAL AND CIVIL LIABILITY §§ 4:06-4:08 (Jeffrey M. Kaplan et al. eds., 1994).

and enforced so that it generally *will be effective*.”<sup>12</sup> To establish such a program, the introductory commentary continues, the company must exercise “diligence.”

- 2) The seven steps constitute the second part of the definition. What is especially important to recognize is that the seven steps are drafted somewhat generally. Each step can be satisfied by a range of possible approaches. Finally, the definitional commentary stresses that the seven steps are the “minimum” steps required.<sup>13</sup> Thus, by their own terms the seven steps are drafted to imply a framework, not a highly specific course of action that companies can simply “adopt.”
- 3) The third part of the definition stresses that the particular features of the company – its size, its areas of risk (due to the kinds of business in which it is engaged), and its prior history all must be given close attention in determining the “precise actions necessary” for an effective program.<sup>14</sup>
- 4) Finally, the definition concludes with a sentence instructing that a company must look to its *external* environment – to compliance standards met by others in the company’s industry and to any relevant regulatory requirements – to ensure that its program measures up.

V. *Conclusion*

- A. The definition of an “effective” compliance program does not envision that the process of developing a creditworthy program will be a passive one. You might say that – within reasonable and appropriate limits – the Commission wanted companies to “struggle” a bit to learn what works, tailor what are found to be generally effective approaches to their own particular circumstances, and continuously evaluate their unique compliance experiences to refine their approaches to compliance.
- B. This is all part of the shift in enforcement policy that I described before. At its heart the new policy contemplates a kind of compact between government and the private sector so that our collective response to corporate crime can be made more effective.
- C. Thus, over the next two days, we will look at how companies are engaging in this “struggle” to make compliance work, and what mechanisms they are

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<sup>12</sup> U.S.S.G. §8A1.2, comment. (n.(3)(k)) (emphasis added).

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

creating to share “best practices” information.

This afternoon’s concurrent sessions recognize the inherent flexibility in the guidelines’ definition of an “effective” compliance program. In Session A, we will look at new external standards for effective compliance approaches that are being proposed to provide additional guidance to practitioners in this area.

In Session B, we will examine how the guidelines should be read to embrace a variety of approaches that prove effective, even when those approaches are not *explicitly* mentioned by the guidelines. This session is particularly relevant to those who have questioned whether good corporate conduct is better supported through a values or ethics-based approach than a “law-centered” one.

Finally, during the course of symposium, we will examine whether and how the government’s role in this new enforcement approach to corporate crime can be improved.

- D. When the Commission drafted the organizational guidelines, it basically took the title of this symposium and divided it into a question and an answer. The question was, “How should we respond to corporate crime in America?” The answer the Commission arrived at was, “Strengthen the ‘good citizen’ corporation.” The implications of this answer are what this conference is about.



*Day One*

**Where Theory and Reality Converge:  
Three Corporate Experiences in Developing  
“Effective” Compliance Programs**

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**Kenneth D. Martin**, Senior Corporate Counsel, Sundstrand Corp.

**Herbert L. Thornhill, Jr.**, Deputy Counsel, Bank of Tokyo

**John A. Meyers**, Senior Vice President and Associate General Counsel, Tenet  
Healthcare Corp.

*Moderator:* **Jeffrey M. Kaplan**, Arkin Schaffer & Supino



**WHERE THEORY AND REALITY CONVERGE:  
THREE CORPORATE EXPERIENCES IN  
DEVELOPING “EFFECTIVE” COMPLIANCE PROGRAMS**

MR. SWENSON: I’m going to let our panel moderator introduce our next panel, but let me introduce our panel moderator very briefly.

Jeff Kaplan may be known to many of you. By background and training, he’s a criminal defense attorney, but you may know him as one of the most prolific, energetic, and I would say creative writers on compliance issues who is out writing on these issues at all. He has written on compliance issues in just a vast range of arenas, everything from banking, insurance, environmental. He is also a co-editor of a book called Compliance Programs and the Corporate Sentencing Guidelines.

We are particularly glad to have him here as a panel moderator, but I should also tell you that he was useful to us not simply to be here to moderate this panel but also in helping us think about how we ought to approach it. So without further adieu, let me turn it over to Jeff Kaplan. Thank you.

MR. KAPLAN: Judge Wilkins, the former Chairman of the Sentencing Commission Commission, has described the organizational guidelines’ carrot and stick approach as developmental, an invitation to shield against potential liability with well-designed and rigorously-implemented compliance systems. This panel will explore the compliance system design and implementation experiences of companies from three industries: defense contracting, in the case of Sundstrand Corporation; financial services, in the case of Bank of Tokyo, Limited; and for health care, Tenet Healthcare Corporation.

More than for their business areas, however, these three companies were chosen for this panel because each one’s experience suggests in compelling but very different ways the importance of accepting the invitation that Judge Wilkins described.

By the time the organizational guidelines went into effect in 1991, Sundstrand Corporation, due in part to an earlier prosecution and in part to reforms in the defense contracting industry generally, had already implemented a significant compliance program. Nonetheless, using the guidelines’ articulation of an effective program to prevent and detect violations of law, the company expanded and improved its program in many respects. One such reform, the “Responsible Executive” feature, became a model for various other companies’ compliance programs.

Sundstrand’s experience thus illustrates that even for compliance-sophisticated corporations, accepting the Commission’s invitation by revising a program based upon the guidelines’ articulation of an effective compliance program, what Joe Murphy of Bell Atlantic has called the new standard of accountability, can be most useful.

Although the Bank of Tokyo had instituted compliance policies and procedures before the advent of the organizational guidelines, it had had no traumatic experience to cause it to create a comprehensive program. It did, however, face a wide variety of compliance-related

needs arising from various legal and regulatory mandates.

For the bank, the guidelines' articulation of an effective program to prevent and detect violations of law offered what Herb Thornhill calls a road map to coordinate its many compliance efforts. The bank has, indeed, found that using this articulation to structure its overall program provides significant efficiencies and cost savings.

A second lesson, then, is that for those creating as well as those modifying an overall program, the guidelines are a sound place to start. The experience of Tenet Healthcare Corporation offers a very different lesson, a "Ghost of Christmas Yet to Come," if you will, for those who might decline the invitation of the guidelines. Tenet, previously known as National Medical Enterprises, was the subject of the costliest prosecution ever for health care-related fraud.

Although the company's General Hospitals Group had developed a significant compliance program, its separately-managed Specialty Hospitals Group had not; and, as part of its settlement of the government's investigations, the company as a whole was compelled to adopt compliance measures more onerous than those typically found in a truly voluntary program.

Because the guidelines may require organizations to adopt a compliance program as a condition of probation, as was described in our first session today, Tenet's experience with what might be called "forced compliance" suggests just how unhappy living with a compliance program instituted under probation might be.

In sum, then, organizations that fail to develop and implement programs in the spirit of the first two companies featured in today's panel and in the spirit of Judge Wilkins's invitation may someday share the fate of the third.

Tenet's experience, however, may carry lessons for the government as well as the business community. Just as Judge Wilkins cautioned that the guidelines approach is developmental, so John Meyers of Tenet notes that the science of compliance is still very much in its infancy. John's frank criticisms of some of the obligations imposed on Tenet, a quarrel with the means, not the ends, will, I hope, be a part of a process of continuously analyzing what actually works in this new science of compliance.

Finally, a necessary disclaimer. In no way was the selection of these companies meant to serve anything other than an illustrative purpose. No Sentencing Commission approval, condemnation, or anything in between obviously should be assumed from their selection.

**KENNETH D. MARTIN**

MR. KAPLAN: Our first speaker is Ken Martin. Ken received his law degree from Duquesne University School of Law. Prior to working at Sundstrand, he worked at Morton Thiokol with the U.S. Navy's Office of General Counsel, the U.S. Army Communications Electronics Command, and the U.S. Army Judge Advocate General Corps.

He joined Sundstrand in 1985, where he is currently responsible for providing legal advice in support to Sundstrand's business operations, particularly in the field of government contracts, compliance program activities, and intellectual property. He is a National Contract Management Association fellow, currently holding the NCMA position of Functional Director, Legal. Ken?

MR. MARTIN: Good morning, everyone. I have some overheads, if we can start with the first one, please.

Thanks very much for the opportunity to be here today, particularly for the invitation from the Sentencing Commission and Win Swenson and Jeff Kaplan, although I have to say I think it might not be a good idea to be here when the title of the conference is "Corporate Crime in America." What I thought I'd try to do in the time that we have allotted is first give you a little bit of an idea of the backdrop of Sundstrand's compliance program as it existed before the sentencing guidelines came into effect and then what the sentencing guidelines meant or what our reaction to the guidelines was. May I have the next overhead, please?

This first chart gives you a rough organizational idea of what our top-level compliance and ethics structure is. We have consciously chosen compliance and ethics in the sense that we try to cover both compliance with law as well as values and ethical standards.

To try to put a little context into the Sundstrand discussion, Sundstrand is a Fortune 500 corporation. We do about \$1.4 billion a year in sales. We have about 10,000 employees. Most of them are in the United States, but we do have a significant number in some overseas locations and some plants and facilities in overseas locations.

We have two segments of the company, an aerospace segment and an industrial segment. Virtually all of the government business is on the aerospace side. The dollars are roughly split 50-50 between the two parts of the company. So one of the things, even though the focus of the discussion is government contracts, from a Sundstrand point of view, in today's environment, we are definitely a lot more than just a government contractor in terms of worrying about compliance issues.

We have a focus on trying to develop international business, which we believe has some obvious compliance implications, and our products range from construction compressors that you may see by the side of the road to the little pumps in your ice machines in the hotel here all the way up to aircraft electric power systems and torpedo motors. So we have a pretty wide range of different types of products and different types of markets that we have to contend with.

Our program, the Sundstrand Business Conduct and Ethics program, originated as a

formal program in the late 1980s time frame, and it was principally in the context of a major fraud investigation relating to government contracts. The results of that investigation led to a payback of about \$200 million, a three-year probation period, primarily under the auspices of the Department of Defense, and essentially many changes in terms of the senior management of the company and many other managers and employees at lower levels. So a fairly traumatic circumstance led to the establishment of the formal program that we started with.

At the time, nobody exactly knew what a compliance program was all about. The Defense Industry Initiative (DII) began around that time with Alan Yuspeh and some other industry leaders coming up with what industry, at least the defense industry, thought might be some guidelines. And until the sentencing guidelines came out, we principally operated under guidelines that were sort of developed by industry for themselves, to a certain extent supplemented by Department of Defense criteria or standards as to what they thought some relevant factors for a compliance program were; and that's where we went from the late 1980s until 1991 or 1992.

As an overview comment, how compliance is perceived within the company is, I think, a gut reaction. Sundstrand is a good old solid Midwest company. Most of the people are good solid Midwest people who believe in ethics and believe in values, so I think, overall, compliance and ethics are viewed as a business strength in the sense that if you don't have that kind of a program or that kind of a workforce, you're just not going to be viewed as a reputable supplier or a worthy business partner. So in an overall sense, that's the general attitude.

But then, of course, you get into the carrot and stick discussion and how the sentencing guidelines specifically are viewed, which I'll address a little bit later.

This chart shows that we have some high-level support and commitment from within the company, starting with the board of directors and the CEO of the company. The next chart, please?

The next few charts are just kind of a "gee whiz" listing of some of the key features of our program. For those of you who have programs, I would be surprised if there are any big surprises on this list. We think we have top-management commitment. We do have a code of conduct. We try to iterate that code about every three years, just to keep it fresh, put it in a different format. The basic message doesn't change unless there are some startling new laws or regulations that have come out on the books.

And, we also have gone through a lot of effort to try to internationalize the code and have it printed in various foreign languages to make it fit not only a domestic U.S. environment but overseas environments, as well.

We have a full-time Director of Business Conduct and Ethics. The person selected for that job has always been selected on the basis of being a fairly long-term employee, well known, well respected by the employees, someone that a lot of people would just know off the top of their head as a good person, a good role model. We have a specific government audit group in our internal audit department that has an expertise in looking at government contracts and government regulatory issues.

We have, in addition to the corporate ethics committee, other committees located at every one of our plants and facilities, a total of about 26 committees, and most of those committees include line worker and union representation where we have unionized plants, because we have also found that, at least for our environment, a key to success is to try to win the hearts and minds of all levels of employees and give all levels of employees an opportunity to participate and feel that they are a part of this process and this program.

As I mentioned, we are also a signatory to DII, the Defense Industry Initiative, and we think that that has been a particularly good forum to talk about and discuss best practices in terms of a compliance and ethics program.

Our corporate ethics committee has some responsibilities which are pretty broad ranging. Its job is to really set the pace for what the compliance and ethics program and policies will be. I don't think we need to repeat anything here. I think the critical factor is developing corporate-wide policies and that's how the committee views itself.

Our ethics director runs an ethics department and this is a short list of what the mission, at least what our ethics director perceives his mission to be. I think the short way of saying this is that his principal job is to continuously improve the program and to continuously assess its health in the best way that you can. Obviously, a lot of this is subjective, but you try to look at some indicators that give you some idea of whether the thing is working or not working and where you need to improve it.

You will also notice, if you look down a lot of those bullets, certainly the second bullet and the last two bullets, a lot of focus on how the employees feel about the program or how they regard the program, and I would put all of those bullets in the category of working on gaining employee trust and confidence, that the company is serious about this, that we mean what we say.

And I think for a lot of people in the room, the rubber really hits the road when you get a live allegation and all people involved in that process need to feel that it's going to be handled in a very confidential business-like manner and that everybody is not going to be roasted and fried just because your name happened to come up in the context of an ethics allegation.

These next two charts are just to try to give you a feel for some of the statistics that we keep or metrics that try to give us some indicators of what's going on in the program. This chart is just a list of the total number of contacts that our ethics director got for the second quarter of 1995. The total number of contacts is somewhere in the neighborhood of 100, 110 or 120, and I believe that these rough breakdowns are probably not too dissimilar from the experience of a lot of other companies.

We have our ethics director and our hotline available for any and all questions. We don't try to tell employees, only call if you have a compliance or a legal concern, so that's why you see a lot of human resources type of contacts. We get the calls where somebody says, "I thought I should have gotten a higher pay raise," and we funnel those off into the HR department. But the object of the program is to take every and all calls, any and all concerns, and this is a place you can call if you don't want to talk to your boss about it or you don't think

that your supervisor is the right channel. It tries to take the sting out of asking questions.

Percent of anonymous contacts – we happen to think that this is a relevant indicator of the health of the program, only in the sense that this is some sort of measure of employees' trust and confidence; that is, when they call to ask a question or to question something that they have seen going on, how hesitant are they to identify who they are and where they work?

Our experience has been the trend that you see, and just to satisfy you that we're not playing games with numbers, the total number of contacts has remained constant over that time frame, so that trend is not just a function of reductions in force or selling divisions or any radical changes in the structure of the company. It's a true trend, and we may be kidding ourselves, but again, we think that that's one factor that may indicate how comfortable your people feel with the confidence and the treatment they're going to get under the program.

And now to move into what happened when the sentencing guidelines came into force, or life after the sentencing guidelines, I guess you could say when the sentencing guidelines became effective, I would be less than candid if I stood up here and told you that everybody in the executive office said, "Wow, this is really a great idea. Why didn't we do this sooner?"

That was not the prevailing reaction because the executive office grasped real fast the carrot and stick concept. So I think in the category of how do companies like these guidelines, things are either necessary, a necessary evil, or just evil, and my guess is the sentencing guidelines are perceived as somewhere in the necessary evil category, but it's also something that you have to recognize. You can't just do nothing and stand there naked.

So the decision that was made was we would incorporate sentencing guidelines considerations into our program. We did not view the guidelines as a program all by themselves. They were a guide as to factors that we should add to our program.

And I think the reception to this carrot and stick thing is, I don't know whether you ever noticed, but sometimes a carrot can sure look like a stick, but I don't think a stick ever looks like a carrot. There's a healthy slug of that, that this thing is to be viewed with a little trepidation because, again, senior managers read the newspapers, too, and they realize that this whole thing is maybe just another invention of all these lawyers that represents another blow to the safety of their species.

So we try to caveat it, and what are the benefits that come out of the sentencing guidelines, and we think there are some benefits. We thought that the principal benefits of the sentencing guidelines were that they clearly illustrate that compliance for a company like Sundstrand is not just government contracts, because one of the big albatrosses that we had around our neck after the situation we went through is that most employees thought that all this "compliance stuff" was just government contracts. It was you guys in government contracts that got us into this mess and all of us people out here in the rest of the company, we don't have anything to do with government contracts so we don't have to worry about compliance.

So obviously, one of the real messages in the guidelines is that it's a violation of any federal law, and certainly, a company the size of Sundstrand runs across virtually every wicket



there is in terms of the alphabet soup of regulatory agencies.

We also thought it was a plus that the standards clearly set forth some due diligence standards, and that's how we refer to them in Sundstrand, the seven criteria. They are due diligence standards, and they are defined by the government, so they are at least some sort of an official starting point that says, to managers particularly, if you do these kinds of things and if we do these kinds of things as a company, if all is right in the world, we should be okay or at least relatively okay, even in the face of a maverick employee or a bad apple or whatever you want to call it that has gone against what we perceive as important standards to be followed.

Being an attorney in the company, I don't know how many people I've had come to me and ask me, what does due diligence mean? And when you sit down and try to go through a discussion of defining due diligence, sometimes it's pretty hard. We think the sentencing guidelines help that process because at least there's some starting point that says, well, the Sentencing Commission has said if our program has these things and if you do these things, again, all else being equal, that should be deemed as due diligence.

The other perspective we had on the guidelines is that we view the guidelines as principally a matter of proof and evidence, in the sense that if we are reading the guidelines the right way, if something happens in 1995 that represents a violation of law, it's not exactly like Win was talking about with a speed trap. When you get a ticket, you get ticketed right on the spot. You're apprehended at the time the offense is committed.

Well, in the environment that we're in with white collar crime, it doesn't happen that way. It's usually three, four, five years later down the road, and so to us, the problem statement was, if something happens in 1995 and we're in front of a judge in the year 2000, how do we prove what our program was in 1995 that says we had an effective compliance program at the time and that this thing happened in spite of good efforts?

I'll get into a little description of how we addressed that situation, but we saw that as a real issue with the sentencing guidelines, just from a pure statement of how do you prove how good you were in 1995 when the prosecution or the investigation doesn't happen until years later.

I'll slip through these next couple of charts and give you an overview. That first overhead was some of the key features of our program. We went down the sentencing guidelines checklist, and again, this is what Sundstrand thinks are the significant compliance risk areas that we have addressed with our program. That's not all the risk areas from a business point of view. That's what we believe are all the risk areas that could involve some possible likelihood of criminal violations or criminal activity. So we didn't try to cover the whole waterfront of every single issue. And again, that's just our list. That list obviously has to be tailored for a particular company. The next overhead, please?

This is a real eye chart, and I know it's also in your materials. The approach that we came up with to address sentencing guidelines is what we call our "Responsible Executive" program, and for each of those risk areas that was on the previous overhead, we selected one individual in the company, in some cases two individuals, and we selected them to be our

responsible executive with principal oversight responsibility for compliance and ethics in that risk area.

And we selected the highest-level person we could find in the company who had policy-level responsibility for that area, not necessarily operational responsibility but policy-level responsibility, and to that person we said, “You are the responsible executive for this area and it’s your job to continuously be sure that our compliance program meets the sentencing guidelines requirements.”

What this chart shows is just an example of the government contracts risk area and how we move across this matrix to say that we identify the area of risk. We try to identify what the company policies are that apply in this area. And then the next column is statutes and rules that are the federal statutes or regulations you can trip across in that area, to make sure we’ve got them covered.

The next column lists the identity of the Responsible Executive. Then the next column lists the functional experts who are the principal supporters of the Responsible Executive in doing a lot of the day-in, day-out compliance function. As you can see, we just try to cover the areas.

We’ll just go through the next two charts quickly, under the area of statutes and rules and violations. This just happens to be the list of statutes and rules that we believe could come into play in the government contracts area, and we have a similar list for each of other risk areas, again, just to try to define for ourselves where the traps are for the unwary in terms of laws.

The next one is just another example of how we identified the Responsible Executive and the statutes and rules for the area of securities law compliance. If we could go to the next overhead, please?

For each one of our risk areas, we decided that we needed to have some method of monitoring each of those risk areas and so we came up with this list. The way we use this list is that our internal procedures say that if a risk area is worthy enough to be identified as a risk area, then every one of these monitoring methods should be used in that risk area.

This is not a pick-and-choose list. Again, the standard that we have is every one of these methods should be brought to bear in the risk area if it’s important enough to be identified as a risk area, so we try to check ourselves to be sure that we are doing some or all of these things for every risk area. The next overhead, please?

To bring this all together, we ask each Responsible Executive to do an annual review of their particular risk area and make a report on that risk area to the corporate ethics committee. The report is actually made in the form of a volume, a binder, a book, and the report that the Responsible Executive makes is keyed to the seven due diligence standards in the sentencing guidelines, and we have a book for each year.

The idea is we will have retained somewhere back in the files of the law department the

books for 1994, the books for 1995, and the books for 1996. So again, if this issue ever comes up – what did you have in place in any particular year to address this particular risk area – the idea would be that we would have something available so we wouldn’t have to go back scrambling through files and records and trying to reconstruct what happened three or four or five years earlier.

The form that we ask each Responsible Executive to sign is nothing more than a listing of the seven due diligence standards with a check block for yes or no. The idea is that in addition to this form, for each of the questions that are asked, there are backup materials and supplementary materials, examples, training lists, whatever the particular subject happens to be.

So this checklist or assessment form becomes the top cover for the 1995 compliance assessment book, and then underneath this form are the particular materials that the Responsible Executive has pulled together that offer some proof or evidence of what we did to answer this question, which we hope makes the program more than just a paper program, so there’s actually some action behind the words.

That summarizes and describes the Sundstrand program. I was glad Win corrected one thing, too. I know when Julie was speaking, I guess I misheard her, because I thought she said that companies today are “nefariously liable” for the acts of their employees. I’m glad Win corrected that it’s still “vicariously liable,” because I thought there was some new standard that was being put out. Thank you very much.

**HERBERT L. THORNHILL, JR.**

MR. KAPLAN: Thank you, Ken. Our second presenter is Herb Thornhill. Herb is Deputy Counsel of the Bank of Tokyo, Limited, where he has played a central role in drafting and developing the bank's overall compliance program. Herb has also published and lectured widely on the subject of banking compliance. He's a graduate of Harvard Law School, a former clerk for a federal trial court judge, and worked at Winthrop, Stemson, Putnam, and Roberts before joining the bank. Herb?

MR. THORNHILL: Thanks for the introduction, Mr. Kaplan. As Jeffrey Kaplan just said, my name is Herbert Thornhill, and I work for The Bank of Tokyo, Ltd. in New York in the North American Legal and Public Affairs Office. I have been involved in establishing the overall structure for compliance at The Bank of Tokyo, Ltd.

I have also been involved in putting together compliance statements in specific areas including criminal liability, environmental liability, insider trading, confidentiality, and ethics. I also consult the Bank's Compliance Committee, which is a group of executives at the Bank that manages and oversees our compliance efforts.

What I would like to share with you today is the Bank's experience in the compliance area and how we approached the goal of assembling a compliance program under the federal sentencing guidelines. However, the basic theme that you will hear me repeat from time to time is this: If you start with the federal sentencing guidelines' definition of an effective compliance program, and use it as the guiding force behind your compliance program, you will put together an overall effort that will efficiently and reliably reduce the prospect of civil and criminal liability at your institution.

The Bank of Tokyo, Ltd. has made the federal sentencing guidelines the focal point of its overall compliance effort, and we have gained three basic advantages by doing so. First, as Jeffrey suggested, the federal sentencing guidelines gave us a "road map" for compliance. It was the only source that gave us an overall view of what a compliance program should look like once it is completed.

Second, to the extent that the definition gave us a sense of what a system of compliance should look like, it gave us a means of managing a series of complicated laws and regulations affecting The Bank of Tokyo, Ltd.'s business activities.

And third, the sentencing guidelines gave us a reference point for measuring the success of our compliance program once it was implemented.

Let me tell you something about The Bank of Tokyo, Ltd. and its activities. In terms of assets, The Bank of Tokyo, Ltd. currently has the largest presence of any foreign bank doing business in the United States. That status will continue after we merge with The Mitsubishi Bank, Limited and become the largest bank in the world. At that point, the size of our asset base will be three times that of Citicorp and roughly two-and-one-half times that of The Chase Manhattan Bank after it merges with Chemical Bank.

We have offices and branches throughout the United States in all of the key money centers, including New York, Chicago, San Francisco, Atlanta and Boston. In the greater New York area alone, we have approximately 1,000 employees.

We are a full-service bank, and we offer a range of financial services. Through our California-based affiliate, Union Bank, we are engaged in retail as well as commercial banking. However, our primary focus in the United States is commercial banking. Our activities include corporate banking, trust and fiduciary services, foreign exchange services, capital markets and securities activities.

Let me tell you why compliance has always been important at the Bank. The Bank of Tokyo, Ltd. operates in a highly-regulated industry: the banking industry. In 1990, we did a survey of the regulations and laws that apply to our banking activities. We came up with a list of more than 400 regulations and laws. Everything from lending and taking deposits to the location of our branches to the issues that our board of directors must consider on a regular basis is regulated to one degree or another.

But, many of the regulations we comply with go far beyond banking. Many of them are the same regulations that the organizations represented in the room today have to comply with.

For example, when it comes to export controls and OFAC regulations, the Bank has to be concerned because it is involved in international trade finance. When it comes to environmental liability, we have to be concerned because we are involved in financing real estate development and power projects. We also have to be concerned about insider trading because we receive confidential information about our customers, but, at the same time, we provide securities trading services.

And, finally, because we are a significant employer in the United States, we have to be concerned about EEOC-related regulations.

But, my purpose is not to merely list the laws and regulations that apply to The Bank of Tokyo, Ltd. My point is this. The Bank of Tokyo, Ltd. is concerned with regulations that apply to banking. However, many of the regulations we comply with are not directly related to the banking business. Yet, we have found that the federal sentencing guidelines definition of an effective compliance program is flexible enough to accommodate all of the regulations we face – regardless of whether they are banking-related. Therefore, the sentencing guidelines can act as a focal point for any compliance program for virtually any corporation, regardless of the industry and regardless of the relevant regulations.

In addition to the regulations that I just mentioned, starting in 1990, The Bank of Tokyo, Ltd. had to confront a new compliance environment. During the recession of 1989-1992, as you will recall, many savings and loan institutions and banks failed. The response on the regulatory and legislative level was to develop stricter laws and regulations.

But, along with the change on the legislative and regulatory level, we saw a change in the attitudes of prosecutors, examiners, and regulators. As you all know, they became more rigid.

The Bank of Tokyo, Ltd. also had to consider the fact that the Comprehensive Crime Control Act of 1990 and the Financial Institutions Reform, Recovery, and Enforcement Act increased the fines and penalties associated with banking-related offenses. Currently, if you are involved in bank fraud, embezzlement, or bribery, you will face possible fines of up to \$1 million and possible imprisonment of up to 30 years.

Under the FDIC Improvement Act of 1991, regulations were promulgated that required banks like The Bank of Tokyo, Ltd. to put in place internal controls for compliance and to establish overall compliance mechanisms to meet federal standards. Moreover, on an annual basis, banks like ours must test their compliance programs and report the results to federal regulators.

We also became subject to a new regulatory system for examining and evaluating the safety and soundness of banks. Under the current system, assessing compliance is a key aspect of the examination process. And, in fact, if a bank has a compliance program that doesn't meet federal standards, its examination rating can be affected adversely.

We also received a flurry of specific pronouncements aimed at a number of issues including money laundering, environmental liability, derivatives trading activities, and real estate appraisals. And finally, on November 1, 1991, the federal sentencing guidelines were adopted.

In response to this new compliance environment, the Bank used the federal sentencing guidelines to guide its compliance efforts for several reasons.

First, the federal sentencing guidelines gave us a clear picture of what a compliance program should look like. We received many directives from several agencies and legislatures. The directives required us, for example, to enhance our anti-money laundering compliance, to make sure that insider trading was addressed, and to ensure that environmental liability was properly managed. But no agency told us how to coordinate all of these directives through an overall compliance program. No one told us how everything should work together.

However, the federal sentencing guidelines gave us a clear picture of what a compliance program should look like and a set of instructions on how to construct a program. Another reason we used the federal sentencing guidelines is that they suggest a flexible structure for managing compliance. We found that virtually every directive we got, whether it was from the U.S. Congress or a regulatory agency or otherwise, could easily fit within the structure that is suggested by the seven elements for compliance under the federal sentencing guidelines. Let me try to illustrate this point.

As you all know, the sentencing guidelines stress several key concepts that should be parts of a compliance program. Number one, clear standards must be effectively communicated to employees. Second, you must establish auditing and monitoring mechanisms that are reliable. Third, you must ensure that discipline is properly enforced. Fourth, you must ensure that your employees are trained properly in the legal and regulatory areas affecting your institution. And, fifth, you must ensure that your effort is properly supervised by senior personnel.

We found that virtually every compliance directive we received, regardless of the source, fit comfortably within the structure that is suggested by the foregoing elements and the other elements contained in the federal sentencing guidelines definition.

An example is the Annunzio-Wiley Anti-Money Laundering Act, which required us to adopt stricter standards on money laundering. In that particular situation, we found that the Act emphasized, number one, proper supervision; number two, training; number three, written policies and statements; and number four, auditing mechanisms.

All of those requirements are already in the federal sentencing guidelines. And, if you put together a structure for compliance based on the guidelines, you will be able to easily introduce any new directive you get into your structure. It’s almost like a computer. When you introduce new software to the computer system, you will give your overall computer system greater capability.

The same thing is true for compliance. If you use the federal sentencing guidelines as your overall structure, you will be able to introduce the new directives to your structure to give your compliance program greater capability. This is true because all the terms, all of the seven elements, are universal and generic.

Also, to the extent that the federal sentencing guidelines gave us a sense of an overall structure for coordinating compliance, they put us in a position where we could manage our compliance program effectively, and, therefore, save money. Clearly, saving money is a key concern in managing an effort of this magnitude.

Let me illustrate this point by giving you two basic approaches to compliance. One approach would be to respond to each compliance mandate that your institution faces on an individual basis. Of course, there is a good reason to do this because as soon as a company receives a directive, its first impulse will be to respond to the directive and ensure that the organization is protected.

On the other hand, if this approach is taken, an organization eventually will be left with a series of unconnected compliance objectives. They will not be coordinated. There will be a haphazard quality to the organization’s overall compliance effort. However, if you use the structure for compliance suggested by the sentencing guidelines, you will have a well-managed coordinating structure, and you will be in a position to save money.

Finally, the reality of sustaining huge fines and perhaps a loss of reputation was important for The Bank of Tokyo, Ltd., as it would be for any institution. However, because we deal in large-dollar transactions, and the fines associated with large-dollar transactions are higher than others imposed under the federal sentencing guidelines, we realized that we had to take the guidelines very seriously. Also, many of the offenses associated with banking-related activities carry higher penalties under the federal sentencing guidelines than do other types of offenses.

The Bank of Tokyo, Ltd. has used the approach suggested by the guidelines. We believe in it. But, other banks have used the approach, and they believe in it also. On an annual

basis, I work with Mr. Thomas Santiago of the International Bank Study Center, “IBSC,” in New York to assemble a presentation for foreign banks on banking compliance.

At the first seminar, Jeffrey Kaplan was a key speaker, and he underscored the importance of using the federal sentencing guidelines as a starting point for assembling your compliance program. That message was well-received by the audience when Jeffrey delivered it originally, and continued to be well-received at each presentation that followed.

Moreover, one of the corporations that attended the original program, the Canadian Imperial Bank of Commerce, “CIBC,” adopted a federal sentencing guidelines approach, put it into practice, and received such favorable results that I asked Mr. Eric Young of CIBC to join the panel to illustrate CIBC’s experience. But it is not only CIBC. Several other New York-area banks have begun to use the guidelines as a foundation for their overall compliance efforts.

Further, state and federal banking agencies that attended the IBSC presentations remarked that starting your compliance program based on the federal sentencing guidelines represents a sound approach to compliance.

Finally, I would like to leave you with a sense of some of the other advantages that you can gain if you use the federal sentencing guidelines as the basis for your overall compliance effort. As you go through the process of constructing and managing a compliance program, you will have to focus on particular areas of your program at particular times. At one point, it will be important to write policy statements. At another time, it will be necessary to strengthen your auditing and monitoring mechanisms. An unfortunate result is that you may lose sight of your fundamental goals.

We found that the federal sentencing guidelines gave us a reference point that we could always refer back to and which allowed us to see the forest for all the trees. As a result, you can use the federal sentencing guidelines definition to evaluate your progress. The guidelines also provide a measuring stick for evaluating where a program is strong and where it is weak; where more resources are necessary and where efforts are sufficient. Another valuable aspect of the federal sentencing guidelines is that they provide an idea of how to prioritize your approach to dealing with a myriad of regulations and laws.

The Bank of Tokyo, Ltd., as I told you, has more than 400 areas of law and regulation that it has to comply with on a regular basis. When we started our compliance effort, the guidelines gave us a sense of how to prioritize our efforts. We focused efforts where our primary business activities were. We focused on where we were likely to run into problems. And, we focused on those laws and regulations that were likely to carry high penalties.

Also, the federal sentencing guidelines’ definition allowed us to visualize how various departments would participate in our compliance effort. For example, by looking at the definition, we identified the need to put together written compliance statements. That task seemed to be a project well-suited for our Legal Office.

Similarly, auditing and monitoring mechanism requirements were easy to delegate



because we already have internal auditors, and we simply added a new dimension to what they already do. We found that the federal sentencing guidelines’ definition was valuable for another reason. It allowed us to keep the attention of employees when it comes to compliance efforts. The mere fact that you can sustain fines that have been estimated to be \$290 million and more helps to keep priorities focused on compliance.

If you come away from my speech with one thought, I would hope that it is this one. The federal sentencing guidelines are the key place to start in constructing your program. They give you a clear picture of where you should be once you have established a compliance program. The definition is flexible enough to accommodate virtually any law or regulation you may face. The guidelines worked for The Bank of Tokyo, Ltd., they worked for the Canadian Imperial Bank Commerce, and I think they will work for many of the other corporations that are represented here today. Thank you very much.

**JOHN A. MEYERS**

MR. KAPLAN: Our final presenter in this panel is John Meyers. John has practiced domestically and internationally in the health care field for over 20 years. He is now a partner in the Los Angeles office of Katten, Muchin, Zavis, where he's a member of the health care department. Prior to this and until recently, John was Senior Vice President, Associate General Counsel, and Special Counsel to the CEO of Tenet Healthcare Corporation, which was formerly known as National Medical Enterprises.

He received his law degree from UCLA, is a member of various bar associations, and has spoken and published widely on health care issues. John?

MR. MEYERS: Tenet Healthcare Corporation is a \$5.6 billion revenue enterprise and is the result of a March 1995 combination of the former American Medical Holdings and National Medical Enterprises. It is now the second largest publicly-traded hospital owner and operator.

Prior to the combination, a three-year trauma commenced in 1991 for NME as its psychiatric hospitals were the target of one of the most thorough-going federal investigations in health care history. NME had been founded in 1968 and owned and operated or managed diverse activities within the health care industry, including acute hospitals, rehabilitation hospitals, nursing homes, other specialty hospitals, as well as clinics, physician practices, and HMO and other provider-related activities.

NME operated in six states and in four countries and had over 30,000 employees. The psychiatric and substance abuse facilities were separately operated through the NME specialty group under the name Psychiatric Institutes of America, headquartered here in Washington, D.C.

In August of 1993, the federal investigators searched a number of NME facilities, including its California headquarters. Certain NME affiliates were charged under information filed by the United States with a series of acts which essentially amounted to the following kinds of violations. First, billing fraud. Second, improper payments to induce referrals. Third, improper waiver of copayments and deductibles.

As a result of the information and investigations, payments in civil settlements to 19 insurers amounted to about \$215 million. The corporation suspended dividends in December of 1993 to conserve cash to pay over an additional \$360 million to conclude federal investigations and to settle additional claims, and lest one think that these fines were severe, whether denominated as restitution or as fines, the judgment of the markets was even harsher. NME stock fell from a high of about 26 to under seven in trading on 180 million shares outstanding.

The three founders of the corporation departed, its board composition was changed so as to be thoroughly dominated by outside directors, and most of NME's 80 or so psychiatric facilities have now been sold or closed, along with more than 40 physical rehabilitation hospitals and outpatient clinics not on acute care hospital campuses.

Certain NME affiliates also entered into plea agreements and a civil and administrative settlement with the United States, which included, among other matters, the corporate integrity program, a program designed to be an effective program to prevent and detect future violations of law. The CIP agreement, I would like to have included in the materials, but its length of some 20 pages prohibited that. It is available through my offices, or if you would like to give me your card, I can give it to you.

It will be, according to Gerald Stern, who is the Special Counsel to Janet Reno on health care matters, the model of imposed corporate programs in the health care industry. So if you are from a health care company, this may give you some insight to what the future bodes for you if you do not come up with a voluntary program that works.

Prior to the emerging crisis in the specialty group, I served as the Chief Operations Counsel for the General Acute Care Hospital Division, which was a separately operated division of NME and headquartered in Los Angeles. As the difficulties in the psychiatric hospitals grew, I was appointed to oversee the legal functions of the Specialty Hospital Group after the removal of that group's chief executive officer.

One of the reasons for this appointment, I think, was that in about 1986, I had begun a number of legal compliance programs within the General Hospital Group and I have to admit that I was completely oblivious of the Sentencing Commission's struggle, as detailed by Mr. Swenson, in its efforts to come to standards.

My own efforts arose from my experience as counsel to the International Division of the company and in attempting to create a program of compliance with the Foreign Corrupt Practices Act. My concern in this regard and in this sort of embryonic compliance program was the following: I was concerned that the advice given by lawyers to the various facilities be performed according to its terms, that contracts that were approved by the legal department to be performed under the terms and conditions as approved, and this arose from the fact that the Foreign Corrupt Practices Act required that documents reflect the underlying transactions accurately.

The then-evolving safe harbors in the health care industry included a provision that agreements of certain types be in writing, and obviously for an agreement to meet the criteria of the federal government, the writing must reflect the underlying arrangement. It couldn't be some kind of a cover-up.

And that was sort of what started my view of this. I know that business people often depart from written agreements just in the ordinary course of business, but I was concerned that a departure might fail a federal test in another area and it reminded me of the strictures imposed under the Foreign Corrupt Practices Act.

What happened in 1991 under the duress of these events was that NME adopted an expanded version of my program, which amounted to a corrective action plan for its psychiatric and substance abuse facilities. Ultimately, these voluntary efforts were the basis for distinguishing a good corporation from its bad sister. NME essentially made the case that there were two companies, one of which had exercised substantial and pioneering efforts to assure

general legal compliance, and that company deserved to survive.

And lest any of you doubt that your very corporate existence is at stake, the sentencing guidelines provide under section 8C1.1 that an organization found to operate primarily for a criminal purpose or primarily by criminal means shall have the fine set in an amount “sufficient to divest the organization of all of its assets.”

I believe this early history is important for you because I think it places me and my management at the time squarely in the camp of those who support compliance programs, not simply because of their effect on sentence mitigation but because compliance with law is sound business in the long run and because it’s basic morality. This belief gives context, I hope, to my remarks concerning how burdensome and counterproductive some elements of a forced compliance program can be. My concern is with the means and not the ends.

The present requirements of the corporate integrity program should provide, I hope, some valuable lessons for businesses which have the present opportunity to voluntarily discover and correct their problems before federal marshals appear and to ameliorate the burdens of a negotiated but still imposed solution.

If you act now, I think that you will prevent the imposition of programs designed to provide a skeptical government with assurances of both good faith and effectiveness at much greater cost and with less flexibility, and here I would like to talk to you about some of the issues raised under the corporate integrity program.

The first is a mandated series of audits which require outside auditing by accounting, law, professional organizations with respect to certain identified billing procedures, provision of certain services, certain payments to physicians, and certain accounting practices. The agreement requires contracting for reports in these subject areas, and under the duress of the agreement, it has been difficult to develop specifically targeted issues and standardized methodology. In fact, the audits begin to be a four-cornered document review.

I think all of you can feel from your own experience that it really is uncommon to find smoking guns which outline consciously criminal action in the form of documents lying around, although there are occasionally unwise documents, I think, within any large corporation. But this audit program and the expense of it to find this little kernel, I think is not an effective approach, and what I believe is a more effective approach is the combination of outside and internal functions working together.

The problem with the CIP program is that it requires numerous reviews by third parties, and not only are these expensive, but what happens is they pit the third party against internal constituencies within the corporation. The mandatory reporting requirement of, for example, material billing violations to Health and Human Services creates some unease both among the third party reviewers and among employees. It causes the third parties to worry about whether employees’ participation in these reviews may compromise their own sense of integrity. It causes responsible employees to worry about the fairness of the conclusion drawn.

This is especially true in the health care area, where billing practices and procedures are

undergoing continuous change and where their administration by government-contracted, private, third-party intermediaries sometimes results in what might be called a difference of opinion, which intermediaries sometimes characterize as a violation of law, and where, I might add, there can arise actual conflicts of interest as these intermediaries increasingly operate their own provider networks and operate as private payers.

This tension and this notion that some of your advisers can be advising some of your competitors and can be using your experience to advance their own interests creates a tension within the corporation. If you don't take the internal constituencies of the corporation and join with this outside system, what you have is two things.

You have a sort of group of enforcers that sit outside the corporation and a group of people who feel that they are somehow being looked at as potential sources of trouble and expendable people to the corporation, instead of tying the two together and saying the objective that we have here is to assure that the corporation complies with law.

But the government's position on this issue is quite simple. The government's position was the corporation had violated a number of laws. They didn't trust anybody in the corporation, and they weren't about to listen to the corporation's views of its own efforts.

So I say this to you while you have a period of calm that in the halcyon days, you really ought to look at this problem to be sure that your internal and external functions are well integrated so that there isn't this juxtaposition of two sort of opposing forces.

The CIP also required review of decisions to admit, for example, psychiatric patients by an NME officer who was not an employee of the admitting physician and an independent quarterly review by third parties of admission practices. This would have been prohibitively expensive and it would have alienated most physicians who believe that the decision to admit a patient to a hospital ought to be theirs, had the agreement not required the divestiture of most facilities to which the requirements were applicable. That's a pretty expensive way to resolve an operating tension.

Additionally, for certain classes of payments to physicians, outside legal review was required. Not only was this review expensive but it created pressure and tension between the inside and outside lawyers, and in effect, a kind of forum shopping occurs. Your inside business people seek the least restrictive alternative and they seek to consult lawyers who will effect their transactions, and I think this is an experience that all of us are quite familiar with.

What happens under such a circumstance is that, first, you go to the inside lawyers, and if they can approve your transaction, you are satisfied. If they can't, then you can go to the outside lawyers and see if they can approve your transaction, or you can go to the outside lawyers first and then to the inside lawyers. What happens is, just as happens among litigators, there is a kind of search for those who will expeditiously implement the objectives of the business principle in the ordinary course of his business, and I think this is contrary to the objectives of the Sentencing Commission, which ought to be to foster a considered review, not a review subject to another kind of law called Gresham's law.

Prior to these various mandated reviews, various employees in the Acute Care Group used to revisit certain transactions and programs to see the degree to which the transactions were performed according to their approved terms, and this had a practical effect. I would take legal teams out into the field. We would review certain of the facilities.

Both the lawyers and the operators educated each other as to the strengths and weaknesses of agreements previously entered into, and this, what I'll call post-op review by the corporation's managers reminded the business people that they were fallible, that conforming actual conduct to the entity's standards and procedures was and is more than just signing a paper that your attorney says is okay, and it reminded the lawyers that they weren't engaged in Euclidian geometry and they had to deal with the reality of the fact that contracts approved according to certain premises might be subject to factual change in the underlying circumstances.

Some employees, I believe, have also expressed fear that previously-taken actions, which now, after their education, they look at and they say, "Gosh, I wonder if that was the right thing or if I reached the highest moral ground or whether I was in compliance with all law in those areas." And they fear that they may be sanctioned by reason of the provisions which make adherence to the corporate integrity program part of each manager's performance standards.

Indeed, the very detail of the compliance report required to be filed with the government and the affirmative duty to report credible evidence of misconduct and the government's right thereunder to subsequently investigate reported matters has an intimidating effect on those who might otherwise report.

And here, I say this in the spirit of Win Swenson's talking about the struggle to implement common objectives. I believe that the government needs to be cognizant of the fact that in the real world, it's not just a fear of corporate reprisal but also a fear of government reprisal which can deter coming forth.

There is an independent corporate ethics and policy compliance body, and I think conceptually, no one disagrees with this notion. Our agreement requires this group to be staffed by certain identified executives, in particular, the president and various high-ranking executives. In a period of calm, I think this is a good idea. It shows that the corporation has got a high-level commitment to preventing problems, and it infuses the moral value of the corporation's leadership throughout the corporation.

But there is a little bit of a counter element here or a counterproductive trend and I wanted to just touch on it for a second. To the extent that high levels of management are involved in this body, while its credibility can be enhanced, there may also be a perception that the body is not truly independent and sometimes that it is created to conceal the sins of higher up.

An imposed program causes a more formalized and removed discussion of some issues and may add some trepidation to those who would like to bring exceptions to the attention of an ethics body. If you are a line employee, you have some difficulty with the very augustness of

this body in voluntarily coming to it, and I suggest this to those of you who have a chance to do some voluntary thing, that you adopt a little bit of what Ken had talked about. I like the idea of having the 25 or so subcommittees that moved about in that enterprise because I think that they enable people a level of access and a level of ability to express their problems and their concerns that are not quite so intimidating.

A second issue is the issue of bad actors. NME was required to cease the following: employing all headquarters, regional, and facility executives involved as of a date certain in the operation of over 90 identified psychiatric and substance abuse facilities and not to employ or contract with such formerly-employed individuals for a period of five years.

We were allowed to retain certain specifically identifiable individuals, but this blanket prohibition cast, I believe, unfair aspersions upon a number of individuals, impacting their livelihood and causing some fear among remaining employees that the corporation would not stand by them in any difficulty. This undercut the loyalty and comfort necessary to make voluntary disclosure work, and there is something, I suggest, Orwellian about such a broadly based provision.

I wanted to suggest that in this developing business of trying to eliminate known bad actors that there are some areas where you can take some comfort. In the health care area, there is something called the Fraud Abuse Control Information System now sold by Strategic Management Services located here in Alexandria, Virginia which provides a valuable service in collating information about people with known violations of law. The CIP agreement itself had a stricture dealing with people actually convicted, and I think that this more narrowly drawn stricture is the preferable approach in a voluntary program.

Under our agreement, there are a series of notification provisions. We have to actually notify all employees and contractors of the fact and substance of the CIP agreement, and I think there's a one-page handout that all of you have. This rather detailed notice we actually hand out to those that we contract with. It was drafted by my former colleague, David Layne in TENET's legal department, as a result of our review of the documents.

The notice has a couple of effects. Given the history of the corporation, it had, actually, I think, an initial salutary effect in dealing with some third parties who might have been troubled in dealing with the corporation. It was a demonstration that the corporation had, so to speak, has reformed and gotten its act together.

But it does also discourage some third parties from proceeding with arrangements which might involve manageable legal risk for fear of the cost of involvement in an expensive compliance program, even, or perhaps especially, innocent third parties who have a fear of their activities being specially reported to the federal government concerning the necessity of their services. The requirement that the corporation report "credible evidence of misconduct," even by outside third parties, disturbed them even more.

Some of our contractors have explicitly stated to me an unease at doing business with what they call a government informant in an area of the law where the government acknowledges various meanings for departures, for example, from its own safe harbors

promulgated as regulations under the anti-kickback statute.

Another complication that arises from the government-imposed program, and it is an odd one and I try to touch on these things, I hope, with some subtlety, is that the process of educating your employees about legal compliance is quite a difficult one. We are not sending all of our employees to law school. We are trying to get them to understand basic constraints that operate on the business and basic principles of law that apply to their distinct areas.

But business has become so complex, and I'll give you an example in the health care area. As you try to make employees aware of laws, there are areas in which the laws actually conflict. Take, for example, the changing health care regulations in every state dealing with who is allowed to employ physicians and to bill and collect for physicians' services.

Jurisdictions vary in their regulation of the corporate practice of medicine, and employees now sometimes fail to proceed with perfectly legitimate undertakings in their new locale because they have been educated by rules applicable only in a different jurisdiction. This happens because newly educated employees now know enough not to consult their lawyers about the law in the jurisdiction where they have gone. I don't know that this is a major problem but I was just trying to give you a sense of tension that happens.

Finally, there were a couple of things that were touched upon by the previous speakers. One was prioritizing. Here is what will happen to you under an imposed agreement. The agreement will lay out various areas and you will focus on those areas because you must and because you are required under the agreement to do so. Here, it's medical fraud; it's billing; it's the medical necessity of services and certain physician payments and bad debt accounting.

Out of necessity in corporate America and because of the limitations of resources, a deemphasis in some other areas occurs, for example, in antitrust, perhaps, or insider trading or in some of the other areas that are more generally applicable.

Finally, I wanted to just touch on this. It's the most difficult area. It's the disclosure requirements under the imposed program. As an in-house lawyer, I found it became ever more necessary to Mirandize employees, to tell them, "I am not your lawyer; I am the corporation's lawyer. Things that you tell me that indicate that we have violated law, I must report to our management, and our management must make a decision about what to do with that, given the constraints of the corporate integrity program."

This has a tendency to make your employees less willing to talk to their lawyers. They formerly thought of you as their lawyer and now they wonder whether they need a lawyer to talk with their ex-lawyer. We tried to solve this problem a number of ways, but I don't really believe that there is a good solution to this problem. I think there is an inherent tension, and I tell you this from personal experience; it played no small role in my decision to leave the corporation because I believe that in some circumstances I could more effectively represent it from the outside.

And this segues into another notion, which is the role of the attorney. For those of you who are lawyers out there, when you have an imposed program, it will raise issues that will



surprise you in their complexity. These issues will make you search for who your client is within the organization; wonder about your function; wonder whether or not your duty is to disclose or to defend under client-attorney privilege; and whether or not to resign. I think it adds a great deal of complexity to operating inside.

If I have any specific thing that I would like to raise with the government it is this conflict between inside and outside attorneys. I believe that the struggle here should be to implement effective legal review and not be so concerned with the source of it. To the extent that corporate compliance programs can strengthen internal legal departments, that should be a legitimate objective. And while you have the chance to do so, you really ought to do so because I think it's much more cost effective than the hourly charge I now impose upon my former clients.

So this concludes my general remarks. I think if there was one last thought I would leave you with, it is that as a practical matter, if you are in business, it is a much better idea to implement and experiment with these compliance programs in a flexible environment where you have voluntary corporate compliance than under the strictures, tensions, and rigidity which accompany an imposed, albeit negotiated, program.

To those of you in the government, I know you are aware of the infant science of creating and implementing these programs and I hope you continue to consider the pressures, the fears, the organizational tensions operating on ordinary individuals who struggle to keep an organization lawful and economically viable.

## QUESTIONS & ANSWERS

MR. KAPLAN: Thank you very much, John. Let me just pose the first question to Ken, which is, “How do you deal with privilege issues in regard to your various auditing and monitoring mechanisms?”

MR. MARTIN: By and large, most of our auditing and monitoring that goes on is done without any particular regard for trying to establish privileges. Under our general rules of doing business with government officials, our audit reports are open for review. We routinely give access to work papers. Our defense auditors routinely see our board of directors’ minutes.

We made one of those conscious decisions a few years back that a lot of this stuff is just not nearly as fascinating as the government people think it is, and after the first few times going through it, they realized that there aren’t all these smoking guns and bad things going on. So with the exception of specific investigations of specific allegations of misconduct, those we do under privilege and try to keep under privilege at least until we have done the review. Except for those relatively rare situations, generally, our books are open.

MR. KAPLAN: Thank you, Ken. Here is a question for Herb. Did the discussion and consideration of Bank of Tokyo’s commitment to an effective compliance program include the directors’ fiduciary duties to its stakeholders to implement such an effective program and what were those discussions?

MR. THORNHILL: I can answer the question broadly, in that the directors were concerned about compliance at Bank of Tokyo, that the executive management of Bank of Tokyo was very concerned about compliance. They have really been a source of momentum for our compliance program.

## QUESTIONS & ANSWERS – WRITTEN

*Jeff Kaplan*

- Q. Do you see a need for an objective or independent assessment or “audit” of a company’s ethical compliance systems? If yes, who should perform this audit or assessment?
- A. While an independent audit of a company’s ethics/systems is not always necessary, it is frequently advisable. Typically such an audit should be conducted by an individual having significant experience with compliance systems but not involved in designing the program under consideration. Utilizing a lawyer (with the appropriate expertise) may promote greater candor in the audit process since the results of his or her effort would be privileged.
- Q. You are retained by a corporation that is under investigation (for an environmental crime) and discover that your client does not yet have a compliance program. Is it too late? What can you do? What advice do you

give the General Counsel? The Chairman?

- A. Even an after-the-fact program is better than none at all. The comments of several of the DOJ representatives at the symposium confirmed that prosecutors will give some credit in charging decisions to companies taking compliance-remedial steps after an investigation has started. Even a convicted corporation should develop and implement a compliance program prior to sentencing so as to avoid having to do so as a condition of probation. *See* USSG §8D1.1(a)(3).
- Q. Most programs on corporate compliance programs and the sentencing guidelines feature speakers and written materials that are slanted to large organizations. The reality is that most investigations and fines have been imposed on small/medium organizations. What practical advice do you have for small/medium organizations (that do not have the financial/personnel resources of Sundstrand or Bank of Tokyo) for developing an effective compliance program, especially with regard to ongoing monitoring and auditing?
- A. The components of an effective compliance program, as articulated by the sentencing guidelines, can readily be adapted to small/medium organizations, as I have found in working with a number of companies. What often works best in organizations that are too small to have a full-time compliance officer is to develop a compliance committee – composed typically of the CFO, head of human resources, in-house counsel (if there is one), and chief quality assurance officer – to meet periodically and review areas identified in a committee charter or “standard operating procedure” (which is drafted by the program designer) that serves as an auditing/monitoring road map.

*Jeff Kaplan and John Meyers*

- Q. If the Tenet Corporate Integrity Program (“CIP”) has been adopted as the model for CIPs for the health-care industry, have CIPs been developed in cases in other industries that will be models for future cases in those industries?
- A. (Jeff Kaplan) A number of these are identified in Kirk Jordan’s materials.

*Kenneth Martin*

- Q. How can a large company with a minimum of government sales (= 15 percent), and having an ethical program primarily driven by the Defense Department, extend the ethics program across the entire company?
- A. Compliance and ethics standards and procedures must be developed to address those common values and rules applicable to all business activities. As an example, the permissible extent of gratuities from vendors and to customers is

an issue which should be faced across the business, even though the Defense Department certainly has unique rules supported by regulations and civil and criminal statutes.

- Q. At Sundstrand, what is the role of the corporate committee in dealing with live allegations or major investigations?
- A. The Corporate Committee does not generally become directly involved in or deal with specific allegations, investigations, or discipline. The principal role of the Corporate Committee is to monitor and improve the Business Conduct and Ethics Program and report on the statutes and health of the Program to the Executive Office and the Board of Directors.
- Q. Should the corporation not only develop its own compliance program but also develop the programs of each of its subsidiaries? Is there a prohibition against such an eventuality?
- A. Sundstrand's approach was to develop and implement a single Business Conduct and Ethics Program applicable to all subsidiaries and affiliates owned or controlled by the Company. There are no prohibitions against subsidiaries developing their own programs and this is an area where each company should choose the approach which best suits its structure, culture, and business activities.
- Q. In what sense is the "responsible corporate officer" responsible? Is this the same as "the Vice President in charge of going to jail?"
- A. Sundstrand's "Responsible Executives" are responsible for using due diligence to review each compliance risk area on an annual basis against the Code of Business Conduct and Ethics, the Company policies that implement the code and the seven standards for an "effective program" found in the organizational sentencing guidelines. Since the "Responsible Executives" are generally in policy-making staff positions with respect to the Business Conduct and Ethics Program, they are not responsible for operational compliance on a day-to-day basis and their role is not intended to be a substitute for the compliance responsibilities of individual employees and managers.

*Day One*

## **Sharing “Best Practices” Information**

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**Alan R. Yuspeh**, Howrey & Simon

**Anne L. Gill**, General Attorney, Sprint

**W. Michael Hoffman**, Executive Director, Ethics Officers Association

**Thomas Furtado**, Corporate Ombudsman, United Technologies Corp.

*Moderator:* **Donald A. Purdy, Jr.**, Chief Deputy General Counsel, U.S. Sentencing  
Commission



**THE DEFENSE INDUSTRY INITIATIVE (DII): LESSONS LEARNED**

MR. PURDY: This is the panel on “Sharing ‘Best Practices’ Information.” My name is Andy Purdy. I am the Chief Deputy General Counsel at the Commission. Our first speaker is Alan Yuspeh. He is a partner with the law firm of Howrey & Simon. He concentrates on government contract law. Perhaps most notably, Mr. Yuspeh is the coordinator of the Defense Industry Initiative on Business Ethics and Conduct. Mr. Yuspeh.

MR. YUSPEH: Andy, thank you very much. The Defense Industry Initiative on Business Ethics and Conduct is an outgrowth of the work of the Packard Commission in 1986. The Packard Commission was a blue ribbon commission on defense management chaired by a founder of the Hewlett Packard Corporation, David Packard, who was also a Deputy Secretary of Defense. This effort predated the sentencing guidelines for organizations by about five years.

The recommendations of David Packard and his commission were, essentially, that among other changes that were needed in the defense industry, there needed to be more corporate self-governance in the industry. Particularly, he called upon the industry to universally adopt codes of conduct, ethics training programs, hotlines, ombudsmen, and the like.

The industry decided to have a concrete reaction to those recommendations and the reaction was one that was basically led by Jack Welch, then and now the Chairman and Chief Executive Officer of General Electric. In response to these preliminary recommendations, Jack Welch convened a meeting of 17 CEOs of large defense contractors, and within a period of two days a document was drafted called the Defense Industry Initiative on Business Ethics and Conduct, to which the 17 companies became signatories.

This presentation is on the lessons learned from this industry initiative. It was initially decided that this effort should not be housed in some existing association, and I think the reason was two-fold.

One was that the way the defense industry is organized is basically by line of business, so you have the shipbuilders in one association, and the aviation or aeronautical companies in another, and so on. So one problem was how if you want something that’s truly defense industry-wide, where do you put it?

The other thing was that this effort was supposed to be, and would become, so important and so significant that people did not want it to be subsidiary to other functions of an existing association. The concern was that if you have a trade association whose primary purpose is one perhaps of lobbying or affecting public policy, would self-governance be subsidiary to that? So the feeling was that the initiative should be a free-standing effort.

The Defense Industry Initiative (DII) principles require these things. They require that the signatories have a written code of conduct, that the code of conduct be distributed to all employees who are involved with government contracting, that there be some type of orientation for new employees with respect to the code, and that there also be training for all employees with respect to the code and other ethics and compliance-related principles.

The DII principles require that there be an internal reporting mechanism, hotline, ombudsman, help line, or concern line, that there be a system for making voluntary disclosures to the government. I might note here that the Department of Defense facilitated this requirement substantially, because shortly after the DII was off the ground, the Department of Defense Inspector General started a formal voluntary disclosure program in the Department of Defense, and the Department of Defense Inspector General, Eleanor Hill, will speak later in this program as will the head of that program, Bruce Drucker. So I will leave it to them to explain the details of the voluntary disclosure program.

The principles also required that the signatories attend best practices forums each year, and finally, that they participate in a public accountability process, and the public accountability process was very straightforward. There was a questionnaire of 20 questions which basically sought to determine that the signatories had met their obligations. The questions were questions like: "Do you have a code of conduct," "Do you have an internal reporting system," and the like. You would have those questions audited by your independent auditors and then submitted to an external internal body which would compile the results. That then became part of an annual report.

I might mention that the annual report has grown substantially. It is now about a 150-page document because it includes, among other things, about a 50-page description of the types of programs that DII signatories have implemented, and it also includes a listing of materials and an information clearinghouse.

In terms of the DII progress since 1986, today there are 55 signatories. Last year, there actually were 60 signatories, but as people know, one of the trends in the defense industry is toward merger. So Northrop and Grumman have merged. Lockheed and Martin have merged. Raytheon and E-Systems are merging, as are General Dynamics and Bath Iron Works. So the consequence of that is that the number has dropped from 60 to 55, really reflecting the merger trend of the industry.

This represents about 55 percent of all the prime contracts with the Department of Defense. It includes all of the ten largest defense contractors and 22 of the largest 25, so it really is the core of the defense industry.

The DII has had a modest governance structure since its inception. There is a steering committee, which is a CEO group of 12 companies. It was chaired initially by Ed Hood, who was a Vice Chairman of General Electric at the time. It has been chaired for the last five years by Joe Gorman, who is the CEO of TRW.

There is a working group which consists of representatives from the same companies. The interesting thing about the working group is it started out virtually as an all-lawyer group in 1986. It has evolved to where the majority of the representatives are no longer general counsels of their companies but are ethics directors of their companies.

The original chairman of the working group was the general counsel of Martin Marietta. The second chairman was the general counsel of Boeing. The current chairman is Carl Skooglund, who is the Vice President for Ethics at Texas Instruments and is also a Vice



President of the Ethics Officers Organization.

The other part of this modest governance structure is that the decision was made early on that if we are going to have conferences, issue reports, do a public accountability process, and the like, we needed somebody on a day-to-day basis to do that, and so the position of DII Coordinator was created. The decision was also made that we wanted this to be a low-cost, non-bureaucratic organization, so they went to someone who was actually practicing in a law firm and would do this on a part-time basis, and I have had the privilege of serving in that role basically since the inception of the DII effort. The role is one, in effect, of serving as the executive director of an association, though the association is one with the very limited purposes I have described.

In terms of the DII activities, they consist of maintaining an information clearinghouse which now amounts to more than 700 items of policies, procedures, codes of conduct, ethics training materials, video tapes, and the like that are maintained in our offices. The annual report of the DII will show a full listing of those and these are all publicly available materials and we regard the clearinghouse as being publicly available. It consists of materials that have been voluntarily submitted by each of the 55 DII signatories.

We do have annual best practices forums which are meetings of a day and a half duration in June in Washington. Typical kinds of things that are done at these forums is that there may be demonstrations of new training materials or tools. Last year we had an interesting film festival for a morning in which four company training video tapes, segments of them, and four commercial training video tapes were shown and discussed.

We always have small group discussions, which people enjoy. We have roundtable discussions where we may bring in three or four CEOs or three or four ethics directors or three or four general counsels and put a lavalier microphone on them and put them around a coffee table and have a sort of informal discussion about things that are posed by a moderator.

We certainly look at different functions, such as the human resources function or labor relations or internal audit and how those tie in with the ethics and compliance effort. These companies have in common the fact that they have really one domestic customer, for the most part, the Defense Department, other than the fact that they are one another's customers because of prime and subcontractor relationships. So we obviously ask the customer (DOD), how are we doing, and we will ask the suspension and debarment authorities for the various military departments, perhaps the head of the Defense Contract Audit Agency or the head of the Defense Contract Management Command to come and be part of the panel and to say what's going well and where can improvements be made.

And finally, one of the important aspects of these best practices forums is that we have sought and obtained very conscientious participation from the Department of Defense, the Department of Justice, and the Sentencing Commission, not just as speakers but as participants. So last year, out of 200 attendees, we had about 25 government attendees who were very senior-level government officials who could participate in this and make a very significant kind of contribution.

The other programmatic efforts are that we have an ethics director workshop for one day each year. We have quarterly meetings of the ethics directors in the Southern California area because there's a large concentration there. We issue the annual report, which I mentioned, which describes these programs in some detail and reports the results of the public accountability process. We meet from time to time with senior officials of the Department of Defense to update them on what's happening in terms of self-governance in the defense industry. Occasionally, we will prepare some training materials and occasionally do some mail outs which will address various kinds of focus issues.

In terms of the accomplishments, I think the accomplishments are primarily that we take pride in the fact that there are robust, energetic, and particularly imaginative programs in these 55 companies. I think that you would be incredibly impressed to look through the clearinghouse at the enormous imagination that has been shown and what these companies have done.

I think another accomplishment is that we certainly have gotten positive feedback from the Department of Defense that they have seen dramatic improvements in the attitude and the quality of the relationship and particularly in the compliance of contractors that have participated in this. We have, as a practical matter, a much higher level of compliance than there may have been ten years ago.

The other thing we find is that there has been broad-based acceptance and excitement in companies, that there is increased morale in many companies as a result of these kinds of programs and I think there's a broad-based recognition that these are sound management practices.

I conclude with a quick list of the lessons learned from the DII experience, and I think there are primarily four. One lesson learned is that setting industry standards, at least in the case of the defense industry, has certainly, I think, raised where the industry would otherwise be. The record shows pretty conclusively, I believe, that as an industry group, the defense industry has the most energetic programs of industry in the United States.

That is not to say that there aren't many companies represented in this room and in other industries that don't have wonderful compliance programs or effective programs to prevent and detect violations or law or ethics programs or the like, but it is to say, I think fairly, that in terms of an overall industry effort where the core of the industry has pulled together and said, "We want to establish our standards at this level," that I think this is the only industry effort of this type and I think I can say fairly that the standards are higher than they would have been without this kind of collaborative effort.

The second lesson learned is that coming together in meetings like our best practices forum is enormously valuable and perhaps valuable beyond expectation. That is, as the defense budgets have fallen and as travel budgets in companies fall, I have thought for each of the last few years, well, we can probably take fewer hotel rooms and get a smaller room.

But the reality has been that we fill the room each year, that there is no sort of languishing of attention to this, and I think the reason is that people joining together for a day

and a half each June have found that this is a time to sort of reaffirm the commitment to these basic kinds of principles and also to start to network again with people who have become very important professional colleagues.

A third lesson learned is that exchanging ideas is critically important and can be very, very helpful. And what we have found, interestingly, is that even though these companies may be intense competitors in the business world, that in terms of their ethics and compliance and commitments under this initiative, they have been as open as possible in sharing ideas with one another and in borrowing from one another in the most constructive and proper kinds of ways.

I think the fourth thing is we have learned lots of lessons about how these programs can be most effectively operated. I did prepare for you some materials that describe key requirements for success of these kinds of ethics and compliance programs, which really fall under the DII principles but are very similar to the kinds of programs contemplated in the sentencing guidelines. I think that you will find those to be sort of interesting kinds of things and a whole additional set of lessons learned about individual company efforts.

I would just say in conclusion that the defense industry very properly takes great pride in the accomplishments over the last ten years from the DII effort, and I think certainly believes that it could be a very effective model for other industries. Thank you.

**TELECOMMUNICATIONS INDUSTRY PRACTICE FORUM**

MR. PURDY: Anne Gill administers Sprint Corporation's ethics and compliance program. She has been active with a telecommunications industry group that meets to share compliance practices, so she can give you another perspective. Anne.

MS. GILL: All of you over 43 or so will appreciate the need for reading glasses. As Andy said, my name is Anne Gill and the reason I have been asked to speak with you today is that I was involved in creating Sprint's ethics and compliance program and for the last three years have regularly participated in a telecommunications industry group that meets regularly to benchmark compliance practice information. I hope knowledge of our forum is useful to you as you try to put what you learn here into effect in your own compliance programs.

Of course, the opinions I will share with you today are my own and not those of Sprint, of the Telecommunications Forum, or of the U.S. Sentencing Commission.

How do you discover that your company requires employees to personally report misconduct to their supervisors when most of the companies in your industry have established anonymous hotlines? How would you know that your company keeps no formal compliance statistics while most companies your size not only keep such statistics but report them annually and sometimes even quarterly to a board of directors committee?

As you heard this morning, failure to know those kinds of things can result in a much larger penalty if you ever find yourself in the misfortune of a criminal problem. One way is to spend your entire work life on the telephone with your colleagues, asking them how they are handling things that are important to you. Other ways include attending seminars that have industry practice breakout groups, sponsored compliance roundtables, or meetings of the ethics officers or ombudsmen associations.

Although all of these methods would be helpful, I have found personally that the most consistently reliable way to gather this type of information over time is to meet regularly with members of my industry for frank, open, and honest discussions about compliance issues that we all regularly face. I also believe that being aware of and able to adapt the best compliance practices of my industry and avoid the costly mistakes of others helped Sprint create a much better, a much more efficient and much less costly compliance program.

We all understand that industry meetings have inherent legal risk, and my group has handled these risks by including antitrust lawyers as member participants, requiring that compliance issues remain the sole focus of our business communications, and by maintaining minutes of all of our meetings.

Additionally, we are very careful, and you are hearing a lot about this lately and I find it personally very upsetting, but we are very careful to make sure that we share information about our respective compliance programs but never concerted attempt to set industry practice. We accomplish this by reporting to each other what each company is doing in various compliance areas but never deciding as a group what we believe the answer should be to any particular compliance issue.

Assuming that you agree that your company could benefit from being part of an industry forum, let's look for a moment at the practical considerations surrounding forming such an organization. How big should the group be? The size of any group is an important factor in both its group dynamics and its success. My goal would be to reach a good balance between being small enough to build trust, and to be able to facilitate informal honest dialogue, and large enough to reasonably reflect industry practice.

My industry group includes a dozen or so major players in the local wire line communications industry and the representatives of each are committed to attending on a consistent basis. Who should participate in such a group? In my opinion, individuals responsible for the day-to-day hands-on administration of a company's compliance program are the best participants for this kind of group. This would include the organization's chief compliance lawyer, not its general counsel, and if there is one, the compliance program manager, not necessarily the chief ethics officer or the company ombudsman, unless in your particular company these are hands-on positions.

The intent would be two-fold. First, to have a working group composed of those people who most intimately are familiar with both the federal sentencing guidelines and with their company's program on a detailed level. Second, you would want them to have access to the highest policy-making executives in the company.

Our telecommunications group also decides whether or not to allow additional participants at any of these meetings, which would include compliance investigators, hotline administrators, conflict of interest auditors, human resources lawyers, and we generally do allow companies to bring these personnel and occasionally hold specific meetings for the chief compliance officer in the company. Those are separately-held meetings, not in the Telecommunications Forum itself.

What does it take to plan an industry practice meeting and how do you set the agenda? I would recommend establishing three primary goals to such a meeting. One, that the meeting be interesting, valuable enough to guarantee regular attendance, that all members actively participate, and that the meeting be easy to prepare for, to host, and to attend.

The Telecommunications Industry Forum rotates the responsibility for planning meetings, which usually last a day and a half and are held quarterly at the headquarters' city of the hosting organization. The hosting company is responsible for providing meeting rooms and enough coffee to keep us motivated, for taking suggestions from participants of topics, and for setting the agenda. The host company then assigns responsibility for each agenda topic to one of the member companies.

What do the meetings actually look like? Well, our meetings are very informal. There are no lectures, although occasionally we will bring someone in to talk on a particular topic, and at a typical meeting, the participant assigned an agenda topic will discuss what his or her company is doing in that agenda area, including any problems they have encountered, suggestions, warnings, tips, and words of wisdom.

We then go around the room and each company will note if it applies a different

approach, has encountered a unique challenge, or has developed any specific tools that might benefit the group, such as database formats, check lists, surveys, and matrices, as well as video or computer training programs. Each company may then adapt these materials to their own company's individual needs, given its risks and its size and its politics and its structure and its corporate culture. As I mentioned earlier, in a concerted effort to avoid any appearance of setting industry practice, we never discuss how this topic should be handled.

I have now explained what my industry forum looks like and how it functions and the reasons that I think Sprint has benefitted from being part of one. At this point, I'd like to take a quick opportunity to tell you why you personally might benefit from belonging to such a group.

In my experience with legal compliance programs, I find that most executives feel much more comfortable, especially if the program is a new one, if they understand what other companies are doing in similar areas. Executives will often choose to take an innovative step and lead the industry, but they always want to know if they're hanging out there alone.

No decision maker wants to discover that they just approved a program that appeared to them to be reasonable and innocuous, only to find out that not only was it extremely controversial but that no one in the industry had been willing to take such a step. No compliance manager with any sanity wants to be the person who neglected to mention those issues.

Belonging to an industry group provides a source of statistics and data and comfort. It's very helpful to be able to respond to questions regarding the cost and feasibility of a particular compliance approach by relating the specific experiences of your competitors. Moreover, collectively, members of your forum will have fielded almost every question and concern you're likely to encounter, and access to their successes and failures will allow you to be more knowledgeable, better prepared, and more confident than you could ever be otherwise.

In conclusion, I'd like to share with you three facts about compliance programs, and by facts, I have to tell you that's my definition for a fantastically accurate compliance truth.

Number one, you will never achieve a program which actually deters undesired employee behavior without the driving force coming from the highest levels of your organization, and if you don't have that, you will be somewhat akin to the internal affairs department of the LAPD.

The more aware you become of the prerequisites for a truly effective compliance program, the more you will focus your attention on issues you know you haven't yet addressed, and the harder it will be not to appear idealistic, and not to become frustrated and discouraged and the more stressful your job will become as a result.

Number three, the lower the understanding, demand, and commitment of senior management for an organization's compliance program, the more likely employees responsible for that program will be seen as lacking in good judgment and lacking in executive temperament and the higher, therefore, your personal level of risk within the organization.

With these facts in mind, the very best reason I can offer you for joining an industry practice forum is to provide yourself with a group of peers who share your understanding of the matrix in which you perform, who have good suggestions for handling political situations that arise, and who will bail you out with a prototype when the general counsel calls and says that he or she needs an insider trading compliance program or an environmental compliance program in time for next Monday’s board meeting. Most important, such forums will focus your attention regularly on what you have accomplished and not on what you haven’t accomplished.

**QUESTIONS & ANSWERS**

MR. PURDY: Let me just follow up one point that Anne Gill made. Alan, you said that your organization attempts to set industry standards. Alan, to what extent do you think there are serious antitrust concerns here and how do you deal with them?

MR. YUSPEH: The industry standards that I was speaking about are essentially process standards, which frankly are very similar to your sentencing guidelines. They are processes such as having codes of conduct, training programs, new employee orientation, hotlines and ombudsmen and the like.

What we have not done, and thought it a bad idea to do, is to try to establish any kind of models. In fact, even on something like a code of conduct, we have left it to each of the signatories to develop their own codes and they all look quite different. In fact, I just got a new code from Rockwell the other day which I think is a superb 45-page book, but every one else's would look different than Rockwell's.

So the bottom line is that we have not established substantive standards nor substantive responses to problems. For example, some companies have more restrictive rules on gifts to government employees than federal law requires. But we would never push all signatories to do that and would think it improper to do so.

So that, essentially, is how I think the antitrust concerns have been observed so that we haven't crossed the line of improper areas.



## **ETHICS OFFICERS ASSOCIATION**

MR. PURDY: Our next speaker will be Michael Hoffman. He is founding Executive Director of the Center for Business Ethics at Bentley College, and he is formerly Executive Director of the Ethics Officer Association, now on its Board of Directors. Mr. Hoffman.

MR. HOFFMAN: Thank you, Andy. The Ethics Officer Association (EOA) started in the summer of 1991. At least, the seeds of it were planted then, when about 40 to 45 ethics officers came to the Center for Business Ethics at Bentley College and began to meet each other, some of them for the first time. The day-and-a-half's very unstructured workshop was so successful that the ethics officers that were there said, "Let's keep this going."

So we had a planning committee meeting at Raytheon a couple of months later and then another planning committee meeting at Honeywell about six months after that. We became a chartered 501(c)(3) non-profit organization about a year after we started the planning. So the EOA is now about three years old. Could I have the first overhead, please?

The mission of the Ethics Officer Association is dedicated to promoting ethical business practices and serving as a forum for the exchange of information and strategies among individuals responsible for ethics programs. To be a member of the Ethics Officers Association – I will call it EOA for short – you have to be involved in some managerial responsibility for an ethics/compliance program in your organization. I will talk about membership in just a minute; the growth of the EOA has been quite dramatic.

Here is a list of services and projects. We have Sponsoring Partner Forums. There is a category in the Ethics Officer Association for a company to become a Sponsoring Partner Organization, and for just the Sponsoring Partner Organizations, there are special forums which are smaller than our general conferences.

We have had four Sponsoring Partner Forums. The first in 1992 and the second in 1993, both held at Raytheon outside of Boston. The third in 1994 held at Levi Strauss in San Francisco, and the fourth this past April at Sears in Chicago. We try to spread our forums around.

We also have conferences. We have had two general conferences so far. The first one in 1993 at the Center for Business Ethics at Bentley College, and the second one in 1994 in Dallas, hosted by Texas Instruments. Our next conference is going to be in Toronto in October, hosted by NORTEL. In 1994 in Dallas, we had about 165 registrants. We anticipate that the Toronto conference will be at close to 200.

Professional development courses (PDC) have just started within the Ethics Officer Association. Our first PDC course, jointly sponsored by the EOA and the Center for Business Ethics, is being held September 17 through September 22 at the Center for Business Ethics at Bentley College. We wanted to have 35 participants in this first executive development course. We have as of now 37. It is closed for September, but we will be offering another one in May of 1996. We already have a waiting list for the May PDC course.

The PDC course is called “Managing Ethics in Organizations,” and has more than 25 faculty members. Seventeen or 18 of those faculty are experienced ethics officers from different companies, talking about different areas in that course.

These ethics officers are flying in from all over the country at their own expense because they feel that this executive development initiative for present and future ethics officers is extremely important. So we have people coming from all kinds of different corporations to participate, giving their time freely, to make this professional development program a success.

The EOA also plans to work with the Center for Business Ethics in a strategic alliance to continue to offer such professional development courses. This week-long intensive course will continue, but we will also have one-day intensive courses that will focus on a specific subject matter, exploring in more depth a particular area that the week-long course touched upon but couldn’t deal with thoroughly.

The Ethics Officer Association hopes, within the next year or so, to be offering credentials for ethics officers. For example, if a person takes the week-long intensive course, and perhaps three one-day intensive courses, he or she would receive credentials for being an ethics officer from the EOA. The EOA intends to provide some professional credentialing for this very new profession.

The EOA is really very similar to the DII, which started in 1986. We started in 1991/92. One of the main differences is the fact that the EOA is open to corporations from all industries instead of just the defense industry, even though we have as many defense companies as members of the EOA.

In fact, just as a change of pace, I wonder if all the members of the EOA who are here today would stand up or those people who know that their corporations have a representative in the EOA. Would you stand up just for a couple of seconds?

That’s a good representation of the EOA at this symposium. I’m pleased to see that all our panelists stood, too. So if you saw people stand and would like to know more about the EOA, please go up to them and ask them what they think of it. I think you will find that they are pleased with what they have been receiving from the services of the EOA.

There are some other EOA services, and I’ll go quickly. There is resource assistance with the Ethics Officer Association. The Center for Business Ethics and the EOA maintain a very extensive research library at Bentley College. It is very similar, I suspect, to the DII’s research library. We have both EOA company materials, approximately 1,500 to 2,000 books on business ethics, the best journals on business ethics are there, and many videos on business ethics.

We have networking assistance. Quite often, members will call EOA headquarters at the Center for Business Ethics to find out who to benchmark with in regard to a safe reporting system? Who can we benchmark with in terms of our training programs? And in addition to being able to come to the Center and look over the materials that are there, we can put people in

touch with companies that have some of the best ethics programs in a particular area.

The growth of the EOA has been excellent. These numbers may not jump out at you right away, but for us, they're very exciting. As of today, we have 84 Sponsoring Partner corporations and 119 individual members. You can be an individual member (IM) even if your organization chooses not to become a Sponsoring Partner (SP), at least not initially. We have 119 in this category. So that puts us over 200 members, including SPs and IMs, in the EOA.

The EOA has numerous plans for future development. We now have a full-time Executive Director. I was more of a part-time Executive Director. Now I have been invited to join the Board of Directors. I think they didn't know what else to do with me, but I am honored.

I would like to introduce you to our new Executive Director, Ed Petry, who you will be hearing from after lunch. And the Chairman of our Board who has been the EOA President, Bill Redgate. Bill is Vice President of Business Practices at Dun & Bradstreet. Ed Petry is still a tenured faculty member at Bentley College and works with the Center for Business Ethics, but he will be the full-time Executive Director at the Center. A full-time Executive Director of the EOA is now needed because of its growth in membership and services.

The future development of the EOA certainly involves improving benefits and services for its members. It has now struck up a strategic alliance with the Center for Business Ethics. The Center is no longer just the administrative headquarters of the EOA, but it is also a strategic partner, an example of which is the professional development course being offered in September, which is jointly sponsored by EOA and CBE.

We are certainly going to continue the progress with the executive education program. We are also going to start carving inroads into the international arena. The EOA has already scheduled conference panels in Tokyo, Germany, and Great Britain, so that we can spread the EOA mission of building best-practice ethics and compliance programs abroad.

The final comment I will make is this. If anything distinguishes the EOA from other organizations it is stressing the importance of ethics/compliance programs not being just compliance driven. We feel that a truly successful compliance program must be value driven, integrity driven. There is too much to lose in an ethics/compliance program not stressing the good things that come about in raising the level of ethical awareness of all members of the company and in providing all employees with the tools to make intelligent ethical business decisions.

If anything could characterize the efforts of the EOA, it would be that out of that effort to raise the level of ethical awareness and to provide the educational tools for making intelligent ethical business decisions, a good compliance program will follow. Thank you.

## OMBUDSMAN ASSOCIATION

MR. PURDY: Our next speaker is Thomas Furtado. He is the Corporate Ombudsman for United Technologies Corporation, and he is President of The Ombudsman Association.

MR. FURTADO: Thank you, Andy. This is sort of a blip in the schedule here because the ombudsman in many organizations doesn't exist and in some is a relatively new fixture. I represent The Ombudsman Association, which has about 230 members. What I would like to do today is give you a brief overview of why I think the ombudsman function has grown because of the sentencing guidelines, and why I think the ombudsman function helps greatly in meeting the requirements of the sentencing guidelines.

I have taken just a small portion of the sentencing guidelines text that relates to, in my opinion, why so many organizations in the last three or four years have appointed ombudsmen. In the last three or four years, there have been approximately 400 or 500 ombudspersons created in the United States, some of them in academic institutions, some in health care institutions, and a great many in corporations.

The underlined portion of this second slide is really the critical part of the sentence that relates to the value of the ombudsman, especially the words "within the organization without fear of retribution."

This text actually is one of the drivers in the minds of CEOs for thinking about an organizational ombudsman. Let me just explain briefly that word "organizational," because there are classical ombudspersons, and we have a number of them in the United States, who are generally appointed by a state or community legislature, and who have subpoena powers, investigative powers. They write formal reports and they actually represent the citizenry on behalf of those issues that they feel warrant investigation of the government.

An organizational ombudsman is totally different. We work within an organization or we contract with an organization to represent them. We are neutral. We stand between employees/employees and employees/management in dealing with issues that need to be resolved by both parties. We are also confidential, and I think that confidentiality is one of the major values that we bring to the sentencing guideline requirements.

The internal formal complaint handling system represents those people who have been chartered by the organization to represent the company. It might be the legal department, it might be a compliance officer, it might be an EEO officer, other parts of the personnel department, security people.

The formal complaint organization has a charter to protect the company, and, in almost every instance that I have known, cannot and does not guarantee confidentiality, especially if someone brings to them a violation of many of the Title VII human resource issues, or government contractual issues, they cannot guarantee confidentiality. The result is that the company is put on notice when somebody comes to them and they must go forward. That is proper and it should be done that way.

However, people using the formal systems oftentimes have problems relating to the

protection that they might have. In my experience, there have been three different groups that I can identify who relate to the formal system, either in terms of being comfortable with it and willing to use it, or being uncomfortable.

The first group consists of the people in the organization who have high trust and confidence. These are people who get up in the morning, get down on their knees and say, "Thank God I work for this company. It's such a wonderful place to work and there isn't anything I wouldn't bring to them in total confidence." I can count those people on the fingers of one or two hands because they are rare and most of their fellow employees would call them naive.

The second group consists of the people at the bottom of the spectrum who have no trust and no confidence in the organization and in the formal complaint handling system. These are people that generally are bitter. They are disillusioned. They have plateaued. They have worked for the company for many, many years without advancing. They see younger people coming in and getting ahead. They really don't like the company anymore, but they're vested, they've got a lot of time in, and so they stay.

These people don't trust anybody, and when they need to come forward or want to come forward, it's not always feasible or in their best interests to do so using the formal complaint handling system. So they look for another place to go, and even when they find that other place, they often report anonymously.

The third group represents most people in an organization and it's a swing group that can be as high as 80 percent. These people are ambivalent about whether they're going to use the formal complaint system, a compliance officer, a lawyer, an EEO officer, and they're ambivalent on the basis of two things.

Number one, what is the issue? I might go to my EEO officer and talk about diversity as a concept and ask for an explanation of what the company is doing to further diversify. I might not go to that same person to discuss sexual harassment that I have undergone. I might feel uncomfortable doing that. I might go to the benefits department to complain about a misreading of my statement that I received in the mail, but I might not go to the personnel department to complain that my manager is retaliating against me.

So people make judgments about whether they are going to use the formal system or not on the basis of how serious is the complaint. Secondly, they make judgments about the integrity of the system. I might go to the personnel department in plant A and feel very comfortable because the manager of that department has utmost integrity, has a staff that reflects that, and has a reputation over the past five years of never breaching confidence unless absolutely necessary, and I may feel very comfortable going to them.

In plant B, I could go to my personnel manager and talk in confidence about an issue and when I get back to my department my manager could call me in and say, I want to talk to you about what you just discussed with the personnel department.

So there is a reputation that precedes all of the departments that are in the formal

system. That reputation covers the legal department, the compliance department, the security department, the EEO department, and people feel comfortable about using them on the basis of whether they have a reputation for integrity.

So we have these three groups. The value of the ombudsman, it seems to me, is that it is an additional service available to the organization that reaches those people who don't feel comfortable on certain issues, because the ombudsman can sometimes reach that low trust or ambivalent employee who doesn't want to come forward to the complaint handling system because they are afraid that the issue may go beyond their control.

Secondly, we get a low percentage of cases but we get a higher percentage of sticky issues, because the very nature of the confidentiality of the ombudsman means that people are more apt to bring serious issues forward. So although all systems get serious complaints, we get a higher percentage of them and therefore are able to surface to management complaints that don't show up any other way.

Thirdly, I think we meet the requirement in the sentencing guidelines of no retribution, because we keep no records beyond a certain amount of time. Mine is six months. Some ombudsmen keep no records at all. We do not release records and we are willing to go to court to fight against the release of those records and have done so.

How secure is the confidentiality of the ombudsman? First of all, it applies to the office and not the employee. It does not apply to the employee, because I cannot guarantee that an employee who comes to see me will not go out and talk about our conversation, but I can guarantee that I will not. So the confidentiality applies to the function.

Secondly, when can we break it? We will break confidentiality when there is a threat to life or a serious threat to property – no other time.

We have gone to court on this issue. United Technologies has gone to court to protect the confidentiality and privilege of our ombudsman office and we won. McDonnell Douglas has done the same. Upjohn has done the same. In fact, Upjohn is on a roll because they have won five cases in a row.

The ones that have been won, which are predominately the organizations that I mentioned, are cases where the judge saw in the spelling out of the program to the employees clear-cut language that said, this function is confidential. Where you spell it out, where employees come to the office knowing that confidentiality is an attribute of the function, they have upheld the privilege.

When they have not upheld the privilege is when the company never spelled out clearly that when you visited the function, the ombudsman office, there was confidentiality. So we have learned our lesson from that, and in the organization, The Ombudsman Association, we clearly tell our membership to be sure everybody in the company from the CEO on down understands the charter of confidentiality and neutrality.

I will just end by talking a bit about the relationship between the ombudsman office and

the formal complaint system. It shouldn't be that we are an alternative, but in many companies we are portrayed that way. The big problem is often the way the program is launched – as a “perk” for employees and an alternative to the formal system. It's not an alternative. It is an addition. It is an attempt to catch those people who won't use the formal system.

The way to make it work is to build solid relationships with the people in the formal system that you have to deal with. I meet regularly with our Senior Vice President of Human Resources. I meet regularly and work closely with Pat Gnazzo, who is in this room today and who is our Vice President of Business Practices and Compliance. I think that when you do that, you make it work.

I will close by saying that the ombudsman function can also be a signal to employees of a value system. I was struck by Judge Conaboy's remarks this morning about values and Michael's reaffirmation of them a few minutes ago. Groucho Marx once said, “I have principles. If you don't like them, I have others.”

Well, I think that often we find ourselves building compliance programs and business practice programs and ethics practice programs on the basis of threats, on the basis of government coddling or not coddling, on the basis of the fear that we have that we might find ourselves behind the eight-ball in the courts. We don't build those programs necessarily on value systems, and that's really where we have to start. Compliance programs do not work when we don't have a value system behind them.

One of the things the ombudsman function does show employees is that we are willing to go after those issues that don't come out in any other system because people are concerned or afraid. Thank you.

## QUESTIONS & ANSWERS

MR. PURDY: We have a question from Andy Apel with the Minnesota Association of Applied Corporate Ethics about the benefits of effective compliance programs compared to the potential harms of having information used against you, and it's in that general context that I wanted to direct the first question to Anne Gill: what are the political dangers of doing this work within a corporation and how you sell the top corporate officials on the importance of what you're trying to do?

MS. GILL: I'd say that, at least in my company, executives have ears and eyes. They read the newspaper. They watch the television. They are aware of what happens when there is a major meltdown in a company and they are very, very concerned about that. They also will have a staff of people who will be telling them to protect themselves and to keep everything confidential and not to write everything down, and it's always going to be a balancing act.

One of the things the sentencing guidelines have done is to really add a push towards a little more openness and a little less benefit in that kind of protection. I frankly am not sure exactly where that is going to go in that we don't have the kind of privileges in place now that would allow us to comfortably go forward and place your soul and all your documents in advance of being subpoenaed or in advance of any discovery, to do that safely.

I think the corporate community wants to be less concerned about protection and more concerned about really detecting and deterring – and I would have to add civil. We are primarily talking about criminal offenses here, but most of the companies I'm involved with have applied all of this to their civil issues, as well.

If I could do anything, it would be to get a little bit more privilege, which would allow you to make your case for the government but in a safer way.

MR. PURDY: Let me ask the question to Alan Yuspeh in this way. How important is it to have the top-level executives on board with the compliance plans, and what do you find through your organization are some of the more effective ways that top-level corporate officers can convey that support?

MR. YUSPEH: I think, as others have said, that it may be the single most important thing to the success of these programs, and I want to associate myself with Michael's comments, too, about values and integrity-based programs being sort of critical. But you can just think that if that message is to be conveyed, the message, in effect, that if there is ever a conflict between business pressures and standards, values, integrity, and often the requirements of law, that the company unequivocally expects the matter to be resolved in favor of complying with law and with corporate policy and with the values of the corporation and not giving in to whatever the business pressures may be.

I think it is only the most senior people in the corporation that can effectively send the message, and I think the way to do that, Andy, is to be willing to talk about it, that in some of our signatories, I have sometimes talked to chief executive officers where others in the company have said, you know, we never find that so-and-so ever talks about this and so we infer that it's



not important to him.

So I think that people need to be not self-conscious about this, need to realize that it is a leadership message, just like you may have leadership messages about the need to stretch your goals, or things like that. You need to have leadership messages about ethics and about values and about the kind of things we’re talking about today.

MR. PURDY: Michael Hoffman. To what extent do you feel that it’s important that you have a high-level full-time official to direct the compliance efforts?

MR. HOFFMAN: That’s very important. In fact, it seems to me that that has been part of the problem that corporations have faced over the last several years, in not having an ethics officer or a compliance officer that really, truly, had a kind of gadfly function within the organization, to make sure that they put into place appropriate training programs for employees, and an appropriate ethics office with proper staff and proper functioning to handle help lines and hotlines.

And I want to make a distinction there, because a safe reporting system is not just a hotline system where all of a sudden somebody calls in with a problem. By the way, down in such-and-such there is somebody doing something wrong. These reporting systems are for employees to get help in trying to understand how to make a decision about an ethically-sensitive situation.

The ethics officer serves as a kind of inspiration for keeping that ethics flame, and that flame of the corporate values, alive in the variety of functions that he or she does, but in overseeing training programs, handling the safe reporting system, making sure that the code of ethics is up to date and properly communicated, and making sure constantly that those values of the company are constantly communicated and that the employees have the proper tools to make important ethical business decisions in a variety of circumstances.

When you talk about a compliance program, it sounds like you are all of a sudden talking about some omniscient policeman who is sort of going to take care of all of the things that a corporation or individuals in a corporation might do wrong. Individuals make individual discretionary decisions every single day of their lives, and no policeman, no compliance program can make that go away. You have to give those people the proper tools and the proper awareness to make those individual decisions autonomously.

MR. PURDY: We have a question from the floor concerning confidentiality and your ability to sustain your confidentiality. One of our audience members says that he or she doesn’t believe that this confidentiality is legally recognized, and they say, for example, if there is an environmental problem that’s significant that comes through the ombudsman’s office that the subpoena can reach that information.

I know we’ll talk about this in greater length in the law enforcement panel later, but I wonder if you might, in 30 seconds or so, comment on that.

MR. FURTADO: Thirty seconds? Well, actually, the test of that has been made. I

mean, there have been at least two dozen law cases in the last five years where sexual harassment issues, racial discrimination issues, environmental issues have been challenged in the courts as far as seeking information from the ombudsman's office.

In most of those cases, the privilege of the ombudsman has been upheld. It is very similar to the privilege that mediators have in the courts through shield laws. One of the things that we're looking for now is a shield law, to stop going through this process every time we have a case and to go after the same protection that the mediator has in mediation law.

If you take an environmental issue to a mediator who enjoys privilege through shield laws, that person is also not going to violate confidentiality unless given permission. Thank you.

### **QUESTIONS & ANSWERS – WRITTEN**

*Thomas Furtado*

- Q. What specific precedent (case law and statute) exists to support the ombudsman privilege?
- A. The effectiveness of organizational ombuds is attributed to their confidentiality and their neutrality. Ombuds practice strictly to the Code of Ethics and Standards of Practice adopted by The Ombudsman Association. The Ombuds practice assures organizations and their members of the promise of confidentiality. In fact, Ombuds believe that if it were known that confidential communications could be compelled in public arenas, then the Ombuds' ability to mediate disputes and help uncover problems concerning safety, health and environmental issues would be greatly diminished and the primary reasons for the existence of Ombuds would be eliminated.

Ombuds rely on a number of legal theories in their efforts to preserve and protect communications including, the Common Law privilege of confidential communications, state statutes protecting confidential communications of labor mediators and other related neutrals, state constitutional provisions relating to rights of privacy, and the Administrative Dispute Resolution Act.

The Common Law privilege of confidential communication is recognized pursuant to Federal Rules of Evidence 501. In order to assert a privilege at common law, the courts have looked to the following: (1) the communication must be made in the belief that it will not be disclosed; (2) confidentiality must be essential to the maintenance of the relationship between the parties; (3) the relationship should be one that society considers worthy of being fostered; and (4) the injury to the relationship incurred by disclosure must be greater than the benefit gained in the correct disposal of litigation. See *In re Doe*, 711 F2d 1187, 1193, (2d Cir. 1983); *Mattson v. Cuyuna Ore Co.*, 178 F Supp. 653, 654 n2 (D. Minn 1959).

The Administrative Dispute Resolution Act, enacted in 1989, was designed to streamline resolution proceedings through the use of alternative dispute resolution techniques instead of litigation. Congress provided a privilege of confidentiality for the neutral serving government agencies. Organizational Ombuds analogize to this legislation.

On September 8, 1995, Senator Grassley and Senator Levin introduce a Bill to reauthorize the expiring legislation. The Bill contemplates a modification designed to further enhance and preserve confidentiality to participating neutrals. Senator Grassley stated, “[T]he Bill addresses agency confidentiality concerns by exempting all dispute resolutions communications from Freedom of Information Act disclosure. Although these communications have always been confidential by implication, this amendment to the 1989 Act makes that confidentiality express and clear.” (Congressional Record-Senate; September 8, 1995; S1224).

In two recently decided cases, trial courts directly addressed the issue of ombudsman privilege. In Jones v. McDonnell Douglas Corporation, Case No. 4:94-CV-355 (CEJ) (memorandum and order of 5/22/95 attached), the Court found pursuant to Rule 501 of the Federal Rules of Evidence that the four factors to support a privilege were present and that communication between the ombudsman and the parties was privileged and not subject to discovery. In Koslowksi v. The Upjohn Company, File No. 94-5431-NZ (opinion and order of 8/16/95 attached), the Court granted a protective order and found that “[t]o successfully assist employees and employers in the settlement of workplace differences, Ombuds must maintain a reputation for impartiality and the parties must feel free to talk without fear that the Ombuds may later disclose what transpired. If Ombuds were allowed or required to testify, not even the strictest adherence to purely factual matters would prevent evidence from seeming to favor one side or the other. The inevitable result would be that the usefulness of the Ombuds in settling future disputes would be seriously impaired, if not completely destroyed.”

Further, in Kientzy v. McDonnell Douglas Corporation, 133 FRD 570 (E.D. Mo. 1991), the court found that “[t]he utility of the program and the office, in resolving disputes in this workplace and thus diminishing the need for more formal resolution procedures, is founded on the confidentiality of its communications to and from company officials and employees.” Also, more recently, on March 14, 1995, in McMillan v. The Upjohn Company, Case 1:92:CV:826, the U.S. District Court, W. Dist. Michigan (order of 3/14/95 attached) found “. . . privilege of confidential communications under Federal Rule of Evidence 501 . . .” and also found that “policy interests favoring consideration of matters submitted to corporate ombudsman in confidence as privileged communications . . .”

Although all the foregoing are non-binding decisions and none has been appealed, members of the Ombudsman Association and the Association itself

would welcome the opportunity to bring the issues of ombudsman privilege before an appellate court.

On October 23, 1995, the California Court of Appeals granted a qualified privilege of confidentiality to ombuds on the basis of California's constitutional right to privacy. In the case of Garstang v. California Technical Institute, (Second Appellate District, Division Two, Case No: B088019), plaintiff Garstang sued the private educational institution for slander and intentional infliction of emotional distress. Plaintiff claims she was treated unfairly when certain rumors were circulated about her in the institution. Caltech's ombud, Helen Hasenfeld, conducted meetings to assist the parties to resolve the situation. However, the ombud was unable to satisfactorily resolve it and Garstang filed suit. During discovery, plaintiff sought to compel Hasenfeld to testify about the substance of the meetings.

In deciding the case, the court weighed competing public values ". . . there must be a careful balancing of the compelling public need for discovery against the fundamental right of privacy." The court also found that, "where the communications were tendered under a guaranty of confidentiality, they are thus manifestly within the Constitution's protected area of privacy."

California does not recognize a privilege unless codified by statute. However, after finding the right to privacy applicable, the Appellate Court also examined the facts in light of the four-prong common law analysis for privileges, set forth in Federal Rules of Evidence 501 and relied on Kientzy v. McDonnell Douglas, (1991) 133 F.R.D. 570. Garstang is the first appellate court in the country to recognize a privilege of confidentiality for organizational ombuds. The appellate court certified its opinion for publication.

- Q. What is the typical background of individuals who serve as ombudsmen?
- A. Organizational ombudspersons come from a number of backgrounds. A large number come from functions in the organization that deal with people issues, such as human resources, communications, and legal departments. Degrees and educational backgrounds come from all areas, mainly because the most important factors in choosing ombudspersons tend to be the personal qualities of the individual. A great deal of emphasis is put on the integrity and interpersonal skills of the prospective ombuds, since without these two qualities it is hard to imagine how one could be effective in the role. The choice, therefore, focuses less on academic background (this is not always true on campus) and more on the person. Some of the most effective ombudspersons have come from such departments as marketing, engineering, and manufacturing. Their success comes from their ability to deal with people and the reputation they enjoy in their organization for integrity and approachability. Today a number of clergy and psychologists serve as ombudspersons to both corporate and academic institutions.

- Q. If the sentencing guidelines and DII disappeared, would your company’s management continue to maintain an ombudsman function? To what extent does this reporting option diminish trust in the organization? To what extent does it build trust?
- A. Since these are hypotheticals, one can only conjecture the answers. The first issue to be faced is whether a company’s ethics program is value-based or compliance-based. Did the company put the ethics program in place because it wanted to do the right thing and to encourage its employees to help it be an ethical company? Or did it establish its program because it was concerned about its legal liabilities and potential fines and public embarrassment. If the program was started for the first reason, then it is likely that the company would retain its compliance and ombudsman functions, regardless of the disappearance of DIE and the Sentencing Guidelines. If the program was started for the second reason, then it seems likely that ethics officers, compliance officers and ombudspersons alike would be hastily dispatched. The continuing growth of the ombuds function at United Technologies, and the support we enjoy from our Chief Executive Officer, not based on fear of liabilities but rooted in our values, leads me to feel comfortable with our situation.

The ombudsman function is not an alternative to the formal complaint-handling system. It is an additional place to go when people, for one reason or another, do not choose to use the system in place. Because it is an option, and because we encourage our people to use the formal system first, it is hard to see how it would diminish trust in the organization. One would be naive to believe that organizations do not have problems that at times inhibit people from coming forward with concerns. The record where ombuds exist says just the opposite. Management will to put in place a function that is neutral, confidential and independent to deal with these issues will be seen by most employees as open-minded, trusting, and willing to seek out the truth about how the company is run.

*Michael Hoffman*

- Q. Do you believe that there is a need to audit the ethics and compliance efforts of business organizations? If so, who should provide this audit?
- A. Yes, I think audits of ethics and compliance efforts are important – if appropriate processes and instruments can be developed for such audits, and if information provided by such audits is properly communicated. I also think audits should be done both by the ethics office and audit departments and by an independent, objective body outside the organization. Without the independent audit the results may appear self-serving and also may be tainted by an insider perspective. Efforts have already been instituted internally and are being developed externally for such audits. But this is an area where much more important work needs to be done.

- Q. How serious a problem is corporate crime among the Sponsoring Members of the Ethics Officer Association?
- A. Many Sponsoring Partner members have had problems and others may be experiencing problems. But this should not be misinterpreted to imply that companies joined the EOA for window dressing. Nor should we think that just because a company has an excellent ethics/compliance program that nothing will go wrong. I am convinced that most, if not all, EOA member companies join to try to prevent wrongdoing from occurring in their organizations. This is no guarantee that it won't happen. Nor does preventive medicine – proper check-ups, habits – guarantee that a person won't become ill. But preventive ethical medicine does help prevent problems and is a responsible course of action to maintain ethical well-being. This is the reason companies and individuals join the EOA, and I, for one, am convinced that it is laudable and beneficial. It is also in keeping with the spirit of the U.S. Sentencing Commission's efforts to promote good corporate citizenship.



*Day One*

## **Keynote Address**

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**Senator Edward M. Kennedy**, *Keynote Speaker*

*Introduction:* **Judge A. David Mazzone**, *Vice Chairman, U.S. Sentencing Commission*





**KEYNOTE ADDRESS**

JUDGE MAZZONE: It is my pleasure and honor to introduce Senator Edward Kennedy from Massachusetts. He has served continuously in the United States Senate since 1962, a long time, I think he feels now. He was formerly Chairman of the Senate Labor and Human Resources Committee and is now the Ranking Minority Member of that committee. He was formerly the senior majority member of the Senate Judiciary Committee and is now the senior minority member of the Senate Judiciary Committee. He was formerly the Chair of the Judiciary Committee Subcommittee on Immigration and Refugee Affairs and is now the Ranking Minority Member of that committee. He was formerly the senior majority member of the Armed Forces Subcommittee on Defense and Contingency Forces and is now the senior minority member of that committee. He was formerly the senior majority member of the Joint Economic Subcommittee on Monetary and Fiscal Policy and is now the senior minority member of that committee. Formerly, he was a Democrat.... Today, he comes before you to make a very important and historic announcement.

Two years ago, at the Sentencing Commission’s initial symposium on drugs and violence, I also introduced Senator Kennedy. That was an easy introduction. He had co-sponsored the Sentencing Reform Act and had worked for its passage with Senator Thurmond of South Carolina. His involvement with the criminal justice system was long, going back to his days when I first heard of him as a young assistant district attorney in Boston prosecuting felony cases.

In the Senate, his leadership with criminal justice, health care, education, and civil rights issues is well-known and his record for improving the quality of life for millions of American people has been widely recognized. Today, I could make the same introduction because the bottom line with Senator Kennedy always has been and always will be – what’s good for the American people is where he will stand.

Today, I introduce him to a group of people which represents corporate America at its best. I listened this morning and was impressed with what I heard from the speakers about making important business ethical decisions and setting out company values. I sat here and thought that this is a great symposium, where we begin to understand and promote the notions of a good corporate citizen.

Today, when government talks about downsizing, budget complaints, and withdrawing, it’s even more important to understand and to promote the role that the “good citizen” corporation will play in the United States. That’s a role that’s been long-recognized by Senator Kennedy in Massachusetts. I recall the support that he received from the Massachusetts Business Council and the Massachusetts business community generally during his last and successful re-election campaign. The support he received, ranging from the Massachusetts Bankers Association, the high-tech industry, and the Massachusetts Biotechnology Institute, for which he obtained the initial funding which, in turn, launched new firms and new jobs. I recall his support for the North American Free Trade Agreement, creating new jobs and opening new markets, and his work with environmental technology to reduce barriers, to speed up the EPA review, and to encourage research and development for alternative technologies in partnership with universities and private businesses.

So, you see, while the mandate of the Sentencing Reform Act gave the Sentencing Commission the opportunity to run these kinds of conferences – whether they are to deal with problems of crime on the streets or deal with problems of crime in the boardroom – Senator Kennedy has been an integral part of that program and those concerns.

It is my pleasure to introduce to you Senator Edward Kennedy from Massachusetts.

SENATOR KENNEDY: Thank you very much, Dave, for that introduction and for your outstanding service on the Sentencing Commission. Thank you. Let me just say a wonderful word about Dave Mazzone because he's been so nice to me today.

Dave and I both started off in Boston a number of years ago when he was an Assistant United States Attorney and I was in the district attorney's office. He went on to become a distinguished member of the bar of Massachusetts, one of our leading state judges, served as one of our outstanding district judges, and then went on to the Sentencing Commission. His career has been a continuing, ongoing, and upward one.

I got out as an assistant district attorney in 1962. I got my job. I came to Washington and I haven't moved since. I've always admired and looked to David for career guidance in whatever way I could. He has been a good friend, a distinguished jurist, and an outstanding member of the Sentencing Commission.

I thank Judge Conaboy and the other members of the Sentencing Commission for their constant pursuit of the mission of the Sentencing Commission and their help in working with us, Republicans and Democrats alike, in the Congress and the Senate, and for always being available to review with us the concerns that have been raised with the Commission. I think all of us in the Senate Judiciary Committee and all of us generally have been enormously impressed with their commitment and their dedication to achieving the objectives of the Commission and extending, really, the envelope to try to make our federal justice system a fairer and more equitable system.

I am glad to see Wayne Budd here. You don't know what a sigh of relief I gave two years ago in 1994 when Wayne decided not to run for the United States Senate from Massachusetts. I am glad he is delighted to be in the private sector and want to keep him doing well, very well, for a long period of time.

When Strom Thurmond and I sponsored the Sentencing Reform Act of 1984, we sought to create an agency that would do more than just write sentencing guidelines for the federal courts. We established an independent, non-political organization to serve as a catalyst for wide-ranging improvements in the criminal justice system. Sessions like this are one of the most important ways in which the Commission educates itself, the public, and fulfills its statutory mission. We in the Senate regard very highly the recommendations, the nature of the discussions, and the suggestions that are made as a result of this conference.

We knew that the Commission would attract controversy over the years, and indeed it has. Unfortunately that's what can happen when an agency does its job effectively. Earlier this year, for example, the Commission took on the sensitive issue of race discrimination in drug

sentencing. Under the guidance of Commissioner Wayne Budd, yet another leader of the Massachusetts bar, the Commission issued a landmark study and has proposed changes to remedy the unwarranted disparity caused by the current laws on sentencing for crack cocaine offenses.

This proposal faces an uphill battle in Congress. But, I for one, am proud to see the Commission fighting for fair, rational sentencing laws. If doing the right thing turns out to be controversial, so be it. That is precisely why Congress created the Commission in the first place; to enable sentencing to be guided as much as possible by the rule of law and not the prevailing winds of partisan politics.

In many ways, this symposium is a mirror image of the Sentencing Commission conference I addressed two years ago. That gathering concerned crime in the streets. We discussed the complex interplay of drugs and violence, and explored ways in which community policing, gun control, and drug treatment could help prevent street crime before it occurred.

Today, we turn our attention from preventing crime in the street to preventing crime in the boardroom. One important goal of the 1984 Act was to eliminate the two-tier system of justice in which white collar criminals received lenient treatment for acts of theft and fraud that would merit lengthy prison terms if committed on the street. There is a long and impressive tradition of the business community working with Congress to tackle the problem of corporate crime. I remember very well, for example, the important contribution made by Irving Shapiro, Chairman of the DuPont Corporation, when we attempted to recodify the criminal laws in the late 1970s. Thus, the attendance of so many members of the business community at this conference is certainly in that tradition.

The same principles of deterrence and fair punishment that apply to street crime apply to white collar crime, even when the defendant is a corporation instead of a human being. In the field of corporate sentencing, as elsewhere, the Commission has brought greater rationality to a subject best characterized as “law without order.” The corporate sentencing guidelines established by the Commission four years ago replaced a system in which penalties were largely dependent on the views of individual judges. Now, there is a set of principles to guide judges throughout the nation and a set of rules to guide good corporate citizens seeking to comply with the law and minimize their criminal liability. True to its statutory duties, however, the Commission did not simply announce this new corporate penalty policy and then assume that its work was done.

Instead, as with all the sentencing guidelines, the Commission is monitoring this policy to understand how it is working and to identify areas where it should be improved. The Commission is doing this by undertaking the kind of empirical research that will be presented immediately after this luncheon and by convening this symposium, which has brought together hundreds of leading experts and practitioners – all of you – to share ideas on these key issues.

At a time when some are trying to gain political advantage by sowing seeds of cynicism towards government, the Commission reminds us that some government functions are important and can be performed in a deliberative, inclusive, and highly competent manner.

These guidelines are designed to address corporate crime, a significant problem that justifies this kind of serious consideration. Some have suggested that corporate crime is just an overblown, anti-business invention of career-hungry prosecutors, regulators, and politicians. Statistics gathered over the past decade and a half demonstrate, however, that these crimes are both serious and distressingly common.

One early study on the incidence of corporate crime was conducted in 1979 by the Justice Department. This study found that in a one-year period, more than 60 percent of the corporations examined had undergone at least one enforcement action and that the average number of enforcement actions among those companies was four.

In 1980, Fortune magazine launched a study that tried to distinguish minor offenses from serious offenses. The magazine wanted to see whether prominent companies engaged in what all would agree are significant acts of impropriety. The study examined the track record of the 800 largest companies in America during a ten-year period and looked exclusively for major instances of what Fortune classified as “corporate corruption” – that is, five serious categories of crimes involving such things as bid rigging, major fraud, and high-level bribery. A number of serious crime categories, such as foreign corrupt practices, environmental, and food and drug were not even considered by this study.

Even so, the study found that 11 percent of these highly respected companies had been caught committing what Fortune called “blatant illegalities.” Several companies were multiple offenders during the same ten-year period. We have no idea how many offenses went undetected.

That was in the 1970s, and things seemed to go from bad to worse during the 1980s. This was the decade of the “Ill Wind” prosecutions, where major defense contractors were involved in bribing the procurement offices. As a member of the Armed Services Committee, I can remember the hearings that we had on “Ill Wind” and how offensive it was in terms of, most importantly, our national security, and secondly, the taxpayers’ investments. Major frauds which had been committed under other circumstances were those at highly-regarded brokerage firms, and savings-and-loan institutions, and even the sale of adulterated juice by a trusted purveyor of baby food.

The 1990s have yet to demonstrate much of a turnaround. We have already seen record penalties imposed for massive violations in the health-care and securities industries. Medicaid and Medicare fraud amounts to anywhere from \$30 billion to \$45 billion a year. It is something that in just that area alone undermines both the effectiveness of health care delivery systems and also of cost. Last month, a Texas company agreed to pay the largest criminal antitrust penalty ever for bid-rigging. In 1994, the Justice Department recovered over \$1 billion in fraudulent government contract billings under the False Claims Act.

But the heart of the matter is people, not statistics. Corporate crime robs the nation. It robs children of clean air and clean water. It robs senior citizens of their security and peace of mind by luring them into unsound investments. It impairs the government’s ability to buy the technology we need to maintain our national defense. It puts dangerous and ineffective medicines in the hands of people whose very lives depend on having medicines that work.

Perhaps its most pervasive effect, however, is something Judge Conaboy has spoken of: the way in which corporate crime undermines public confidence in our free enterprise system. Consumers become cynical about buying when they discover that they were lied to about the juice, the life insurance policy, or the automobile they just bought. They become cynical about the prices they pay when they learn that an antitrust conspiracy, not competition, has set those prices.

Finally, there is the effect on a company’s own workforce. As executives, you know how demoralizing it is when the majority of employees who have played by the rules get tarred by the conduct of a few who did not. This kind of blow to a company’s reputation and morale has rippling effects that can go on for years.

That is why I believe that the corporate sentencing guidelines – and a number of complementary policies pioneered recently at the Justice Department, EPA, and some of the other agencies – are so significant. As Win Swenson of the Commission said this morning, the guidelines recognize a fundamentally important fact about corporate crime: the culture and policies of a company make all the difference. The sentencing guidelines reflect this fact by setting penalties that depend on how well a company has taken steps to prevent, detect, and disclose corporate offenses. When companies take these steps, corporate crime is deterred.

The significance of this new policy is recognized by the experts. Leading criminal defense lawyers have written that the guidelines constitute a “revolution in organizational sentencing philosophy.” Two prominent compliance experts recently praised the guidelines as an example of what they call “smart regulation.” A professor at one of the country’s leading business schools put it simply: “[T]he Sentencing Commission did a masterful job in assessing [corporate] culpability.”

The corporate guidelines have attracted international attention as well. For many years, America was the only western nation to impose criminal penalties on corporations. Now, countries such as France are emulating the United States, and the Commission’s work has helped inform these efforts.

All this attention is deserved, but the accolades are somewhat premature. The guidelines are still largely untested. In a very real sense, the success of this new policy rests with you – those of you in the audience today and many others like you across the country. That’s why I’m hopeful that the lessons, ideas, and suggestions that come from the conference be available to the various business and graduate schools, law firms, and law and medical schools of this country. A number of them are in different stages of addressing these kinds of issues and I think it would be useful to be able to have the kinds of observations, recommendations, and comments available to the academic institutions that are working with the young people in this nature in the future.

In a very real sense, the success of the new policy rests with you and with many like you across the country. Members of the business community and those who counsel corporate clients must recognize that there will always be skepticism about a policy that gives any break to corporations that have committed crimes, as the guidelines will sometimes do when a corporation demonstrates a solid compliance program. That skepticism will grow if the public

comes to believe that companies are approaching the guidelines with a “window dressing” compliance effort and a clever law firm waiting in the wings at the first sign of trouble.

As this symposium shows, commendable efforts are underway to help ensure that companies doing business in this country are, in fact, good corporate citizens. The impressive attendance by the business community at this symposium is a very positive sign. But some companies are taking the “window dressing” approach to compliance. Management’s support for compliance at some companies is half-hearted, at best. Compliance and ethics officers are being told to scale back and spend less. The amount of resources a company should devote to compliance is a legitimate issue, and it is impressive that many of the companies represented here today are demonstrating a serious commitment to compliance, despite going through difficult economic times and downsizing.

Judge Conaboy was talking about the nature of the discussion of business ethics and the high nature of those comments and debate earlier today in morning sessions. But neither the public nor Congress will be fooled if the business community as a whole approaches compliance with superficial efforts. To make this new policy work, businesses must embrace compliance wholeheartedly. Many of you here today are trying to accomplish just that, and I commend you for your leadership.

The government also has a role in ensuring the success of this new policy. If companies are going to do their part and commit to more than “window dressing” compliance, those who are responsible for enforcing the law must be able to tell the difference between sincere and cosmetic compliance efforts. Unless prosecutors, debarment officials, judges, and others have the expertise to assess compliance program effectiveness, there is a risk that companies without substantial compliance programs will get a free ride, and those with strong programs will not receive the credit that they deserve. Either outcome is a threat to the new corporate crime policy.

Government officials also have a duty to reduce red tape and coordinate multiple overlapping enforcement tools. Companies face a wide range of criminal and non-criminal sanctions. While the notion of coordinating these sanctions is not new, the guidelines make coordination all the more imperative. In effect, the guidelines make a basic promise to companies: “Act as good citizens and your penalty exposure will be reduced.” But that promise is false if companies face non-guideline penalties that take no account of these “good citizenship” efforts. I’m pleased that tomorrow’s proceedings will consider these important coordination issues.

Finally, enforcement authorities must weigh the special issues involved when small businesses are the target of prosecution. We must make sure that mom and pop businesses have an opportunity to develop effective compliance efforts so they, too, can prevent crime and minimize their criminal liability.

Let me close by again commending you for being here. Your presence is a welcome endorsement of the goals of the corporate sentencing guidelines. Working together, we can combat corporate crime with the same strength and commitment that we use to combat violent crime. These deliberations, discussions, comments, and debates at these sessions are of

enormous importance to all of us in the Congress and on the judiciary committees. We take seriously the work that is being done in the morning and afternoon sessions of these two days. They are extremely important. I don't think that we have had in this nation the kind of thoughtful consideration of these matters that we have had as the result of the leadership of the Sentencing Commission. We want your recommendations, comments, and suggestions. That is a goal that we are fighting for – a goal that can be achieved. I look forward to working with you to achieve it, and I thank you very much.

JUDGE MAZZONE: That concludes our lunch program. Well, I'll send you on your way with a little story, then. I closed the last symposium with this same story. It has to do with how much we all have to learn and how much we all have to know as a result of what we're learning today. I'll tell you about a particularly humbling experience I had in my own family. I was at home alone one night when the phone rang. It was one of our daughters who was away at school. She said, "Dad, is Mom home?" I said, "No, she's not." She said, "Well, that's too bad because I want to ask her a question." I said, "Well, why don't you ask me?" And she said, "Dad, I don't want to know that much about it."

That doesn't apply to us here. We have a lot to know and a lot to learn. Thank you very much.



*Day One*

**A Presentation of Empirical Research  
on Compliance Practices: What Com-  
panies Say  
They Are Doing – What Employees  
Hear**

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**Andrew R. Apel**, *Executive Director, Minnesota Association for Applied Corporate Ethics*

**William S. Laufer**, *Associate Professor, The Wharton School*

**Edward S. Petry**, *Senior Research Associate, Center for Business Ethics*

**Rebecca Goodell**, *Howrey & Simon*

**Mark Pastin**, *President, Council of Ethical Organizations*

*Moderator:* **Cameron Counters**, *Senior Research Associate, U.S. Sentencing Commission*

**A PRESENTATION OF EMPIRICAL RESEARCH ON COMPLIANCE PRACTICES:  
WHAT COMPANIES SAY THEY ARE DOING – WHAT EMPLOYEES HEAR**

DR. COUNTERS: Good afternoon and welcome to “A Presentation of Empirical Research on Compliance Practices: What Companies Say They Are Doing and What Employees Hear.” I am Cameron Counters, a senior research associate in the Office of Policy Analysis at the U.S. Sentencing Commission and I have the privilege of serving as the moderator for this panel.

In previous sessions, it has been noted that the Commission is mandated to serve as a clearinghouse for federal criminal justice research. Given the importance of compliance programs under the organizational sentencing guidelines and increasingly other enforcement settings, the Commission concluded that research that contributes to our understanding of compliance practices among U.S. businesses would benefit both the business and the enforcement communities.

To help develop an appropriate survey instrument for compliance practice research, the Commission convened a diverse panel of practitioners with expertise in this area.

The goal of the survey instrument was to provide an initial but comprehensive inventory of the compliance policies and practices being used by businesses, both the common and innovative. Interview questions were grouped by the organizational sentencing guidelines’ seven steps that serve as a minimum indication of a company’s due diligence in seeking to prevent and detect criminal conduct by employees.

The Commission contracted with representatives of the Minnesota Association for Applied Corporate Ethics, Bentley College’s Center for Business Ethics, and the Wharton School of Business to conduct telephone interviews of company representatives in small, medium, and large firms in a variety of businesses.

Using the Commission’s basic interview instrument, the interviewers asked company representatives about their company policies and practices regarding: the company’s standards of conduct; who has formal responsibility for compliance; sanctions for employee non-compliance; communication of company standards of conduct; internal reporting of non-compliance; prevention of retaliation against employees who report violations; responsibility for compliance oversight; company efforts to assess compliance; investigations of reported non-compliance; and company efforts to assess the effectiveness of compliance efforts.

The Minnesota Association for Applied Corporate Ethics interviewed representatives from over 300 U.S. companies. Each company was randomly selected from a pool of companies in the same industry and size category. The Wharton School targeted 200 randomly-selected small U.S. companies, also stratified by industry category. The Center for Business Ethics targeted 200 U.S. companies that are members of an ethics or compliance-related organization. This latter group of companies was thought to be especially aware of alternative organizational compliance policies and practices.

All three of the surveys asked the same set of basic questions. The instrument for

interviewing small and compliance aware companies went beyond the set of basic questions by having more follow-up questions. The follow-up questions allowed the interview to move to a deeper level of detail.

The Commission spread its research effort over these three distinct yet integrated projects in order to provide a more comprehensive picture of organizational compliance efforts at the national level.

The empirical research of the Ethics Resource Center and the Council of Ethical Organizations provided a different perspective on compliance policies and practices, a perspective that complements the approach taken by the Commission-sponsored interviews of company representatives. The Ethics Resource Center and Council of Ethical Organizations have collected and analyzed data from employee questionnaires. Both of these studies provide insight on how employees perceive organizational compliance efforts, a factor often cited as a critical aspect of an effective compliance program.

I need to add a few words of caution. While the Commission established methodological criteria and funded three of the research studies, the Commission neither endorses nor criticizes the findings presented by the panelists. Furthermore, the Commission cautions the audience that the studies presented on this panel represent initial efforts to bring empirical data to bear on important issues about compliance policies and practices. Until replicated in other studies, the findings presented here should be viewed as tentative and may not be generalizable to all companies or industries.

## **A NATIONAL STUDY OF COMPLIANCE PRACTICES**

DR. COUNTERS: Our first presentation is by Mr. Andrew Apel, Executive Director and principal founder of the Minnesota Association of Applied Corporate Ethics, an association of corporations that have or are working to implement compliance programs. He is also the editor of Benchmarks, a publication of MAACE.

He holds a J.D. from the University of Iowa, a master's degree from the University of Minnesota, and a bachelor's degree from the University of Northern Iowa, both in philosophy. He has been involved in the design, implementation, and interpretation of numerous telephone research projects, some involving as many as 10,000 contacts, and he is well acquainted with the compliance issues facing companies. We are fortunate to be able to draw upon his experience.

He will discuss the highlights of interviews of over 300 U.S. company representatives. As I noted before, the MAACE project is the most general of the three Commission-sponsored surveys.

MR APEL: My name is Andy Apel and I worked with Lorman Lundsten and Jack Militello at the University of St. Thomas to complete a survey of compliance practices in organizations with 50 or more employees in virtually every industry in the United States. Of the three surveys commissioned by the USSC, ours was the most general.

Some of you out there may have participated in this survey, and I would like to express my appreciation for your help. I only have a few minutes for this presentation and a lot of data to cover. Since you have copies of my abstract already, I would like to take this opportunity to add to what has already been written.

First off, I would like to caution everyone on the use of this data. It is not benchmarking. Benchmarking is an effort to find what policies and practices work the best and the average or most prevalent practices might neither be ideal nor even good enough for anyone's operations, which also means, don't use these numbers to help establish per the guidelines what the industry practice is. That's a far too dangerous game for everyone involved, and insisting on average policies and behavior would only stifle the creativity and ingenuity displayed by the many corporations I had the pleasure of interviewing. I think the patterns behind the numbers will bear this out.

Here you can see the patterns of leadership in charge of compliance efforts. You can see there is a tendency to make compliance the job of one person, which is preferred two to one over putting a committee in charge. Some companies reported that having an individual in charge made it difficult to make compliance part of everyone's job. On the opposite end of the spectrum, one company in five has nobody in charge of compliance. This does not imply that they have fully integrated compliance into the corporate culture.

When a committee is in charge of compliance, senior managers make up over half of the committee. Executives make up most of the remainder, with only a few companies involving line managers and hourly workers. That is all fine and good since the guidelines

require the involvement of high-level personnel. The guidelines don't imply that companies should exclude line managers and hourly workers, but that seems to be what has happened.

Roughly three out of four compliance committees report to the executive level and virtually all of the rest report to senior managers. There is virtually no reporting back to line management, which seems to complete a pattern. In compliance efforts, accountability and reporting is almost uniformly in an upward direction, starting at the senior management level with little or no input from below.

Four out of five companies tell employees that compliance has an impact on their performance reviews. It is more likely that poor compliance will weigh against an employee than that exemplary compliance will be rewarded. I had it often explained to me that compliance was not something you reward, it's just the minimum you expect.

But you need to take these numbers with a grain of salt. The question asked about compliance with company standards. So what needs explaining, perhaps, is why requiring employees to live up to expectations is less than universal.

Not all companies make overt efforts to communicate standards of conduct to employees. Of those that do, you can see a written code of conduct is the most popular means, followed closely by written materials of similar import. Live training comes in at third place – more on that later. Half of all companies report using posters. But keep in mind that the law requires posters on a number of different and popular compliance topics. That means that posters should be in number one position, except that most respondents forgot they were there. This should tell you something about the effectiveness of posters in communicating standards of conduct.

Compare the most popular means of communicating standards of conduct with what people think works the best. We saw earlier that a code of conduct is used by 84 percent of companies responding. Here we see it is considered effective by 7.2 percent. Live presentations get the highest marks here as the favored method by nearly two out of five companies, closely followed by video.

Management is the most popular target audience for the code of conduct, but you can see that companies with a code are pretty good about getting a copy to virtually everyone in the organization, from 93 percent of management to a low of 81 percent for hourly workers.

Agents and customers don't get much. Only 15 percent of companies with a code of conduct circulated it to those "outside" the organization. Those familiar with the guidelines know the requirements regarding agents. Those familiar with the Internal Revenue Code know the tax consequences of governing the conduct of agents. People are still trying to sort this one out.

Training in compliance matters is most intensive at the top of the organization, with managers leading the list. Executives and other salaried workers follow. At the level of hourly workers, only six out of ten companies give them training. A number of companies said they had given up trying to train hourly workers because the turnover was simply too high. And

again, agents are near the bottom of the list.

For detection of wrongdoing, most companies rely primarily on the willingness of employees to report what they see, most often to a supervisor. In almost all cases, this procedure is announced in the company's code. More proactive efforts are less common, such as spot audits, and more on that later.

With a little imagination, you can see a bell curve in the frequency of internal investigations, with over half of all companies doing between six and 24 investigations in the last five years. Almost nobody gets away with doing none at all. Considering that we sampled all the way down to companies with as few as 50 employees, this is pretty strong evidence that there is a lot of misbehavior being investigated.

When non-compliance is detected, companies respond in interesting ways. Broad-based employee involvement in a compliance program is minimal, but after a violation, their input suddenly becomes more important. Meanwhile, the relative importance of auditing and reporting by employees trade places. Nearly half of the companies with significant violations modify their auditing practices after something goes wrong, but fewer than one in five modify their reporting mechanisms.

One in three brought significant violations to the attention of law enforcement, which shows how little trust many managers place in involvement with the legal system. This also means that two times out of three, there will be no public record of the employee's infraction. Couple that with the standard employee policies on giving references and you can see how hard it is, or can be, to avoid hiring those with the wrong propensities.

Companies with compliance efforts reported a wide variety of motives. The most prevalent is the intent to maintain an ethical reputation. This is both laudatory and sound business. General legal concerns and responding to the guidelines tie for second place, followed closely by fear of litigation. Whether or not this is the ideal state of affairs would make a good topic for a conference all by itself.

But certainly, the guidelines are having a significant impact on what organizations are doing to prevent and detect violations of law. Nearly half of their compliance efforts were made more vigorous and one out of five added new programs, that is, among companies that are aware of the guidelines. Most aren't.

Here, a pattern repeats itself. The individuals involved in creating a compliance program are roughly the same as those who staff the committees which run them. Again, line managers have little involvement, but then, neither does outside counsel.

People who work in compliance generally feel positive about their efforts but find it hard to compare their efforts to others in their industry. They may compare their legal troubles to those of their competitors. Sometimes they compare notes with others they meet at conferences or establish small informal groups for sharing information on compliance programs.

Some of these latter efforts are boycotted by those who fear that the Antitrust Division

of the Department of Justice will prosecute them for sharing information on industry compliance practices, although one stalwart soul confessed he would be proud to defend against such an action by Justice.

Here is the compliance history of respondents. Those who feel their efforts are effective or better nonetheless have suffered many legal consequences for the wrongs of their employees. Six percent of organizations have been convicted of a criminal offense. One in six has reported adverse adjudications as a result of employee misconduct, and this actually under-reports companies' experiences. This does not count the numerous out-of-court settlements. One company in four has seen an employee convicted of an employment-related criminal offense.

Finally, most organizations try to play their internal documents close to the vest. If they involve personnel records, this is often a legal requirement. In spite of the large numbers, there are actually few organizations which attempt to take advantage of any legal privilege. Those who do try to cover their documents with a privilege often doubt that their efforts will make a real difference.

**A STUDY OF SMALL BUSINESS COMPLIANCE PRACTICES**

DR. COUNTERS: Our next presentation is by Dr. William Laufer, Associate Professor in the Department of Legal Studies at the Wharton School. He holds a Ph.D. from the School of Criminal Justice at Rutgers, a J.D. from Northeastern University, and a bachelor's degree from Johns Hopkins.

Bill has written extensively on corporate compliance issues in a variety of literatures, including legal ethics and criminology literatures. We are glad to have him with us today. Bill will discuss the results of interviews of small businesses.

DR. LAUFER: Last year, when staff members of the Commission first started discussing the possibility of drafting a survey of corporate compliance efforts, I suggested a consideration of small business practices. After all, Commission data from 1984 onward revealed that over 90 percent of all corporations convicted in federal courts each year are small businesses. This remarkable finding, along with the fact that 99 percent of all non-farm businesses in the United States have fewer than 500 employees argues in favor of studying standards of conduct in small firms.

Commission data suggest a very strong association between firm size, ownership structure, and successful corporate prosecution. The median number of employees remains below 60 throughout the Commission data, with the percentage of privately-held firms convicted ranges from 90 to about 97 percent. So it's remarkable. If you look at successful prosecutions in relation to convictions, we are talking about small privately-held firms.

Scholarly research on small businesses identifies three distinguishing characteristics. Generally, small firms differ from their larger counterparts in the informality of their structure, culture, and communication, their available resources, and their orientation toward governmental regulation.

These differences fueled a number of hypotheses regarding the proposed study of small business practices. Due to time limitations, I will only mention some of them.

First, we thought that only a small percentage of firms surveyed would have clearly articulated and/or codified standards of conduct and we also hypothesized that only a small percentage of firms surveyed would have designated a person and/or committee with oversight responsibility.

Two-hundred-and-twelve organizations completed a similar survey as administered in the national study. All organizations had between 50 and 500 employees. The average number of employees was 155 with mean revenues of about \$17 million. It may be helpful to summarize these findings before I take some time going through the survey results, and the highlights are as follows.

Seventy-five percent of survey respondents acknowledge having standards of conduct with oversight by high-level personnel. Twelve percent credit the sentencing guidelines as influencing a reassessment or modification of such standards. Small firms use a combination of



written codes, legal memoranda, posters, and personnel meetings to communicate standards of conduct. Compliance with standards is often considered in both employee performance appraisals and promotion decisions. And finally, 71 percent of all firms conclude that their compliance programs are effective or very effective.

It is worth noting here that we were generally surprised to see such a high percentage of small firms with identifiable standards of conduct and compliance procedures. The data support the view that in spite of the conventional academic wisdom that small businesses are informal customer-oriented organizations, most small firms have codes, programs, and compliance procedures that in many respects resemble their larger counterparts.

With the balance of my time here today, I would like to quickly review some of the most interesting findings. All of the results, of course, relate to the guidelines criteria for what constitute an effective compliance program. As has been noted, the guidelines criteria for an effective program turn on the notion of organizational due diligence.

The first criteria for due diligence is the presence of an established compliance standard, procedures to be followed by employees and agents. Seventy-five percent of the survey respondents acknowledge such standards. This is less than the reported percentages of large firms with ethics codes but is nevertheless impressive. At the very least, it strongly suggests that the majority of small businesses have taken the time and committed the necessary resources to identify standards of conduct, whether written or unwritten.

Due diligence, according to the Commission, also requires a showing that organizations have delegated responsibility to oversee compliance with such standards. Of the firms that have standards of conduct, 47 percent have assigned corporate-wide responsibility to a person, 19 percent to a committee, and three percent to a person and a committee. Once again, this is quite impressive. Close to three-quarters of all small firms with standards of conduct engage in oversight.

There is additional evidence that compliance oversight in small firms is taken quite seriously. Nearly 50 percent of all designated persons are high-level employees. Most have a background in human resources and report directly to the owner, CEO, or president of the firm.

Employee accountability to standards of conduct is an integral part of organizational due diligence. A modest number of small firms actively use compliance information. For example, one-third of the small firm respondents with standards of conduct consider compliance and performance appraisals. Nearly one-third consider a poor track record of compliance in promotion decisions, as well. Notably, this is considerably less than that observed with compliance aware organizations and with the national study that was just described.

Due diligence requires effective communication of standards. As in the national study, a majority of small firms distribute ethics codes to officers, managers, salaried, and hourly employees. As you can see, and I hope you can, training topics include workplace safety, labor, product quality, environmental issues, tax issues, gifts, gratuities, all the way down to false advertising, which is listed at 17 percent of the firms sampled.

Under the guidelines, organizations must take reasonable steps to achieve compliance, including the implementation of monitoring, auditing, and reporting systems that detect non-compliance. Sixty-seven percent of the firms indicate that employees report non-compliance to immediate supervisors and/or personnel departments. This compares favorably with the national study, which noted that 79 percent of companies have employees reporting non-compliance.

Sixty-one percent of the small firms with standards of conduct publicize the ways in which non-compliance may be reported. Nearly three-quarters treat reports of non-compliance as confidential.

Motivations to implement compliance programs are similar to that found in the national study. They include establishing a better culture, reaction to industry trends, fear of litigation, and prompting by corporate officers. Surprisingly, only 12 percent of the small firms with standards of conduct said that they were influenced by the sentencing guidelines for organizations. This is considerably less than that found by my colleagues in their surveys.

Finally, 75 percent of small firms reported that compliance measures helped ensure that employees comply with standards of conduct, a distribution similar to that found in the national study.

A plea for future research. In the future, additional research should be conducted that employs objective measures of compliance effectiveness. Unfortunately, that wasn't done here. We need research that focuses on the role of corporate culture – that was omitted – considers informal compliance efforts, and that contrasts the effectiveness of compliance initiatives that are prompted by and not prompted by the passage of governmental regulation. Thank you.

## **A STUDY OF COMPLIANCE PRACTICES IN “COMPLIANCE AWARE” COMPANIES**

DR. COUNTERS: Our next presentation is by Dr. Edward Petry, Executive Director, Ethics Officers Association, and Associate Professor at Bentley College’s Center for Business Ethics. Ed received his Ph.D. in philosophy from Penn State University and has degrees in philosophy from the University of Toronto and Trinity College. He has also written extensively in the area of business ethics.

Ed has served as a consultant and provided business ethics workshops to numerous companies and has a working familiarity with companies that are aware of the importance of compliance issues. Ed is here today to discuss the results of his interviews with what we’re calling compliance aware companies.

DR. PETRY: First of all, I would like to thank John Desmond, who is with us in the back of the room. John, as some of you know, was formerly the general counsel and ethics officer at Boston Edison. He helped me considerably with this study, and in particular with the interpretation of the data. Thank you, John.

Our main goal in this part of the study was to look at organizations that have been at this for a while and that have made a concerted effort to develop effective ethics and compliance programs. What has their experience been and what exactly have they been doing?

We chose our sample of 200 organizations primarily based on the organization’s participation in associations that encourage awareness of ethics and compliance programs. This included the Ethics Officers Association and the DII. We also included organizations that have regularly attended conferences that feature best practices, conferences such as the EOA conferences, the DII conferences, and also the Conference Board Business Ethics Conferences.

Consideration was also given to geographic and industry diversity. As you might expect, large companies, over 10,000 employees, made up a significant portion of the sample. Defense and highly-regulated industries, including telecommunications and public utilities, were also well represented. Most industries were included in the sample, and also, we had some large non-profits and some governmental organizations.

The most striking feature is the overall similarity of the formal initiatives. I will talk about each in more detail, but we find that written standards, oversight at high level, multiple means of communicating standards, training, and internal reporting systems were all common throughout the entire sample.

Beyond this, there was also consistent efforts to conduct in-house investigations and protect confidentiality and inform only on a need-to-know basis. For example, in one question, interviewees were asked who receives reports on investigations, and the overwhelming response was that this information was limited to the employee under investigation, their immediate supervisor, the ethics officer or ethics committee, and that’s about it, limited on a need-to-know basis unless it was an extraordinary situation.

There was also evidence across the board that compliance audits, monitoring and

reviewing processes, were all well integrated into the organizations.

Now let’s look at several of the questions in more detail. As you would expect, all 200 of the organizations had standards of conduct for their employees.

When asked if the organization had a person or committee with corporate-wide oversight of compliance with standards, 84.5 percent had either a person, a committee, or both. Only five percent of these had just a committee, so of our sample, 79.5 percent had a person with corporate-wide oversight responsibilities for compliance.

Who are these people, what is their background, and where are they located in the organization? First, their expertise. The three most common areas of expertise are, one, general business management background, about 31 percent of those who have such a position. Next was a legal background, about 26 percent of those who have such a position. Third, audit and finance, and then a distant fourth, human resource.

An indication of their position in the organization is shown by the fact that they tend to report directly to the CEO and to the board or to a board committee. The most common reporting line was to the board or board committee. One-hundred-and-eight of those who had such a person, 68 percent, report to the board or board committee; 102, or 63 percent, to the CEO; and one of the more common answers is that they report to both a board committee and the CEO.

On the topic of communication of standards, over 90 percent of the sample used written codes, additional written materials, training, and memos or letters from a supervisor or from the CEO. In addition to that, over 50 percent also used formal scheduled personal meetings with employees and their supervisors or senior management, a newsletter or articles in an existing newsletter, training videos, and posters. High-tech methods are not yet common.

In addition, there were several interesting additional methods that were used for communicating standards. These included table tents on the lunchroom tables to remind employees of, or to highlight, certain values or issues; messages in their paycheck envelopes, either on the checks themselves or included in the checks; and it was pointed out by a few respondents that these were the two places they were sure to have people’s attention, at lunch and on payday.

Other companies use in-house closed-circuit TV. And as Alan Yuspeh said earlier, there were some interesting additional examples, particularly in the defense industry, where there were many creative ways to communicate standards and to keep the message fresh. These included having theme days, paperweights, and memo pads. Some of this may sound corny but it, in fact, keeps the message fresh, renews interest, and keeps ethics and compliance as its priority.

On the topic of training, here, I believe we see the influence of other factors beyond the sentencing guidelines. Training on 14 of these 15 topics was provided at 70 percent or more of the organizations.

On the issue of reporting non-compliance, it's clear from the data that multiple avenues are being used. The most common, literally in all of the surveyed corporations, is that the reports are directed to supervisors. Eighty-two percent of the sample reported also having a hotline or a help line, and some of those who said they didn't have a help line quickly added that they were in the process of putting one in place. So today, that figure would probably be a bit higher. Given the difficulties of having a hotline, the fact that so many organizations do have them clearly indicates the influence of the guidelines.

Now I would like to turn to some questions and problems raised by the data. First, on the issue of a high-level person, 79.5 percent reported having a high-level person, either an owner, director, or other executive officer assigned corporate-wide responsibility in this area.

A few questions: how many of these are figureheads? Second, what percentage of their time is devoted to overseeing compliance? And I might add that in many of these organizations, the person who I was talking to was the ethics or compliance officer. However, the person who they said was designated with corporate-wide responsibility was someone higher up in the organization to whom they reported to, but they, nevertheless, had the day-to-day responsibilities. Third, given their high level, how hands-on can they be, and does that limit their effectiveness?

And a fourth question we might add, should an emphasis be placed on the individual being high level if, in some cases, this means having a figurehead in that position? Instead, should more emphasis be placed on the individual's direct reporting line rather than his or her level in the organization?

Next, as far as the legal background of some of these ethics officers, 26 percent of the organizations with a high-level person and 21 percent overall reported that the person's general background was in law. Will a chief legal officer in this position emphasize a legalistic approach? Will he or she have neither the time nor the expertise to address managerial issues and other responsibilities as they relate to compliance? And, does having the chief legal officer in this position further complicate attorney-client issues? As John Meyers said this morning, this may further complicate issues of trust and confidentiality.

Regarding broad-based representation on the ethics committees, only 20 percent of the organizations with a corporate-wide compliance committee, or only nine percent overall, reported having mid-level managers or below on the committee. As Andy pointed out, the question is, "Does this relative absence of operating personnel on compliance committees limit the committee's effectiveness?" It is important for a successful program to have a buy-in. Also, diversity brings alternate points of view. This may be lost if the committee is made up entirely of senior executives, as is mostly the case. This was also a point mentioned this morning by Ken Martin from Sunstrand.

Next, the place of compliance in performance appraisals. Seventy-eight percent of the organizations in my sample reported having a requirement that an employee's track record be considered in performance appraisals and 27 percent also reported requiring that an employee's exemplary track record of complying with standards of conduct be considered in recommending the employee for promotion.

Questions: One, how do you measure “exemplary compliance”? And two, should compliance be considered exemplary performance? And third, we didn’t ask how compliance is weighed against other performance criteria. When push comes to shove, is it the first thing to go?

Distribution of written materials and training to non-employees, again, a similarity with Andy Apel’s material. Seventy-five percent of the organizations in this sample do not distribute copies of the standards of conduct to non-employees and 78 percent do not provide training to non-employees on any aspect of the organization’s standards of conduct. This may not be cost effective, given that problems often emerge at employee/non-employee points of contact. Are communication and training resources therefore being used effectively?

The high percentage of Human Resource (HR) calls also raises questions. We have seen in some of the data from earlier and here, as well, 74 to 80 percent of the calls to help lines involve HR issues. Now, this may indicate a disconnect between the organization and the employees’ priorities. Employees might perceive ethics and compliance primarily in terms of fairness and personnel issues while the organization is stressing regulatory compliance.

Lastly, one interviewee commented that as far as he knew, the only way to receive any kind of validation of a program is to be on probation under the guidelines. He suggested that this seemed an unfortunate arrangement and hoped that there might be some other method of getting a program validated, suggesting either some third party or governmental agency. Thank you.

**THE ETHICS RESOURCE CENTER'S SURVEY OF  
ETHICS PRACTICES AND EMPLOYEE PERCEPTIONS**

DR. COUNTERS: Our next two presentations constitute what the employees hear component of this panel. Our first employee perspective is by Ms. Rebecca Goodell with Howrey & Simon. She has a J.D. from the University of Virginia and a bachelor's from Notre Dame. Rebecca is well-versed in employee perceptions of company ethics practices and how perceptions may vary by employees' role within the company and the industry in which the company operates. Prior to joining Howrey & Simon, she was a senior consultant at the Ethics Resource Center. While at ERC, she authored Ethics in American Business: Policies, Programs, and Perceptions. Today, she will be discussing some of the highlights of that study.

MS. GOODELL: This survey that I am going to present on is mostly about ethics programs. We didn't really delve into the compliance areas.

This survey was a mailed questionnaire. It was done approximately a year and a half ago and included 48 questions. We had 4,035 responses, which was a 53 percent response rate. We worked with a group called NFO, based in Greenwich, Connecticut, which is a market research firm, to survey a cross-section of U.S. employees. We excluded certain groups, such as non-profit and government workers, so that it was representative of business. So at least in that way, it's not cross-sectional.

ERC performs a significant amount of consulting work for major corporations and there is a standard survey instrument that they typically develop from interviews and focus groups with client companies. In creating this questionnaire, we simply adapted and expanded the client survey instrument.

The data in the survey report is broken out by chapter into several different categories. We looked at the data by industry classifications. We grouped different SIC, (standard industrial classifications) together by job function to see which job functions had different responses, as well as level of responsibility in the organization to see how senior management differed from middle management differed from hourly workers.

The final way that we cut the data was by presence of a comprehensive ethics program and that is really what I am here to talk about today. We defined a comprehensive program much like some of the other studies have done. It was the presence of a code of conduct, training on the standards of conduct, and an ethics office or ethics ombudsman to whom people could report violations or seek advice about proper business conduct.

This survey differs from the three that you've already heard. First of all, it surveyed individuals and not corporations, and it wasn't specific individuals within corporations; it was simply individuals across America who are employed in companies.

It was also different from some previous studies that have been conducted in that it surveyed employees in companies of all sizes. We don't have data on the size of companies that our respondents were in, which is unfortunate. I don't think most respondents could accurately say, whether theirs is a \$10 billion company or a \$2.5 billion. So, we did not include that

question. It would have been useful, had it been reliable.

The third and most significant way that this survey is different is that it looks at the effect of ethics programs. We didn't really go into great detail about how you trained your employees or who you distributed your code of conduct to. We simply asked people basic questions. Does your company have a code? Does your company provide you training on proper business conduct? Does your company have an ethics office? The rest of the survey focused on whether these elements worked and what their effect was.

Unfortunately, we weren't able to evaluate the quality of the programs. It would have been nice to distinguish a good program from a bad program, an elaborate program from a simple program, and how the answers differed, but I think we would have had about a 300-question questionnaire if we had combined all the work of the Commission and all the work that we did.

In our employee survey, 33 percent of employees said that they have some sort of ethics office where they can report suspected violations or seek advice. This was surprisingly high, since it is a cross-section of U.S. employees, with small companies and big companies. As Bill Laufer said earlier, 99 percent of companies are small, which may not necessarily correlate that 99 percent of employees work in small companies.

We asked employees whether they feel pressure to engage in misconduct to meet business goals, pressure from their management, and nearly a third of respondents overall reported that they do feel this pressure, and half of that 29 percent reported, when you asked them the frequency of feeling pressure, they said they feel it pretty regularly.

That doesn't necessarily mean that management is asking them to do things that are wrong. They may be setting stretch goals and employees interpret that as, they're asking me to do something wrong. The only way I can achieve this sales figure is to break the law or cut corners. So that doesn't mean that all of management is evil.

We asked them, “What were the causes of these pressures? Where is it coming from?” And as I think most of you in the compliance community are not surprised – neither was I – it comes from aggressive goals. This is where the pressure comes from. Meeting financial goals, and schedules are the two principal causes of the pressure. Helping the company survive was also a factor, as well as advancing the boss's career interests.

We asked how that pressure translates into misconduct. We asked, “In the last year, have you witnessed misconduct that either violated the law or company standards?” You can see that one in three employees surveyed said that they had witnessed this misconduct.

And lest you think this is smoking in the bathroom or bad manners; it's not. I would hardly call falsifying records and lying to supervisors minor infractions. Some companies would like to think they're just witnessing small breaches.

We asked them, “Did you report this misconduct? Did your company find out? Did you tell them?” We compared employees with comprehensive programs with those with no



program, and no program is defined as not having a code of conduct, not having training, and not having an ethics office. And each group, comprehensive programs and no program, represented at least 20 percent of respondents, so it was a fairly large number that we were dealing with.

In terms of reporting, there is an eight percentage point difference between the two. People with comprehensive programs were eight percentage points more likely to report misconduct.

That may seem small, and I think some of us may be disappointed that the differences aren't bigger, but if you think about it, there is a societal bias that is very difficult to overcome to get people to blow the whistle. No one wants to blow the whistle. But I think eight percentage points is noteworthy and in some ways we should take heart from that. If you can detect misconduct earlier, the earlier the better, you are more able to protect your company.

We said, "Okay, so you reported your misconduct – what happened – what did your company do?" The variation in percentage points is between 13 and 18 percentage points. Now, these were just a variety of answers and these are three of the more positive ones, and you can see that employees in companies with comprehensive programs were much more likely to have had a positive experience.

Going from the specific to the general, we asked them, "How satisfied were you with your company's response?" The employees with comprehensive programs – no surprise – were more likely to be satisfied with their company's response to their report of misconduct, and hopefully that will translate into increased reporting, or at least that's what we all hope. In the "very satisfied category" there was an even greater difference in the numbers.

We went back and we asked those employees who hadn't reported, who had observed misconduct but hadn't reported the misconduct, why they didn't report their misconduct. And again, these are only a few of the responses. Those with ethics programs were less likely to say that they feared retribution from management and also that they didn't believe corrective action was taken.

One anomaly in this data which isn't on a slide is that those with comprehensive programs actually had greater concerns about confidentiality and also were more likely to cite as a reason for not reporting that they didn't want to be known as a whistleblower. If we had more data on the quality of the programs, I think this would be useful to see what were the factors that caused people to not want to be known as a whistleblower and to be concerned about confidentiality. But I think for all of you out there with ethics programs, those are good factors to know because those may be lurking in employees' minds.

Regarding some of the added and perhaps even unintended benefits of ethics programs – employees with ethics programs were much more likely to say that the ethical commitment of various groups, CEOs, senior management, direct supervisor, was about right. For anyone who's having trouble convincing senior management of the value of an ethics or compliance program, this may be one of the things you can do. It will make them look better. But it clearly does work.

Another benefit of an ethics program is how well your company fulfills its obligation to the following stakeholder groups, and one of the answers was “exceptionally.” You can see the effect of an ethics program is noteworthy. There is a significant difference between those with a comprehensive ethics programs and those without ethics programs. And customers – that is a big difference. That’s something, you want employees to think that they treat their customers right because they probably do.

In conclusion, having spent literally thousands of hours looking through thousands and thousands of pages of data on the effectiveness of ethics programs, trying to determine, do they work, do they not, I would say very cautiously that while there are several anomalies in the data which various theories can explain, I think the overall trend in the data does say that ethics programs in whatever form do have some positive effect on corporate conduct.

**A STUDY OF ORGANIZATIONAL FACTORS AND THEIR EFFECT ON COMPLIANCE**

DR. COUNTERS: Our next presentation is by Dr. Mark Pastin, President of the Council of Ethical Organizations. Mark has a Ph.D. in philosophy from Harvard and a bachelor's degree from the University of Pittsburgh. Mark has been working in the area of business ethics since the early 1970s. As a faculty member, he has been instrumental in establishing academic programs on business ethics. He has also been an ethics adviser to corporations, federal, local, and foreign governments, and is an author of numerous articles and books.

The Council of Ethical Organizations has been collecting information on employee perceptions of company ethics policies and practices since the mid-1980s. Mark's presentation adds an interesting perspective to this panel and his analysis looks at how organizational factors affect employee perceptions of a company's commitment to ethical behavior, which he refers to as the ethics compliance environment.

DR. PASTIN: It's hard for me to believe that you are hungry for still more statistical data at this point, so I will take a somewhat different approach.

The purpose of the Council of Ethical Organization's study was simply to learn what works and what does not work in ethics-compliance programs. By now, you are familiar with the sorts of things people do in these programs – codes, hotlines, training programs, compliance officers and so on. The question is: Do these things work?

As we originally conceived the study, the question to which we sought an answer was: “why is it that there are companies, doing all the ‘right things’ according to the accepted compliance wisdom, who are still sitting in our lobby with a settlement agreement – or worse – in hand? What would keep them out of our lobby?” It is not that we do not welcome clients, but we prefer them without handcuffs.

Study issues included what are the factors that influence the corporate ethics compliance environment? What are the key factors? How effective or ineffective are such compliance tools, now much employed, as codes of conduct, hotlines, and training programs? What are the main compliance risk factors? What is likely to create an environment where violations of law or other standards will occur? And as the study proceeded – it started in 1988, we were urged by our constituents to look at the impact of the sentencing guidelines (for organizational crime).

Our premises included: 1) that there is very little empirical data on factors influencing the ethics compliance environment of companies, 2) that compliance programs had settled into a recipe form with little evidence as to the effectiveness of this form, and 3) that the study should be conducted according to sound research standards.

To be clear about the recipe issue, we do not mean the seven steps or building blocks associated with the sentencing guidelines. We do not see the guidelines as offering or intending to offer a recipe for how to build a compliance program. The guidelines are more like an order for a cake than a list of ingredients for the perfect cake.

Finally, we felt that the study should be conducted according to sound empirical research standards. We did a validation study preliminary to the full study to ensure that the items used in the study survey meant what we thought they meant when read by employees. The preliminary study encompassed 200,000 employees in 47 companies. Why bother with this preliminary step? Consider an example. If someone asked you, “Are you a truly great lover,” would they be likely to get the truth? No, because that’s a very personal subject and most of us would rather not bare our souls on a survey.

Ethics is much the same. We are not likely to assess our own ethics candidly on a survey. So items had to be carefully constructed and tested to ensure that they produced useful and reliable information. We did not conduct this study as an opinion poll.

Companies were resurveyed beginning in 1992 after enactment of the sentencing guidelines. Eventually, approximately 750,000 employees in 203 large companies, roughly Fortune 650 companies, responded to the survey over five years ending December of 1994. A lot of the surveys were rejected as unscorable – as usual in such a study. We ended up with about 660,000 scorable surveys, an average of about 3,500 employees per company.

#### **What factors indicated a good compliance environment?**

This is a very difficult question. You will see there’s a list of items here. A positive response indicated a good compliance environment, by our standards agreed to for the purposes of the study, and a negative response indicated a poor environment:

- Employees **will/will not report apparent violations** of law or ethics
- Employees see ethical/lawful conduct as **contributing to/diminishing employment success**
- Employees perceive that **discipline is/is not fair and consistent** across rank and position
- Employees believe that their organization **will/will not accept short-term losses to maintain standards**
- Employees believe that **tolerated illegal/unethical conduct is unusual/common**.

Our general results showed the following: common compliance practices may actually contribute to or at least fail to influence a poor ethics compliance environment, whereas variations on these practices improve the ethics compliance environment.

The **two factors that most significantly correlated with a poor ethics compliance environment** are, first, performance measures or reward systems that employees see attaching financial incentives to behavior inconsistent with ethical conduct. In other words, the company is paying for something that isn’t consistent with ethical conduct. The second factor significantly correlated with a poor ethics compliance environment is employee indicated fear of retribution and reprisal by supervisors or managers for reporting apparently unethical or illegal conduct.

Fewer than ten percent of the surveyed companies reported addressing reward and management systems as part of their ethics compliance efforts. Just a comment on that. We asked companies a question: Has there been at least one supervisor or manager denied a raise or promotion for an internally-detected compliance problem? That was one of the criteria we applied in determining whether a company's reward system was sensitive to compliance issues.

A major goal of the study was **assessing the effectiveness of different compliance tools**. The companies participating in our study were a representative sample. They were not "compliance aware" or "compliance unaware." They were companies. We did divide companies in the sample by industry type, size, and other factors. (Differences by industry, company-size, form of organization and other factors are not reported in this presentation.) We found that 88 percent of the companies had codes of conduct; 67 percent had ethics or compliance hotlines; and 58 percent had ethics compliance training programs.

By the way, some of the companies reported that they had certain elements of a compliance program, but we were unable to verify that they did. For example, some companies reported that they had a code of conduct, but we were unable to find any employees or managers who were aware of it. So we did verify each factor before reporting it.

**Codes of conduct were generally ineffective as compliance tools.** They had a negative correlation of 0.55 out of 1.0 with a good compliance environment, but they were somewhat effective under certain conditions. Codes of conduct viewed by employees as legalistic and one-sided, *i.e.*, in favor of the company, increased the likelihood that employees would exhibit behavior that they identified as unethical or illegal. Codes of conduct viewed by employees as straightforward, informative, and even-handed decreased the likelihood that employees would exhibit behavior they viewed as unethical or illegal.

When you look at the numbers, 86 percent of the codes in effect in those companies were viewed as not effective; eight percent as effective and six percent were in the category of "effectiveness not determined."

**Hotlines were more effective** in improving the ethics compliance environment. Employees observing infractions had little confidence in hotlines that they identified as answered by the legal department, outside lawyers, or by an outside answering service. However, employees had confidence in hotlines that were answered in-house by a named representative, that were backed by a non-retaliation policy, and that had more than two years of continuous operation. Employees had the least confidence in other reporting mechanisms, such as write-in reports and use of an off-site ombudsperson, that is, a rental ombudsperson.

If you look at the pie chart, you see that 69 percent of the hotlines were in the category "defensive or not effective." Eleven percent were effective; 20 percent had a non-hotline reporting mechanism – the least effective option.

These findings indicate that employees will use hotlines to report compliance problems provided they feel the hotline representative will give them a fair hearing, they feel protected against retaliation and perceive the hotline as an established mechanism.

**Training programs of certain types proved effective** while other types of training programs proved ineffective or harmful to the ethics compliance environment. This following result brought the wrath of the compliance gods down on us, so I offer it with a caveat:

Training programs delivered – and here’s the caveat – *primarily* by means of video, interactive technology, or in game format were ineffective or harmful to a company’s compliance environment. Training programs that were interactive, over one contact hour in length, delivered in person and periodically repeated were effective.

Our interpretation is that employees are skeptical of training programs in general. They all agree to the statement, “Please, God, don’t let the boss read another management book.” And they are especially skeptical of ethics compliance training programs, assuming the programs are not in their best interest. This assumption can be overcome when the manner in which the program is delivered evidences genuine commitment to the program.

On this chart, 22 percent of the training programs were effective; 51 percent were ineffective; and 27 percent were indeterminate as to effectiveness.

**The compliance risk factors that stood out quite significantly** are:

- Employees who felt that they had been punished for reporting a concern (a fairly large population in many companies) indicated that they were likely to notify outside authorities.
- Employees who reported awareness of observed unpunished violations of ethics or compliance policies by a supervisor or manager indicated they were more likely to have violated policies or laws themselves.

Employees in many companies participating in the survey were surveyed again 12 or more months after enactment of the sentencing guidelines. Employees of companies that had implemented or fortified comprehensive ethics compliance programs in response to the guidelines, as per verified company self-characterization, reported that they were less likely to violate laws and policies. Employees of companies reporting that no changes or only minor changes were needed in response to the guidelines reported that they were more likely to violate laws or policies.

Our summary reading of the results of this study is that many compliance measures being taken by companies have no effect or a negative effect on the compliance environment of the company. Secondly, companies that enact these same measures as part of a comprehensive program significantly improve their ethics compliance environments.

**The impact of the guidelines on a company’s ethics compliance environment depends on the thoroughness and employee-perceived sincerity of a company’s response to the guidelines.** In other words, they’re watching closely and they’re going to look for more than a *pro forma* effort on the part of the company. Our results indicated that 38 percent of the companies significantly improved their ethics compliance environments post-guidelines. It’s not just what you do, but how you do it.

I guess what we learned about this, and we are continuing research, currently focusing on the health care industry, is that sometimes copying or sharing what other people do is not a good idea if you don't have an independent reason to think that what they're doing actually works. By "actually works," we mean keeping the company out of trouble and convincing employees to help a company keep its compliance environment clean.

DR. COUNTERS: Due to the time constraints, the panel members were limited in the information they could present today. The information presented by the panel members was only the tip of the data iceberg and probably generated as many questions as it does answers. With this in mind, the Commission encourages others to utilize the information collected by the three Commission-sponsored projects. It will make that data available to the public.

## QUESTIONS & ANSWERS

DR. COUNTERS: Let me move on to some of the questions that we have received. This question is directed to Dr. Laufer but I think it also applies to Andy and Ed. Bill might want to take the first shot at it. Did you find that companies were training in the area of corporate ethics and ethical decision making?

DR. LAUFER: We found a conspicuous absence of active training taking place.

MR. APEL: Yes. In our sample, we didn't ask that question specifically on point, or at least sufficiently pointedly to generate a quantifiable response.

DR. PETRY: Same here. That wasn't one of the questions we asked. However, there are other indications that that is becoming increasingly common in training programs, but it wasn't on the survey.

DR. COUNTERS: Here is another question directed to Bill. What objective measure of effectiveness of compliance programs do you propose?

DR. LAUFER: This one, I would be delighted to take. Even though I think it's a very difficult question, it's a great question.

We'd use a scale of subjective self-perceptions. At the very least, we would like a study of the aggregate subjective perceptions of employees and would much prefer to try to do something culture-based.

We would also like to examine more than just self-reports of violations. We relied exclusively on the companies' reports of either criminal law violations or civil violations. It would be nice to have some independent external evidence of law violations. Of course, that is a tricky issue because you can have a company that has a very effective program with many law violations and you can have a company that has a very effective program and has very few, so it's difficult. The bottom line is we would like to see more culture-based questions given to a larger number of employees.

DR. COUNTERS: Does anybody else want to step in on this question?

DR. PASTIN: That is what we tried to do. We tried to define effectiveness in terms that were real, and we did do a lot of things to establish the validity of the items, such as measuring them against items otherwise independently tested and validated, some of them for a very long period of time in studies of organizational culture and otherwise.

And the conclusion we came to is really that people are liars when it comes to ethics and compliance unless you do darn good research in writing to find out what they are going to be saying. I think any of you who have ever conducted an investigation, for example, are not going to be surprised that people do not, at first blush, tell you their worst sins or their worst imagined sin, although they may be extremely aggressive in reporting those of their brothers and sisters at the next work station.



DR. COUNTERS: This question is directed to Rebecca. How did the study determine whether a company has a comprehensive ethics program and – the second part – what percentage of the employers fell into this definition?

MS. GOODELL: That's a very simple question. We determined whether someone had a comprehensive ethics program simply by three questions. Does your company have a code of conduct, yes or no? Does your company have training on its standards of conduct, yes or no, and do you have an ethics office, yes or no. And then in terms of the exact percentages, I know that it's over 20 and whoever that person is, I have it in this booklet, the exact number, and if they want to see me afterwards, I'll be happy to look it up for them.

DR. COUNTERS: Mark, on what basis did your survey determine that certain types of training were ineffective or harmful, in other words, personal opinion or active behavior?

DR. PASTIN: Active behavior is an interesting thing. If you look at the criteria we used, did employees participating in it say that they were more or less likely on a valid item to report an infraction of law or ethics, and in many cases, they reported that they were less likely to report. Did they feel that acting ethically would improve their chances of employment success, and so on?

This is the only way you can do it. You try to validate the items so that you know that these employees are responding in a truthful manner, not in a manner that enables them to position or negotiate with you.

I would add that we believe, but this is not an empirically-supportable belief, we believe these indicators have been very predictive of companies that have had significant compliance problems over the past two or three years at a time in which poor compliance environment could evidence that, but that still must be viewed as episodic and it will not be corrected from a research viewpoint since large companies settle, and they may settle because they're guilty or they may settle because it's cost effective to settle rather than to fight, so it's very hard to get a clear external validator for that kind of information.

DR. COUNTERS: This next question is actually a combination for Ed and Mark. In light of Ed Petry's concerns about the effectiveness of a legalistic approach and Mark Pastin's findings regarding legalistic codes of conduct, are lawyers best placed to develop compliance programs?

DR. PASTIN: I have a little different view in this, in that I don't think employees really want to hear a lot of baloney. They don't want to be sold truth, justice, and the American way, and they don't want you playing with their soul.

They want you tell them what's important and why and what the rules are for doing it and how they will be treated when it happens. When I say plain language, I don't mean soft-side puffery. It may be the general counsel is the best person to lead that effort, but the actual task of writing and doing part of it must be a team effort. I think it depends very, very much upon the inclinations and particularly the common sense and influence of corporate general counsel in being the person to take on that task.

DR. PETRY: Certainly someone from the law department or the general counsel needs to be involved in the process, but I think the most important things in developing a code is to have, first of all, candor, why it’s being done, why it needs to be done, and second, cooperation at all levels throughout the organization.

Rarely do you see this. Too often, the codes or the revisions of the codes are handed down from on high, and this is a missed opportunity. In, I think, the best situations, the code revisions or the original code is done as a cooperative effort involving focus groups and other task forces throughout the organization. It takes longer but the end result is much more effective.

DR. COUNTERS: This question is directed to Bill but I think Andy might be able to contribute something. The Wall Street Journal reported last week that last year, most of the companies sentenced under the guidelines were less than ten years old, had fewer than 50 workers, or a pre-tax profit of less than \$1 million annually. Senator Kennedy said today that we must make sure that mom and pop businesses have opportunities to develop effective compliance programs. In view of your findings, what do you recommend?

DR. LAUFER: Courts and prosecutors are often hesitant to proceed with a criminal indictment against a large decentralized entity under a standard of vicarious liability. I think because of that, we should just focus our attention on those companies that end up as defendants in federal court – small businesses. And we certainly need additional resources to develop compliance programs for small businesses. A few suggestions. It is important to seriously consider the role of leadership – especially in small firms. Compliance programs must be developed to match corporate culture. And, perhaps most importantly, all compliance efforts must never lose sight of the informality of structure and communication in small businesses.

MR. APEL: One luxury that we have when we are dealing amongst ourselves as larger organizations at this particular level is that we share fundamentally the same model of business and the same model of management and compliance. We tend to be very familiar with the seven steps, many of which would be difficult to adapt to a small business environment.

If a model for small business compliance were developed and readily available, I think it would be very easy to roll this out to the small business community and actually have some rather substantive results emerge.

#### **QUESTIONS & ANSWERS – WRITTEN**

*Rebecca Gooddell*

- Q. The Ethics Resource Center’s study appears to show that a comprehensive ethics program makes only a minor difference in whether or not an employee reports misconduct but makes a big difference in how the company responds to a report of misconduct. Therefore, shouldn’t one place a higher priority on response mechanisms rather than line employee ethics education and reporting?

- A. Unfortunately the ERC study does not analyze the quality of the comprehensive programs included in the survey. There is an eight percentage point difference in reporting of observed misconduct in companies with comprehensive ethics programs compared to companies with no program elements. While this difference is small, it is not insignificant. I believe that companies need to do more to improve the likelihood that employees report misconduct through training, discipline and by trying to create a culture where reporting misconduct is expected and accepted.

Clearly, employees in companies with comprehensive programs do have better experiences when they report misconduct. Companies should keep up the good work in this area. The more important thing is finding ways to increase employee willingness to report misconduct which should include satisfying employees who have gone out on a limb and reported misconduct in the first place. If employees do not report misconduct, companies are exposed.

- Q. Does your study involve private law firms? The legal community is often criticized for recommending to clients ethics or non-discrimination requirements that are stricter than the law firms themselves follow.

- A. The study does include private law firms but the numbers are too small to have broken the data down into this sub-category. There is a certain irony that many law firms do not have policies and internal reporting mechanisms that are as rigorous as they recommend to their clients. Law firms may believe that trained lawyers know and understand the law and therefore that firms do not need to provide training, policies, and reporting mechanisms. However, the track record of law firms indicates that they are not immune from legal problems and would do well to take the advice they give to their clients.

*Mark Pastin*

- Q. Your studies correlated compliance techniques with “ethical behavior.” Can you say anything about correlations with criminal behavior?

- A. Actually, the Council of Ethical Organization’s study did not focus on “ethical behavior” *per se*, but on a set of behaviors widely viewed as correlated with both unethical and criminal organizational conduct. In fact, we focused on many of the same factors addressed in the sentencing guidelines for organizational crime. For example, we focused on the likelihood that perceived acts of misconduct would be reported internally, whether employees perceived that unethical and illegal conduct were rewarded by the organization, and the perception that wrongful conduct is or is not routinely tolerated. So, the results of our study should relate to criminal conduct in rough proportion the extent that the guidelines themselves relate to criminal conduct.

At the level of empirically indicated but not empirically proven results, we see a clear correlation between our results and criminal corporate conduct. None of

the companies in the top quartile of our study in terms of overall ethics-compliance climate has been convicted of or entered into a settlement concerning a significant corporate crime subsequent to participation in the study (1988-1994) – at least in so far as we can determine from public records. Several of the companies in the bottom quartile have been charged with serious organizational crimes and rough calculations show that they have collectively paid well over half a billion dollars in fines since participating in the study. It was a condition of participation in our study that we not name individual companies, so that is the best we can do to substantiate this point.

At another level, we doubt that it is possible to achieve the level of empirical significance needed for a study of this kind if criminal behavior is defined in terms of charges brought or convictions won against individuals or organizations. Large companies may commit great resources to forestall the bringing of charges against or conviction of key employees and the company itself. The justice system must often choose between inflicting great harm on innocent employees, communities or, in some cases, the country itself, and the abstract interests of justice. This is not a criticism of the justice system, but a simple fact of prudence. Thus, any correlations obtained tend to be based on records of petty infractions committed by large companies or a combination of serious and petty infractions by smaller companies. We would like to see more empirical study of organizational factors and actual crime, but the inherent limits must be recognized as well.

*All Panel Members*

- Q. Wouldn't it be useful to ask exactly the same questions in the two kinds of surveys presented here to find out if employees are aware of the programs that management thinks are in place? For example, Mr. Petry's study found that about 85 percent of the companies say they have assigned someone oversight responsibility, but employees said that only 33 percent of their companies have an ethics office or ombudsman.
- A. (Andrew Apel) Yes, it would be useful, but I think we can guess the outcome in advance. Consistently, the most difficult part of doing our survey was finding out who to talk to. Even within organizations with mature, well-developed compliance programs with aggressive training and communication, most employees did not know if there was an ethics or compliance program, or a code of conduct, or someone assigned to talk to or take calls about ethical and legal problems at work. This same sort of difficulty was sometimes encountered within corporate legal departments.

The difference in the numbers does not mean that there are fewer compliance programs out there than were reported to us. Rather, it is simply that the methods many organizations use to communicate their compliance standards do not make their compliance programs very visible. Whether the visibility of a compliance program has anything to do with the “effectiveness” of its

communication component is best left for others to decide. However, I would recommend that those involved in compliance efforts call their own switchboards and try to discover who's in charge of compliance. The experience would be enlightening, and in most cases, will suggest a need for bolstering communication efforts with the use of more memorable media and messages.

- A. (Mark Pastin) In the Council's study, we had to compare what companies said they were doing with what employees were aware of in order to obtain results. In other words, to determine if the measures a company was taking were achieving the intended results, we had to know both what measures the company was taking and whether or not employees had any awareness of the measures. For example, we had to verify the company's representation that it did promulgate a code of conduct, training program, or reporting program.

Our data did show that in some cases companies represented that they had implemented some aspect of a compliance program while employees had little or no awareness thereof. Indeed, a program element could be effective in the sense we defined only if employees were aware of it. However, the data show that it is quite easy to broaden awareness of compliance measures, but not at all easy to convince employees that the measures were seriously intended.

In summary, our response to this question is, "Asked and answered." The problem is not whether employees have awareness, but why that awareness is accompanied often by so much employee skepticism.

*Day One*

# **Evolving Compliance Standards: New Models and Proposals**

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**Edward A. Dauer**, *President, National Center for Preventive Law*

**James T. Banks**, *Director of Government and Environmental Affairs, WMX Technologies*

**Christopher L. Bell**, *Sidley & Austin*

*Moderator:* **Marguerite A. Driessen**, *Senior Staff Attorney, U.S. Sentencing Commission*

## **THE NCPL COMMISSION ON CORPORATE COMPLIANCE GUIDELINES**

MS. DRIESSEN: Good afternoon, ladies and gentlemen. In this session we are going to be discussing “Evolving Compliance Standards” and some new models and proposals.

All day today, you have heard about the sentencing guidelines. You have heard about compliance efforts. You have heard what people have been doing, and we just heard a panel that discussed some empirical information on how well the existing practices are working. In this panel, we are going to talk a little bit about where we’re going in the future. What are some ideas people are trying? Where are they aiming? What are their goals?

I want to introduce our speakers. First up, we have Edward Dauer. He is President of the National Center for Preventive Law. He authored the first law school textbook on preventive law. I think that makes him the foremost expert in these matters. That’s what we’re talking about today, developing compliance plans for preventive law. Without further adieu, I will turn the mike over to Ed.

MR. DAUER: I want to cover very quickly four points this afternoon and to go through the first couple of them very rapidly. One of them is to tell you who we are, because the National Center for Preventive Law may deserve to be a household name, but it isn’t one yet. The second point is what it is we’re doing that is connected to the topic of this particular conference.

Third, and most important is the question of why we are doing it. In fact, that may be the only point of any real significance. And then, if we have some time at the end of this, I’ll try to come back and see if we can tease out some implications from what we are doing for the larger question of the corporate compliance enterprise in general.

The word “we” in each of those sentences, again, is the National Center for Preventive Law, which is a loose confederation of a large number of private lawyers, general counsel of corporations, some legal educators, public interest organizations, and a variety of other people, including some non-lawyers, brought together only by a common interest in developing ways of reducing the dis-economies and adverse effects of avoidable legal risk in both the public and the private domains.

We operate at the present time on the basis of gifts and grants and an occasional seminar and some contracts here and there, but essentially we are completely independent of any industry or group.

We have been offering seminars in corporate compliance systems since 1985, maybe even earlier. But it was in 1991 that, if we had had listed stock, they probably would have halted trading, because when the U.S. Sentencing Commission had its guidelines authorized in the fall of 1991, suddenly, people who were just casually acquainted with what we were doing became very interested in knowing what we knew about how to build compliance systems within corporations.

Since that time, we have emphasized in our own work, developing skill and knowledge

about how to build compliance systems. It is not the only area of our activity, but it is a central one. We offer seminars and publications and act as a switchboard for information and resource sharing for corporations and other organizations in the area of the development of these systems.

We have, in the course of that work, met literally hundreds and probably thousands of lawyers and compliance officers, who call us from time to time or come to our programs, and we have some sense, though it is anecdotal to be sure, of the needs and interests that the constituency out there has.

Two years ago it occurred to us to start a project to respond to those needs, which is the one that I want to talk to you about today. It is a project to develop guidelines for building compliance systems within organizations; it includes guidelines, suggestions, and examples illustrating how these systems are assembled and designed and implemented and how they are operated. It is of greater specificity than the seven or ten admonitions that are in the official sentencing guidelines themselves.

We assembled for this venture a group of about 30 people, mostly, but again not entirely, lawyers who are divided into four working groups and who are now producing, in effect, a private restatement. I'm not going to walk you through it; I don't have nearly enough time. But this product, when it's done within the year – my target, at least, is within the year, probably early 1996 – will be a book of compliance guidelines and recommendations and suggestions that will operate in three layers.

What we tried to do was to take the federal sentencing guidelines and the whole world of ideas about compliance systems and boil it down into 20 principles. We start off with a layer of black-letter text, called "principles." Two layers are completed so far. One is these 20 black-letter principles. Underneath them is a series of what we call considerations, or factors to consider in putting these principles into place.

Very much like the restatements, it starts with a black-letter text that says something rather general. The theme is some commentary, which in our case is the "factors to consider." That's a little more precise. The theme is something under that called "examples." One third layer is also concrete examples.

The black-letter text, again, is pretty general. To take an example, the first one says that "an effective compliance program is designed to prevent, detect, and respond to legal risks and to promote compliance with the law." That's a fairly high level of abstraction.

A typical "factor to consider" under that is "Identifying liability-causing conduct, such as questionable acts and behaviors, as well as the occasions for such risks." That is a factor to think about when putting this principle into effect. And then we offer some examples.

Here, we start getting fairly concrete. One of them, for example, says, here is how you identify the areas of greatest risk. "To conduct a comprehensive review of existing files for documents that demonstrate the risk of violations, companies can review litigation records, civil complaints, SEC disclosure documents, board of directors minutes, prior investigative records,



insurance policies, risk management documents, accountants' and auditors' work papers, employee questionnaires, and so on. The inventory should be documented so that a company can establish how it achieved compliance but should never be fully completed because compliance itself is dynamic."

We are now collecting these models and examples, to try to build concrete ideas about how each of these more general principles is put into place when designing a compliance system.

The question of why we are doing this is, I think, the more important. We have heard today from a number of large corporations, probably many of them in the Fortune 500, who have described the federal sentencing guidelines as road maps for the construction of compliance efforts by corporations.

But to steal a phrase used by some of my law students, there is also the bottom 90 percent of the class. The Fortune 500 represents one category of companies, but there is a whole world of others who are experiencing far more difficulty in the implementation of the Commission's recommendations because they lack the resources, skill, or whatever it may be, to deal with something that's as broad and flexible as those official recommendations are.

We're responding to a disquiet we found among our seminar participants, particularly in that second level of company – not the very small company, since they don't come to our seminars, but among the level below the very top. That disquiet, I think, has a cause about which I'd like to speculate.

The existing guidelines as issued by the Commission, regarding compliance systems, mix together two very strong themes in our legal tradition. The tension between those two themes, I think, may be causing a problem, or at least a problem with expectations. You who are lawyers will remember that our Constitution requires due process and equal protection with respect to criminal matters. That is, government in its behavior is restrained by, among other things, the requisites of giving prior notice.

A government is permitted to have only limited discretion. It is supposed to hold people liable for acts only when it warns them, with specificity, in advance. You may remember the phrase, a statute can be "void for vagueness." That is, it doesn't pass constitutional muster if it's not quite specific enough to tell you what it is you're supposed to do or refrain from doing.

On the other hand, we have in the civil liability side a more passive role for government. Civil liability rules, and the common law, cover an infinity of possible behaviors and so they grow out of broad principles, like "negligence," like "due care," and phrases of that kind. Here, the tradition is the very absence of specificity rather than its presence. It is tolerated because it is not punitive.

I think that what's happened. The U.S. Sentencing Commission's guidelines have taken the style of the common law of negligence and engrafted it on top of the liability of the criminal process. In fact, it's the misfit. The tension between those two may be what is creating the difficulty.

In effect, what they have said is that this organization has a duty to exercise reasonable care to avoid committing a crime. It's a negligence standard for criminal liability. I think that the problem may arise right there.

It may be that the Commission was trying to be that broad and open textured to effect a culture shift, rather than to create pat kinds of programs, and so that's the way they did it. But the bottom 90 percent of the class doesn't see it quite that way. I think that a substantial number of the bottom 90 percent of the class see this as a regulatory effort issued without the customary regulation, and so feel themselves somewhat in jeopardy.

There are three problems. First, what's flexible is of necessity vague and non-directive. Second, we have very little real data, about what works and what doesn't work. Third, unlike the common law of negligence, there aren't ever going to be enough cases from which an organization can derive predictable principles about when something is going to pass muster and when it isn't. There simply won't be enough reported appellate convictions in which there are discussions of the meaning of compliance programs to be able to provide sufficient guidance.

And so the Commission has created both the incentives and the jeopardy of a common law system without providing the common law body of case law from which people can derive what it is that really matters and what's going to count. They find out only retrospectively whether something passes muster or not.

And that, I think, is the reason for the disquiet that we are beginning to see. It was the reason for our trying to step in and provide some additional specificity, some assistance to the bottom 90 percent of the class.

If I can take just a minute and speculate a bit about what it may mean in terms of where we might go with this, I think it's fair to say that what the Preventive Law Center is doing really isn't important, at least not in the grand scheme of things. But the appetite to which we are responding may be.

I remember a physics professor once saying to me that “systems always equilibrate.” Ultimately, any unstable situation reaches equilibrium, even if you don't like the equilibrium that gets reached. Somehow, somewhere, even in the absence of very good data about what works and what doesn't work, standards will emerge.

The situation with the vagueness, or the flexibility, of the existing guidelines is, from the point of view of a part of the world that we think we know something about, an unstable circumstance. Standards are going to emerge whether we like it or not.

They might emerge from the few judicial opinions that we can read every year. They will emerge from some consent decrees that we can read about. They will emerge from stories, apocryphal or not, about the enforcement behavior of particular agencies or even about particular prosecutors and what those people want. They may even begin to emerge from the activities of industry groups, such as those we heard about today, or maybe even from private groups such as ours.

I think the question is, should we allow them to emerge willy-nilly, or should they be guided with some kind of a plan in mind. Or to go back in recalling negligence, which is both accurate, I think, and a metaphor, I would ask whether we should let the reasonable man evolve naturally or whether we ought to engineer him. That, I think, is one of the more significant questions facing the house and all of those who are interested in this area.

We hope that the product we are generating will never be taken as a standard. We don't mean it to be a standard. We mean it to be guidelines and suggestions. But as we are doing it, we are mindful of the fact that it inevitably will be a standard in some more or less limited way. It won't be taken as a standard by prosecutors and it won't be taken as a standard by courts, but it probably will be taken as a standard, whether we like it or not, by companies, probably smaller rather than larger, whose hunger has no other place from which to be satisfied.

I would suggest that this is too much responsibility for an organization like NDCPL to bear, but I would also suggest that to provide common law liability without a common law body of data to support it is too much responsibility for individual small businesses to bear. Thanks very much for your attention.

**ENVIRONMENTAL ADVISORY GROUP**

MS. DRIESSEN: Our next panelist is Jim Banks, seated here to my left. He is Director of Governmental and Environmental Affairs for WMX Technologies. I have been acquainted with Jim for a number of years because he, quite cordially and perhaps unknowingly, agreed to participate in a U.S. Sentencing Commission advisory group on environmental sanctions that you all may have heard about. The group started work in May of 1992, I believe, and they worked for nearly two solid years to come up with a proposal to the Commission where they focused exclusively on organizations and environmental offenses and how to develop appropriate sanctions for organizations that are convicted of environmental crime. I believe that's going to be the substance of his remarks today, and without wasting any more of your time, I'll turn the time over to Jim.

MR. BANKS: Thank you, Marguerite. I have to admit, she left out one pretty important part of my background. That is, about two years ago, I had the distinction of standing up in front of a federal district judge and entering a guilty plea for my corporation, the only conviction in its history, to six felony counts of environmental crime and agreeing to pay something like \$11 million in penalties. It happened to be in a little courthouse in Scranton, Pennsylvania, before a very distinguished judge. And I can tell you from that experience that Judge Conaboy can give as good a lecture on corporate ethics as you're ever going to hear. It was painful to my ears, but it was well deserved.

I was fortunate, also, to be a part of the advisory group that developed proposed sentencing guidelines for environmental crimes. I must say, when the group released its proposal about two years ago, the standing ovation we received from our colleagues in industry was a little shorter than what Cal Ripken got last night. The work was controversial, to say the least, but I think it was important work. I think it moved the discussion along, certainly heightened the debate, and created some controversy. And I think that's good.

There were 16 members of the committee, which, as Marguerite said, worked for nearly two years on that product. There were representatives of environmental groups, government, academia, the private bar, and business, including the general counsels of three major corporations. The proposal was issued in November of 1993, styled as a new proposed Chapter Nine to the sentencing guidelines.

I think the reason that the Commission decided to convene such an advisory group was to explore whether Chapter Eight, Chapter Two, or some combination of them would be suitable for environmental crimes. When Chapter Eight was issued, the Commission omitted coverage of environmental crimes. This was an exercise in trying to figure out whether environmental crimes are sufficiently different to justify a different approach.

The perceptions at that time, I think, were that environmental regulation and control is far more complex in many ways than other fields, and that compliance with environmental requirements is unusually difficult. In addition, that the *mens rea* provisions of federal environmental statutes are such that convictions of environmental crime are a good deal easier to obtain than many other types. With that background, the group decided to explore whether existing provisions of the guidelines fit or did not.

It is not my purpose to review the entire proposed guideline, nor, more importantly, to defend it. As I mentioned, it was criticized widely. It has many defects. But nonetheless, it has some important innovations, and my focus here today is on that portion of the proposed Chapter Nine that spelled out the elements of a compliance program. I think it is worth examining, and I mean to be provocative, which should not be difficult. I know a number of my colleagues found it overly prescriptive and detailed, and indeed, in many ways, it was. But it includes some important new directions worth laying out here.

In order to understand the result of that effort, I think you need to begin by appreciating the starting point that the advisory group adopted, and I think it's fair to say that there was consensus among the group on three essential things.

The first is that the goal of the effort should be to use sentencing policy to increase compliance with environmental law, and therefore to facilitate an increase in environmental protection. It was not an exercise just in crafting something that would deter or punish environmental crime. It was not even just an exercise in creating equitable sentencing guidelines for environmental crime. I think the objective was much broader, as I have said. And as a result of that, I think the agenda was much more activist than perhaps many of us thought it would be going in.

Secondly, I think there was consensus that a high rate of environmental compliance is achievable only if the organizations, the corporations and other entities, take on that responsibility for themselves. Government inspection, investigation, and enforcement catches only a very small tip of the iceberg in environmental violations, and changing corporate behavior toward compliance was, therefore, considered to be a central key to success.

Third and finally, there was consensus that a very substantial incentive is needed to bring about that result. There are many incentives at play. You will hear Chris, for example, describe business relationships as an incentive toward managing environmental liabilities, and there are certainly sanctions on the civil side that can be mitigated in order to provide incentives.

But the advisory group had only one, and that was the opportunity to mitigate criminal penalties. The group believed that a very substantial offer of penalty mitigation in the criminal arena could be effective in changing corporate behavior.

With these basic agreements in mind, I think we led ourselves then to the central question. If substantial criminal penalty mitigation is to be offered, what kind of corporate behavior is expected? What would merit that kind of favorable treatment? In other words, is the Chapter Eight compliance program description, the so-called seven steps, good enough?

I think the answer of the group was two-fold. First, there should be some kind of expectation of compliance management efforts as the norm in corporate America, and that led to a feature of the proposed guideline which would aggravate criminal penalties in the absence of some sort of organized effort at managing compliance.

And the second part of the answer was, no, Chapter Eight is not good enough to merit substantial criminal penalty mitigation. So the group set about defining what is good enough,

and when they were finished they proposed that criminal penalties could be mitigated up to a maximum of 45 percent for companies that had made a substantial commitment to environmental compliance. That’s not counting the so-called “collar provision,” which would put a limit on overall penalty mitigation. The compliance program element itself could merit up to a 45-percent reduction in criminal penalties.

My purpose, then, is to outline how and why the proposed Chapter Nine compliance program differs from Chapter Eight, the so-called seven steps, and from other federal government policies that were built around it. It’s not completely different, of course, but it does go beyond Chapter Eight, I think, in three important ways.

The first is that its orientation is not just toward criminal violations. It is not just a program to detect and prevent crimes, unlike Chapter Eight. The second is that it calls for the integration of compliance efforts into the management of operations in the entity. Unlike Chapter Eight and many existing corporate compliance programs, it does not envision a separate compliance department or effort within the entity.

And finally, it is very deliberately preventive in nature. It is not reactive. Unlike EPA’s policy, the Department of Justice’s policy, Chapter Eight, and all 14 of the state audit privilege laws that have been passed so far, it is not built around the notion of auditing, correcting, reporting, and learning from those lessons to improve compliance in the future.

So let me walk you very briefly through each of these. I will try to keep it short so that we have plenty of time for discussion. The first is that the Chapter Nine proposed program is comprehensive. It is not aimed at preventing crimes. As I mentioned, the objective of the group was to try to do something that would make a real difference in compliance across the board.

A very large percentage of environmental violations never involve criminal conduct. Therefore, the Chapter Eight program was considered at the outset too narrow because of its exclusive focus on preventing criminal conduct. It starts, for example, with prescribing that there be standards and procedures capable of reducing the prospect of criminal conduct. Everything else in the seven steps, then, is designed to ensure implementation of those standards.

In contrast, the proposed Chapter Nine starts by requiring policies, standards, and procedures necessary to achieve environmental compliance, a very different approach, very, very different kinds of standards, and a much more comprehensive look at compliance. Proposed Chapter Nine then goes on to say how these standards should be implemented. It does that by aiming at the principal causes of violations today: management inattention, sloppy production practices, an ignorant workforce, and lack of motivation. So it makes great demands on organizations that want to truly exhibit a commitment to environmental compliance. This is no easy thing to do. But the judgment of the advisory group was that if a very large break on criminal penalties was sought, then a very large effort by the corporation was what was needed.

The second main distinction between this proposal and Chapter Eight is that it calls for the integration of compliance management within the management of the operations of the organization, not for a separate program. Chapter Eight, in my view, encourages programs like

those that were prevalent in corporate America in the 1970s and the 1980s. Typically, they involved separate departments. You had an environmental vice president in a corner office. He or she had a cadre of environmental experts, and their job was to set standards for compliance, to audit against those standards, and then, one way or another, to try to enforce those standards and those audit findings on the operating functions of the entity. It became an internal game of cops and robbers, an internal police force, if you will.

What that led to in many companies, mine especially, was that the operating entities tried to hide the ball from the auditors. You had operations folks with the authority and the resources to do something about compliance but without the ownership or the understanding of what was needed.

The proposed Chapter Nine turns that completely on its head. It starts with the judgment that the responsibility for environmental compliance belongs in the hands of those who control the functions that can lead to violations. So it begins by assigning compliance responsibility to line management of the entity, not the usual “high-level personnel” that are mentioned in Chapter Eight and in other policies.

Then it requires, or at least suggests, that those managers use the same management systems and techniques to manage compliance that they use in running the other facets of their business. The theory is: these are good businessmen who know how to achieve results; let them apply those same techniques and tools for achieving compliance.

And finally, it calls for incentives for compliance to balance other existing incentives in the corporate setting, and for accountability to achieve it. These are all the points that I think integrate compliance with operations, and that motivate operations managers to achieve it.

Finally, the proposed Chapter Nine focuses on prevention of violations rather than simply detecting existing ones and overcoming them. Chapter Nine stresses those measures that are, I think, most effective in preventing violations in the first instance. Chapter Eight’s emphasis, as I mentioned, is on auditing, correcting problems that are detected, and then applying those lessons learned to prevent future violations.

Chapter Nine is very much like total quality management. It resembles the functions that Chris is going to describe in a moment in connection with ISO 14000. It is designed to systematically prevent defects, just the way manufacturing operations work to prevent defects in products. The most important aspect of that is to integrate the standards into the operating function to get the work done properly because it is designed properly. There are many other management techniques mentioned in Chapter Nine to do that as well. These all go well beyond Chapter Eight and, I think, give line managers the tools to achieve compliance in the environmental arena.

So these are pretty important distinctions. Some are fairly subtle; some are not. They opened up a new line of discussion in this arena. I think they make the difference in achieving a high rate of compliance. And the bottom line for the advisory group was that if substantial penalty mitigation is to be warranted in the criminal arena, then this program goes far enough to justify it. Thank you.

## **ISO 14000**

MS. DRIESSEN: Chris Bell is a partner at Sidley & Austin, and he has an extensive environmental background, which I imagine is why he is now one of the lead players in the U.S. delegation to what you heard alluded to as ISO 14000. That acronym stands for the Organization for International Standardization, International Environmental Standards Initiative. Did you get that?

ISO 14000 is obviously beyond just the United States. It is beyond just Chapter Eight and the corporate guidelines, and Chris is going to take some time now to bring you up to speed on what that effort is about and what we can learn to go forward from here. Chris?

MR. BELL: Good afternoon. What I'm going to be talking about today I think meshes well with what both Ed and Jim were talking about, because what I have been involved in for the last three years is this international effort to develop a consensus standard on good management practices in the environmental area.

One way that I usually like to start thinking about this, and this is getting back to a point that Ed was talking about, is to ask where do you go for information on this issue? Some companies, big companies, might have large programs and they've got it all figured out and they've got a lot of internal head counts to figure all this out, but for the most part, if somebody walks into your office and says, "Okay, how do we do an environmental management program and I want one on-line in the next six weeks," or something like that, to whom do you turn, where do you turn, and so on and so forth.

What you've been hearing about today is a lot of guidance from the United States government, particularly on what I would call the end-of-pipe section of the United States government, *i.e.*, the enforcement side, on what a good management program is. Sentencing guidelines, I'm sure you've heard some discussion of and you will hear some more tomorrow about the U.S. Department of Justice prosecutorial guidelines, the EPA audit policy, and the revisions to the U.S. EPA auditing policy.

These are all programs which are grounded in the classic American command and control approach. Which, by the way, when I went out internationally, people found sort of interesting. The most formal U.S. government statements on what preventative programs should look like have come from the people who deal with people who go to jail. They found that rather ironic, that some of the most creative thinking in the U.S. government on compliance programs was coming from the rear end of the program, not the front end of the program.

Now, of course, that's been changing through EPA's Common Sense Initiative, the Environmental Leadership Program, and other initiatives. In fact, in ELP and CSI, you've seen a variety of environmental management systems, initiatives, and pilots being suggested. EPA's Project XL is another piece out there.

There are also state initiatives. For those of you who are familiar with the U.S. Department of Justice prosecutorial guidelines, the New Jersey prosecutors have their own guidelines which actually are far more detailed than the U.S. DOJ's.



Then there are a variety of voluntary initiatives at the industry level. The International Chamber of Commerce has its principles for sustainable development, there is the Global Environmental Management Initiative, and you've got the Chemical Manufacturers Association's Responsible Care effort. You've got a variety of U.S. domestic standards organizations that are working on environmental management and systems standards. I mention here only NSF International, Inc., which is based in Ann Arbor, but ASTM has also been working on them, as well as others.

Then you get outside the United States and there has also been quite a bit of work going on in this area. I mention only one here, BS 7750, which is a U.K. standard written by the British Standards Institute. It is probably the one that has gotten the most press around the world up to now. There are companies around the world, including in the United States, Asia, and Europe, that have actually gotten registered third party verification to that British standard, but there are lots of others. The Irish have IS 310. The Spanish have one. South Africa has one. New Zealand, Australia all have one.

The European Union has one. They have something called EMAS, the Environmental Management and Auditing Scheme. Though it is a regulation, it is actually a voluntary standard that has environmental management systems and auditing components. That became effective in the European Union in the spring of this year. I think the U.K. and Germany are just about on-line to actually be able to start having companies go to work on it. There have been a few pilots.

And finally I get to what I was supposed to be talking about this afternoon, which is ISO 14000. The point of all this is to indicate that really there is an awful lot going on out there. There are a lot of sources. And, in fact, my experience has been it's not so much the absence of information but just a little bit too much.

One of the concepts of ISO as an international standards writing organization was to try to simplify the process, bring experts from all around the world together, and to do a little bit more one-stop shopping. One problem, particularly for U.S. multinationals, is that if you've got facilities all around the world, which environmental management system am I going to pick?

Am I going to do BS 7750 in the U.K. and EMAS for my German location? And I've got to worry about the sentencing guidelines in the states. And I want to control all of this in some rational way from corporate headquarters. This is a mess. One of the aspects of ISO is to try to harmonize these kinds of activities.

Now, who are these people that are following us in ISO? The International Organization for Standardization was invented in 1946. It's a non-governmental organization based in Geneva. It has about 113 country members now but it's a non-governmental organization, so the representatives to ISO are standards bodies. For example, the U.S. vote in ISO is held by the American National Standards Institute, or ANSI. It's not held by the State Department.

Anybody can play in the U.S. delegation. ANSI holds our vote in ISO, but ANSI doesn't have all the resources to develop U.S. positions so they develop what are known as technical advisory groups or TAGs, and that's what the U.S. delegation is. And, in fact, the

U.S. delegation on ISO 14000 is having three days of meetings at the end of next week in Philadelphia.

Within ISO, they create a whole series of technical committees. You can tell they're all the way up into the 200s. They've been writing a lot of standards. Historically, they've been technical standards, things like the light sensitivity of film. You look on a box of Kodak film, it'll say ISO 400 on it. It doesn't say DIN 400 and ASA 400 on it. It says, ISO 400.

ISO put itself on the map with general management, though, with the development of the ISO 9000 quality management series that maybe some of you are aware of. That came out in the 1980s and it's basically a TQM standard or a Deming standard or a "plan, do, check, act" standard. Much to everybody's surprise, getting third party registration to this standard has actually become a condition of doing business in a lot of parts of the world and in a lot of industrial sectors. There are about 100,000 ISO 9000 registrations worldwide, a little over 10,000 in the United States, and it's growing.

Coming out of the work of ISO 9000 came Technical Committee 207, which is the technical committee that's working on the ISO 14000 series of environmental standards. It was formed in 1993 and has been working away feverishly ever since then.

In this last set of boxes down here are the basic sets of standards that ISO is working on in the environmental management area. I think the key one of interest to us here is the environmental management system standard, EMS, headed up by the U.K. There are also standards being written on auditing, labeling, environmental performance evaluation, life cycle assessment, and so on and so forth. So there's a lot of work going on there.

Let me focus here for a minute on the key components of the environmental management system specifications document. It's called the specifications document and it will have the number ISO 14001. This is the document that, if people are going to get third party registration, they will be audited against. By third party registration I mean an accredited auditor coming in and verifying that you actually meet the standard and that you can document that you meet this standard. If you are going to get third party registration, this is what you would get third party registration to: ISO 14001.

It will be a final standard sometime in 1996 but it's essentially in a complete form right now. There's just some lengthy international balloting going on. It's about 15-16 pages long with about another ten or so pages of informative guidance.

And most of these things are very similar to the kinds of things Jim was talking about. In establishing communicative top management policy, this policy has to include commitments to comply with the law, commitments to continually improve your system, (TQM again), and a commitment to pollution prevention.

Once you've got this policy, you have to go out and identify your significant environmental obligations and set measurable objectives and targets based upon those obligations. You can split the obligations into two halves. One set are your legal obligations and the other set go to actually going out into the environment and determining the significant environmental issues

that are associated with not only your factories, your facilities, but also your products and any services that you might deliver. So it's a fairly comprehensive concept.

Then once you've set these objectives and targets, you have to actually have plans and procedures and identified personnel and trained personnel to actually meet them. This is sort of the hole in the doughnut that I think Jim was talking about. A lot of people have a great policy and they've got a great auditing program, but they don't have a whole lot in the middle to make sure everything gets done.

Then you measure your performance. You verify your performance through auditing. Then you correct problems that you find. Then you have senior management review on a periodic basis to check this whole thing. Once you've got the program in place, you're not supposed to just go to sleep and let the dust collect on the shrink-wrap on the nice binders. You're actually supposed to keep an eye on it.

Now, in the few minutes I have remaining, I just want to toss out a few thoughts on how all this might relate to compliance programs and the sentencing guidelines, and we might be able to generate some discussion on this.

First of all, a few thoughts on the sentencing guidelines, and on this, I was sympathetic with some of the thoughts that Ed was suggesting as to whether or not the sentencing guidelines and the whole criminal context is really the right place to be thinking about overall comprehensive environmental management systems. The focus of the sentencing guidelines is that you're dealing with criminal situations. You're essentially dealing with situations where you are trying to avoid or deal with potential or actual criminal violations of the law.

And so a lot of what the sentencing guidelines are about, and essentially what the prosecutorial guidelines are about that DOJ has, is that we are trying to figure out at what point in time are we going to say that an organization is actually culpable for criminal conduct, because as we know, an organization by itself doesn't really have a state of mind.

What we're really trying to do is figure out at what point are we going to assign responsibility for the actions of individuals to the organization as whole and say that this organization is criminally culpable. That is what we're about in the criminal context, and that, I think, is the focus of the sentencing guidelines.

ISO 14001 is a little bit different. It has both a narrower and a broader set of issues than the sentencing guidelines. On the one hand, it is narrower than the sentencing guidelines, because standards such as ISO 14001, BS 7750, or EMAS are only worried about the environment. The sentencing guidelines, on the other hand, have a general approach to compliance programs.

On the other hand, ISO is much broader than the sentencing guidelines because it is not worried just about crime. ISO 14001 is a management systems standards that has a much broader scope. It addresses issues such as pollution prevention, talking to your suppliers, communicating with the public, setting measurable objectives and targets. These are all issues very, very important in the environmental arena to do a good job.

But it could be seriously questioned whether the presence or absence of, for example, a really nifty pollution prevention program or the presence or absence of a system to communicate with your suppliers is really relevant to determining criminal culpability of organizations. It might be highly relevant to doing a good job. But I think it might be useful to distinguish between doing a really good job and the issues that we should be worrying about in the criminal context.

I think that the existing compliance assurance provisions in the organizational sentencing guidelines are adequate to their task, which is to focus on preventing criminal violations. I don't think that special compliance assurance program provisions are needed just to focus on environmental issues, because I think we can make the same argument for antitrust or Medicare fraud or anything else, and we would have all kinds of different compliance programs out there.

I think that the existing provisions are flexible enough to allow different parts of organizations to do what they need to do in their particular areas to get a good compliance program going. And then to close, I would say that compliance, or conformance – you don't comply with a voluntary standard – conformance to something like ISO 14001 or some other appropriate environmental management system standard that you might choose – it might be BS 7750, it might be something else – should be considered a viable option for demonstrating conformance to the sentencing guidelines. If I conform to ISO 14001 or a similar standard, I should be deemed in conformance with the sentencing guidelines.

It is also important to note that there is no one way to implement a program, and my experience has been in these three years of international negotiations, as soon as you get down to detail, there's always somebody else who says, I've done it differently and it works, and there's a real danger in the U.S. government starting to get into hardly any detail at all into these issues.

And so finally, my last concluding point would be apart from the basic concept that conformance with accepted standards like ISO 14001 should be considered appropriate for demonstrating conformance to the sentencing guidelines, that standards like ISO 14001 should not actually be incorporated into things like the sentencing guidelines or Federal Register notices by EPA or so on and so forth. Thank you very much.

## QUESTIONS & ANSWERS

MS. DRIESSEN: I have a number of questions here, and since you're walking up to your seat, Chris, I guess we'll start with you. I have a couple of questions here relating to ISO 9000, so I thought I'd start with that.

The first one is coming from your esteemed colleague, Ed Dauer, on the panel. He said that ISO 9000 certification can be applied for apart from any criminal or even civil liability. He wants to know if the experiences there have shown whether prevalidation of a federal sentencing guideline program might be possible.

MR. BELL: Prevalidation?

MR. DAUER: Right. The question of whether you're ISO 9000 certified is done apart from any risk of liability.

MR. BELL: Yes.

MR. DAUER: The question is whether a solution to some of the difficulties of retroactivity under the federal sentencing guidelines could be resolved by allowing companies to have their programs validated and approved prior to the time that any criminal liability is an issue. I wondered if the experience with ISO gives us any reason to believe that prevalidation would work under the U.S. Sentencing Commission's own standards.

MR. BELL: I guess the only concern there that I think might be expressed amongst at least the industry people that I've worked with is they are concerned about getting into detailed third party validation systems as a condition for demonstrating conformance with the sentencing guidelines.

I think they would want to see a lot more flexibility because there are a lot of elements in the voluntary standards that I think go beyond what most people would think are necessary for a good compliance assurance system. I mean, the concept of third party verification might be useful, but transferring it directly over from the voluntary standards program might be a little bit dangerous.

MS. DRIESSEN: I have another question that follows up on that. In an area where you might get prevalidation, you mentioned that ISO is not a governmental entity. Do you have any indication that if people voluntarily comply with ISO, that will be considered as some sort of an exemption from criminal liability in the event of some sort of a violation?

MR. BELL: There is increasing interest in various elements of the U.S. government about the potential uses of ISO. Some of those areas of interest are in the area of regulatory flexibility. So, for example, the Office of Clean Water has launched an initiative to write new permit guidance to give more permit flexibility for companies that have a third party validated environmental management system plus good performance.

In the area of enforcement discretion and penalty mitigation, EPA's Office of Enforce-

ment has expressed serious interest in the presence/absence of a good environmental management system in determining how they would proceed. But this is all really in the preliminary stages, though I do think that there are some real fruitful discussions that can be had in that direction.

MS. DRIESSEN: Thanks. We've got a number of questions here and I want to move on. We've got some questions here for Jim Banks. There are several that are sort of related. First, is the Sentencing Commission the best or even the second-best forum to be establishing the elements of a comprehensive environmental compliance program?

And a sub-question of that relates to whether or not the Sentencing Commission's guidelines for punishing criminal conduct are the appropriate place for bringing in standards that go beyond just criminal activity to total compliance, or even beyond compliance. That's really what your emphasis is. You're talking about a gold standard. You're talking about changing corporate behavior, and the questions relate to whether or not it's appropriate to pool those standards into a system of criminal penalties.

MR. BANKS: Well, I'll give you my own personal opinion. I think the advisory working group that I was a part of answered that in the affirmative by proposing that a fairly comprehensive program be prescribed by the Commission as one of the things that would warrant serious penalty mitigation.

In environmental law enforcement, for decades, there has been the concept of "good faith efforts to comply." Most of the major environmental statutes include it. EPA and Justice Department policies have it. And the notion is that the severity of sanctions can be mitigated, depending on whether the corporation or the entity was making an effort to get it right, and whether the instant violation occurred despite their doing all you could ask them to do.

I think in the criminal sentencing area, it is just as logical to consider good faith efforts to comply as it is in the civil arena or in debarment and blacklisting, which has been done for many, many years, and is equally appropriate and effective as a way of encouraging appropriate compliance behavior by entities.

If it is deemed to be too far afield from the narrow purpose of criminal sentencing and the objective of deterring crimes *per se*, so be it. Maybe it is not yet time for the federal government to reach that far. As a matter of policy, my view is that it is time, it is appropriate, and it probably will be highly effective.

MS. DRIESSEN: Thanks. We also have a couple of questions for Ed here. The first one asks you to perhaps think about some examples or some mechanisms a company can use to demonstrate that it has exercised due diligence to ensure that persons with a propensity to commit criminal illegal acts are not placed in positions where they exercise substantial discretionary authority. Do you have some ideas on that?

MR. DAUER: Yes. It's dangerous, because there is probably not a very wide gap between the duty to investigate under the federal sentencing guidelines and violations of privacy under civil liability.

I don't have an answer for that that I can give you now. We have been collecting examples of how companies actually do this. When we come out with a final draft later this year, those will all be available. We have seen examples that run all the way from running fingerprint checks in one report that we got from a fairly substantial corporation, to another which says that what you ought to be doing is looking at police investigations in the county of record as well as in the county of residence; and then there are a lot of people who aren't doing anything at all.

I don't have any magic answers for this, but I can tell you that one of the areas we are concerned about is that this is one of the few parts of the federal sentencing guidelines that we have not wanted to tinker with because it's so strange and the language is so precise, and yet the danger is there if one goes into areas of protected confidentiality. It's a narrow path. So the bottom line answer is, no, I don't have any magic words, but we're working on it.

MS. DRIESSEN: I have a follow-up question to that. You spoke of some tension between Chapter Eight and traditional ideas of negligence liability and criminal liability, and that the guidelines themselves therefore produce vague directions and vague guidelines. I was wondering if you could speak to things the guidelines could do or could incorporate that could eliminate a little bit of that vagueness or perhaps you could suggest changes.

MR. DAUER: Yes. I'm glad you asked. There are two or three, and again, I don't have any magic bullets, and certainly not all of the ideas there are, but two or three that I can think of.

One obviously is the encouragement of the development of industry-wide collaborative groups. There is, I understand, some question raised about whether industry groups that get together are not also getting together about other matters and whether they ought to be encouraged or not.

My own feeling is that any source of information that can be provided, so long as we don't have violation of other rules, ought to be encouraged and maybe even facilitated, if not by the Commission, then by some other agency.

A second possibility would be the development of model programs. This, for example, has been done by other agencies. As I recall, it was done under regulations B and Z in the banking industry. When they came out, the agencies even generated sample forms. Some people thought that was probably cookie cutter, but it sure helped achieve their objectives and at the same time not create any disincentives by setting new traps.

The third is the question that I put to Chris. I think there is a disincentive to invest in creating a compliance program on the part of a business that will not find out whether it's up to snuff until it's too late. There might, however, be an incentive to invest in a compliance program and therefore to change behavior in a pro-compliance direction if that corporation could have validation or approval of this program outside of the context of any serious risk of criminal liability.

So suppose that someone were to create a program and ask that it be inspected at the time and approval given then, in advance. It would be a kind of presumptive validity which

could later be inquired into if it turned out it was only on paper or it wasn't in good faith being followed.

I think what we might find is a reduction in the uncertainty, and therefore a reduction in the disincentive effect; and, consequently, an increase in compliance. That's what I meant by asking whether some of the private programs which certify people to do business under certain regimes, like ISO 9000 – not that they themselves would be the deemed triggers to show that one satisfies the federal sentencing guidelines – whether the experience under that kind of investigation and approval gives us any reason to believe that there is feasibility to the suggestion that a compliance program designed to meet the federal sentencing guidelines might be approved in advance.

MS. DRIESSEN: I guess we'll be addressing some of those issues a little bit more tomorrow with the law enforcement panels. I see by the clock on my desk that our time is past. I did want to ask one more question briefly because I think it kind of sums up where we are going. It was a question for Jim, and perhaps all of you can think about this, too. It was regarding the story of your guilty plea. The question here is, should the CEOs make that plea and get that lecture from Judge Conaboy or whomever rather than the general counsel, and do you think there is an additional deterrent effect if the CEO has to stand up and account, as opposed to an attorney?

I wanted to ask this question to get everybody thinking about it, because really, what we are talking about here is changing corporate culture. It's the theme of the conference. We're talking about corporate crime in the context of strengthening the good citizen corporation, and a lot of what we're doing and saying are things we hope will change the sort of corporate culture where these things are allowed to happen.

Jim, would you speak to that?

MR. BANKS: I think corporate managers need to understand and appreciate how third parties, including federal judges, view their conduct or their employees' conduct, and be made to recognize that and report it to the board and explain how they're going to prevent it in the future. But standing up in front of a judge isn't the only way to get that done, and certainly, in our case, the pain of paying a large penalty, of having a permit put at jeopardy, and of running the risk of debarment from doing business with the federal government, was enough pain to get their attention.

#### **QUESTIONS & ANSWERS – WRITTEN**

*Jim Banks*

- Q. You said that proposed Chapter Nine goes beyond Chapter Eight to seek to prevent all non-compliant activities, not just criminal ones. What justification did your advisory group have to conclude that sanctions in the criminal system should be based on a failure to prevent civil or administrative violations?



- A. The Advisory group did not propose to base criminal sanctions on a failure to prevent civil or administrative violations. Indeed, the proposed aggravator for “prior civil compliance history” would apply, not to mere failures to prevent violations, but only to a pattern of violations so severe and extensive that it “reveals a disregard by the organization of its environmental regulatory responsibilities.”

Instead, the group proposed to modify criminal sanctions depending on the rigor with which organizations make the attempt to manage their compliance responsibilities in a comprehensive fashion – even if those attempts ultimately failed. In this sense, the proposal differs a little from the existing Chapter Eight program description. The key difference, as the question properly notes, is that the proposal’s compliance program is directed to compliance in general, while Chapter Eight’s is specific to criminal conduct. The justification for this is simple and straight forward: if the eight-style program is thought to justify substantial penalty mitigation, then its proponents should pursue that goal. The advisory group didn’t buy it, and I doubt the Commission will either.

- Q. Chapter Eight was considered too narrow because it focuses solely on preventing criminal conduct. Presumably, this is because only a small portion of inappropriate behavior is criminal. One could argue that a system of criminal penalties should focus solely on criminal conduct. Is proposed Chapter Nine’s ambitious approach more appropriate to ethical standards instead of criminal practices?
- A. I don’t think this is a question of appropriateness or legal symmetry. I think it is just the opposite. It is a very practical, bottom-line question: are corporations that invest vast resources in compliance management programs going to get tangible credit for it when an employee flouts company policy, ignores his training and procedures, and jeopardizes his employer’s well-being by committing a criminal act? If we expect companies to continue doing those things, and for the sake of the environment I think we should, then the answer has to be a resounding “YES!” We only have systems for imposing civil and criminal sanctions within which that credit can be offered; ethical standards are great, but they don’t lead the CFO to approve resources for this kind of effort.

*Chris Bell*

- Q. ISO-9000 is widely accepted as a “model/standard” for a quality management system. Why continue to develop “program guidelines” for compliance, ethics, environmental, etc.? Simple application of an ISO-9000 management system to the management objectives of compliance as well as product quality should be sufficient (ISO-9000 contains 20 elements for a program to achieve management objectives). Comment?
- A. ISO decided to establish environmental management systems as a separate

standards writing activity because the member countries concluded that managing environmental issues is sufficiently different from quality management in that distinct standards, written by environmental experts, were necessary. In particular, the deep public interest in environmental issues, as well as the heavily-regulated status of environmental matters, create some unique systems issues. However, many of the components of ISO 14001 are consistent with the ISO 9000 quality systems standards, and organizations with ISO 9000 systems in place are likely well along the way to conforming to ISO 14001. Such facilities might choose to integrate their ISO 9000 and ISO 14001 systems.

Q. Given all the work going into ISO 14001, what will the practical effect be? If your program is accredited, does that mean you will be exempt from criminal prosecution in ISO’s member countries?

A. ISO 14001 is a voluntary, non-governmental standard. Therefore, by itself, it has no legal effect and does not provide immunity from civil or criminal enforcement. However, regulators may choose to exercise enforcement discretion or penalty mitigation to organizations that conform to ISO 14001. The practical efforts of conforming to ISO 14001 will differ from organization to organization. For some companies, it might be necessary as a commercial matter: customer demand. Others might use it as a foundation to improve their environmental management system, which may result in improved compliance performance, pollution prevention gains, enhanced environmental risk management, etc. The important point to understand is that compliance assurance is only one element of ISO 14001, and it has a broader, overall environmental management systems approach.

Q. ISO 9000 certification can be applied for apart from any criminal or even civil liability. Have the experiences there shown whether pre-validation of a “FSG” (federal sentencing guidelines) program might be possible?

A. Experience with third-party registration to the ISO 9000 quality systems standard and to existing environmental management systems standards such as BS 7750, indicates that it would be possible to create a “pre-validation” program for the U.S. sentencing guidelines. The more important question is whether such a program would be a good idea. Pre-validation would likely require a more detailed approach to compliance assurance programs than is currently in the organizational sentencing guidelines. Organizations should have the option to choose the systems approach most appropriate to their operations, and not have to conform to a specific approach mandated by the government.

Some of the interest in pre-validation is the perception that organizations do not have sufficient guidance on what constitutes an adequate compliance assurance system. This perception appears to be based on the absence of case law or formal government statements on these issues. However, the narrow

focus on traditional legal sources of information ignores the fact that there are a wide variety of approaches to establishing and implementing compliance assurance systems, many of which are already reflected in extant documents such as ISO 14001. Therefore, pre-validation is not necessary for purposes of having some confidence in the robustness of a compliance management systems.

Lastly, there is some concern regarding the value of third-party registration, or pre-validation, in the ISO 9000 and ISO 14001 contexts. After several years of experience, there has been criticism about the value-added of the third party registration process and increasing interest in less cumbersome, less intrusive and less expensive approaches to determining conformance to the standards. In the context of the U.S. sentencing guidelines, we should be wary of creating an administrative structure and bureaucracy for pre-validation purposes. Accordingly, federal policies, including the guidelines, should be flexibly applied to allow determinations that organizations conform to those policies if they have implemented compliance assurance programs that are consistent with generally accepted practices. For example, since the scope of ISO 14001 is far broader than simply compliance assurance, registration to ISO 14001 should not be a condition of “qualifying” for the “benefits” of federal enforcement and penalty mitigation policies.

*Ed Dauer*

- Q. On the NCPL guidelines for corporate compliance, have you considered developing these guidelines as an ISO chapter – similar to the ISO 14000 chapter for environmental management systems?
- A. No, we have not. One of the advantages our work enjoys is its independence – our members speak as practicing efforts in compliance. Yet we too are having our internal discussions about how our guidelines will be shaped. I would guess that an affiliation with ISO at this time would distract us from our own work. Perhaps we can consider this idea when our product is complete.
- Q. You spoke of tension arising out of Chapter Eight of the guidelines, perhaps because of vague standards. What could the sentencing guidelines do to reduce that vagueness?
- A. This is the central challenge. One possibility is to publish non-binding “models” for several of the key areas. A second is to encourage and nurture industry groups that are attempting to create information exchanges. Third – and my personal choice – would be to create a pre-incident approval procedure. Doing so could lead to a number of useful results.

*Day One*

**Bringing Carrots and Sticks In House:  
The Role of Ethics, Incentives, and  
Private “Inspectors General” in  
Achieving “Effective” Compliance**

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**Ronald Goldstock**, *Director of Monitoring Services, Kroll Associates, Inc.*

**Gary Edwards**, *President, Ethics Resource Center*

*Moderator: Mary E. Didier*, *Staff Assistant for Legal and Legislative Affairs,  
U.S. Sentencing Commission*

**INTRODUCTION: READING COMPLIANCE CRITERIA INTO  
THE GUIDELINES: INTEGRITY-CENTERED VS. LAW-CENTERED PROGRAMS**

MS. DIDIER: Good afternoon and welcome to the afternoon session of the symposium. My name is Mary Didier, and I am a staff assistant for legal and legislative affairs at the United States Sentencing Commission. I will be moderating this afternoon’s panel discussion.

Before introducing the panel, I would like to expand on a theme Win Swenson touched on this morning because it has particular relevance to what the next two speakers are going to talk about. For the reasons Mr. Swenson discussed, the guidelines’ seven steps of “an effective program to prevent and detect violations of law” are not intended to be a checklist. Rather, the definition of an effective compliance program should be viewed as somewhat “elastic” – in other words, able to accommodate a range of compliance approaches with the ultimate focus of the definition being to encourage companies to devise programs that actually work.

This interpretation of the guideline definition has an important implication. It means that as certain compliance practices become recognized for their effectiveness, companies should, in a sense, “read them into” the guideline requirements even if the guidelines do not *explicitly* require these practices. How do we draw the conclusion that the guidelines should be interpreted in this manner? An initial indication is evident in the introductory commentary to the organizational guidelines, which states that one of the Commission’s purposes in drafting the organizational guidelines was to provide “incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct.” It is unlikely that the Commission wanted to encourage the development of such internal compliance mechanisms but did not care whether they worked.

More concretely, though, the guideline definition of an effective program itself strongly implies that companies should read effective compliance approaches into the guidelines definition. As Mr. Swenson noted this morning, the introductory text of the definition establishes the definition’s baseline requirement: an effective program to prevent and detect violations of law is one “that has been reasonably designed, implemented, and enforced” – and here is the key language – “so that it generally will be effective in preventing and detecting criminal conduct.” The definition continues by explaining that the hallmark of a qualifying program is that the program provides evidence of the organization’s “due diligence” in seeking to prevent and detect violations by employees and agents. Finally, the definition stresses that the often-cited “seven steps” that an organization must take in order to meet the due diligence standard are, in fact, the “minimum steps” companies must take. Moreover, they are referred to in the definition as “types of steps,” meaning they are more in the nature of general principles than highly detailed rules.

All of these considerations together – the emphasis on effectiveness, the requirement that companies use diligence in developing their program, and the fact that the seven steps are somewhat broadly worded and are called “minimum” steps – suggest that companies should approach compliance with more than a cookie-cutter attitude. They must be prepared to learn what works and incorporate that learning into their program whether the guidelines *explicitly* say so or not.

These considerations are relevant to a debate recently spurred by an article published in the Harvard Business Review by Lynn Sharp Paine. Professor Paine describes two contrasting models by which organizations might seek to foster desirable employee conduct: a “legal compliance” approach and an “integrity-based” system.

Professor Paine describes the legal compliance model as being lawyer-driven, unduly focused on the narrow objective of avoiding criminal violations, and too reliant on threats and punishments to achieve its law-related objective. This model contrasts with an integrity-based approach to ethics management which, she states, combines a concern for the law with an emphasis on managerial responsibility for ethical behavior. I refer you to Professor Paine’s article for a further description of these two models. The point I want to make here is that if, as Professor Paine argues, the integrity-based approach is more effective in bringing about lawful conduct, there is every reason to believe that the guidelines would embrace such an approach.

All the foregoing is not to suggest that the guideline definition of an effective compliance program cannot be improved. Indeed, the Commission hopes to gain some insight from this symposium on areas for possible improvement. In the meantime, the guidelines seem to encourage companies to experiment with and evaluate their compliance efforts with a goal toward finding out what works best. With those thoughts in mind, I would like to turn now to our two speakers who have compelling but somewhat different ideas about how companies can develop effective compliance environments.

**MAKING COMPLIANCE CREDIBLE: THE INDEPENDENT  
PRIVATE SECTOR INSPECTOR GENERAL (IPSIG) APPROACH**

MS. DIDIER: Our first speaker is Ronald Goldstock. He joined Kroll Associates as a managing director and director of Kroll Monitoring Services in January of 1995 after 13 years as director of the New York State Organized Crime Task Force. The Task Force played critical roles in the Mafia Commission, the Lucchese and Gambino family prosecutions, and the Cali Cartel drug and money-laundering cases. As director of the task force, Mr. Goldstock designed and developed the Independent Private Sector Inspector General Program, which has become a significant force in promoting organizational integrity worldwide. Mr. Goldstock has served as Inspector General of the U.S. Department of Labor, Director of the Cornell Institute on Organized Crime, and Chief of the Rackets Bureau in the New York District Attorney’s office. He has also written extensively on subjects related to organized and white-collar crime, money-laundering, and labor racketeering. I present to you Mr. Goldstock.

MR. GOLDSTOCK: Thank you, Mary. I guess after Senator Kennedy’s talk, it is fashionable to quote Win Swenson. He’s clearly the most quoted person here today; as he said at the outset, the sentencing guidelines provide an outline, but not a model for the development of compliance programs – programs which control through prevention and detection illegal behavior and which, presumably promote the work of the organization, whatever it happens to be, the delivery of goods and services or other operational objectives.

Actually, at the time that the guidelines were developed, there existed a potential model for the program envisioned in the guidelines – the Federal Inspector General Act of 1978 – effective in all of the major departments and agencies within the federal government. The IG program mandated that those departments and agencies have an inspector general to reduce waste, abuse, and fraud and to promote economy, efficiency, and effectiveness within the department and the departmental programs. It also provided for the assignment of auditors and investigators to the IG’s office and created the positions of Assistant IGs for both investigations and audits.

Designed to be independent of the head of the department – although it would report to that head – it also reported to the Congress of the United States. The program was certainly not perfect; there were a number of flaws within it.

First, an entity designed to reduce waste, abuse, and fraud and promote economy, efficiency, and effectiveness, should be utilizing individuals with more than audit and investigative skills. Second, depending on where a case was assigned – to the Assistant IG for Audit or to the Assistant IG for Investigations, there was an audit response or an investigative response. The audit response generally was to disallow costs and increase internal controls. The investigative response was to indict, convict, and incarcerate. Auditors looked at investigators as Nazis, and investigators looked at auditors as wimpy without credentials or guns. But in either case what was missing was an Inspector General response.

Let me give you an example. Let’s assume that somebody came up with a brilliant idea to deal with ineligibles in a particular entitlement program. A computer match would be run of Social Security Numbers of the people on the program and some other list which would be



inconsistent with being eligible. Assume also that the computer match is an amazing success. One thousand people, 1,000 ineligibles, are found to be on the rolls of the entitlement program. There are arrests and newspaper headlines and everybody thinks that the IG did a wonderful job – so wonderful, in fact, that the following year, the same thing is done. The computer match is run, and then – it worked again! Another 1,000 people were found to have been involved in obtaining benefits illegally. While it was a wonderful investigative success, as an IG matter, it was a complete failure. Nothing was done to stop those 1,000 people from getting on the list in the intervening year.

That was understood, I think, by the best IGs, who included a loss prevention component in their programs. They also recognized several other concerns. It is, in fact, possible for an IG to eliminate waste, abuse, and fraud from the department and the departmental programs. I'm not saying control it; I'm saying you can eliminate it. The only problem is that as a result, no goods and services are delivered.

Two is something called IG toleration. People who are involved in the programs, who have to implement the controls that are designed, have a natural tendency not to do so; I think this is so for two reasons. By accepting internal controls, they are admitting that what they were doing before was wrong or ineffective. Moreover, it is not something that they have a stake in. IG toleration is dramatically increased by bringing the people who are involved in the program into the process of reform.

But even with all of those flaws and even with the governmental environment, the IG programs are successful. They work. Imagine the possibilities in the private sector, especially when modified. And such a program does exist: Private Inspectors General. The problem with the term Private Inspectors General is that the acronym doesn't work all that well, hence Independent Private Sector Inspectors General, or "IPSIG." What is an IPSIG? An IPSIG is an inspector general with the additional skills and disciplines that are necessary to look at problems of waste, abuse, and fraud along with the promotion of economy, efficiency, and effectiveness. In addition to investigative and audit skills, it adds legal, loss prevention, opportunity blocking, research, analytic, business, computer, and industry specialization.

Rather than separating into separate skill areas, individuals work together as a team to address problems. They design and implement internal controls, codes of conduct, and codes of ethics; they work with the management and staff to determine where vulnerabilities to fraud and corruption exist, and help create cost-effective countermeasures; then, they implement the controls and codes and monitor the systems through investigations, forensic audits, integrity tests, hotlines or anything else that is appropriate to ensure that they are working well. Then, after reviewing the results of investigations and audits, and the controls that were put into place, and after analyzing the results, they make whatever modifications are needed so that either people do not get too used to the systems and tend to ignore them or that they are not obsolete due to changes in the economy or changes in regulations.

The IPSIG has to have independence – independence guaranteed by dual reporting responsibility – to a high executive officer within the corporation and to some external body. In the case where there is a probationary status because a company has been in trouble and the IPSIG is implemented as part of a deal with law enforcement, reporting is probably to a law

enforcement agency. But reporting can also be to an external body that is independent of the company as an outside board of directors.

What are the advantages of having IPSIGs within a corporation? Because they are independent and are not corporate employees with a corporate career path, there is no confusion as to their mission. That is important. Remember the scene in one Barney Miller episode where Captain Barney Miller was speaking to the obsequious Police Officer Levitt, who always wanted to please his superior, Barney Miller. Barney Miller said that one of the detectives had a personal problem and was going to be in late that day. Levitt, who was taking the role, said: “Right. I’ll dummy up the records.”

Barney Miller said, “No, I don’t want you to dummy up the records.”

“Gotcha.”

“No, I really mean it. I do not want you to dummy up the records.”

“You don’t have to say anything more.”

It was clear that no matter what Barney Miller really wanted him to do, Levitt would always believe that Miller wanted him to change the records.

That’s what happens inside any bureaucratic organization with success in the career paths dependent on the hierarchy. People will act in the way they believe they’re expected to act regardless of the words or particular codes that are in place.

But an IPSIG not dependent upon the corporation culture and management is not constrained by that problem. Employees speak more freely to IPSIGs generally than they do to their own corporate colleagues. The IPSIG acts as a type of ombudsman. Credibility is enhanced with the IPSIG making a finding rather than an internal compliance program, once that credibility exists within the corporation, within the marketplace, with regulatory bodies, and with law enforcement. It is probably also true with federal judges when it comes to implementing the sentencing guidelines.

Since the IPSIG’s job is not only to look at dishonesty, illegality, and unethical behavior, but to reduce waste and abuse, and to promote economy, efficiency, and effectiveness, the IPSIG’s acceptance and IG tolerance is enhanced. The IPSIG is seen as being part of the process for the delivery of goods and services in an effective manner, not as an obstruction.

IPSIGs can be used to prevent the company from being victimized, not only from internal employees but from outside companies and corrupt governmental officials. It is very handy for somebody in the company to have an excuse for extortionists – “Look, I would be happy to pay you the money, and I would do so, only I have this IPSIG sitting on my shoulder, and anything we do they catch and report.” It’s like having The Club™ in the car; the thief just goes to another car.

It works internationally when companies having to do business overseas must deal with unknown corporations and governments. Indeed, companies can use IPSIGs in any high-risk areas to deal with contractors and suppliers, by requiring that the vendor hire an IPSIG which reports to that company and to the corporation in question. For example, how can a company who hires the contractor ensure that a contractor is not going to be selling goods that are made

by prisoners or children? The use of an IPSIG – the contractual use of an IPSIG can deal with that problem.

Let me end with a true story. The NYC School Construction Authority (“SCA”) exists because the government of the City of New York was incapable of building schools. The SCA has an IG’s office which prequalifies contractors who want to do business with them.

One company had a problem and the SCA required it to hire an IPSIG. The company objected because they thought it would put them on an uneven playing field. The School Construction Authority IG insisted, and the company eventually had no choice but to do so.

The contract called for the company to have the IPSIG for a period of 18 months. At the end of 18 months, the company found that the internal controls, the reduction in waste, abuse, and fraud, and the promotion of economy, efficiency, and effectiveness had made them much more effective and profitable. And because they were then able to market themselves as a company that had an IPSIG, demonstrating their integrity, they decided after the 18-month period to keep the IPSIG on.

It is a win-win-win-win situation; society benefits, the Sentencing Commission benefits, the IPSIG benefits, and the company does as well. It is, in effect, the compliance program which doesn’t cost. More dollars are saved than is spent on the program. Thank you.

**HOW FAILURES IN CORPORATE VALUES, STRATEGIC PLANNING, AND INCENTIVE AND REWARD SYSTEMS DRIVE ORGANIZATIONAL MISCONDUCT**

MS. DIDIER: Our next speaker is Mr. Gary Edwards. He has been with the Ethics Resource Center for 15 years and has served as its Executive Director for 10 of those years before his promotion to President in 1991. Mr. Edwards has designed and conducted ethics training for companies in numerous industries including manufacturing, financial services, and defense technology. He has led the Ethics Resource Center’s production of a series of award-winning videos designed to help businesses and managers promote greater awareness of ethics issues in the workplace.

Mr. Edwards has also aided more than 130 companies and government agencies in developing and implementing codes of conduct and internal support mechanisms. His clients have included major corporations such as General Dynamics and Martin Marietta. He has testified on the defense industry self-governance initiatives before the House of Representatives Armed Services Committee, and he has also consulted on behalf of ERC for the Internal Revenue Service, the U.S. Postal Service, and the cities of Chicago and Milwaukee. I present Gary Edwards.

MR. EDWARDS: I want to take a few minutes this afternoon to talk about how failures in corporate values, strategic planning, and incentive and reward systems drive organizational misconduct. That’s the title of my remarks.

What I want to do, in a certain sense, is to cut against the grain of the presentations that have been made today and, indeed, to a certain extent against the grain of the work that we do at the Ethics Resource Center, because I want to talk about the inherent limitations of the efforts that are being undertaken.

A word or two about the Center and its role in corporate self-governance. I know many of you are familiar with us, but I know also that many of you are not, and I want to provide that information as briefly as I can as background for the conclusions that I draw.

The Center is an 18-year-old, not-for-profit educational corporation. We were founded with a mission to strengthen public trust and confidence in our institutions, public and private, and to try to do that by raising ethical standards and practices. We were essentially in a business that had no market, at least if you mean by market *demand*, as opposed to *need*. We were set up as a non-profit so that we could be supported by contributions from well-meaning individuals and organizations and begin to try to do work that we thought was necessary.

Many of you are familiar with the research that the Center has done since 1979, including the studies that we published in 1979, 1980, 1985, 1988, and the research project for 1994-1995 which was the National Business Ethics Survey (NBES) that Rebecca Goodell just presented in the morning session.

Our work is direct and “hands-on” with corporations. Unfortunately, of the nearly 150 clients that we have had, about 100 of them have come to us too late; they are the headlines that got it wrong, and they want to know why. More importantly, they want to know how to

stay out of trouble in the future.

We interview their senior executives; we talk to their people in focus groups; we administer a standardized survey instrument to get baseline data to gather information along four parameters: knowledge, attitudes, values, and behavior. After we complete our work, which includes extensive education from the top down in organizations, we then readminister the survey to measure change. That provides some assurance that the company's efforts made a difference, but it also helps them localize where change has not been sufficiently effective. They then can direct scarce resources for ethics in the future to the most important, continuing issues.

One of our better-known clients, mentioned in my introduction, General Dynamics, gave us an opportunity to create what we believe was the first corporate ethics office in any company back in 1985. (There had been an ethics office by name at Dow-Corning, but it was, at the time, a Foreign Corrupt Practices Act audit team.) An ethics office, as conceived for General Dynamics and numerous clients since, is a place to get advice and counsel when you don't know the right thing to do and, when necessary, to blow the whistle internally on misconduct. To our knowledge, an ethics office at a high level within a corporation reporting to the board and to the CEO began in 1985 with General Dynamics. As other statistics have shown you today, they have spread and spread widely.

It was our work with General Dynamics and Martin Marietta that led to our invitation by the Packard Commission to draft the recommendations on self-governance for their report to President Reagan. Those recommendations became the backbone for the Defense Industry Initiative on Business Ethics and Conduct about which Alan Yuspeh provided you information earlier today.

Since 1985, we have worked with about 150 major U.S. and multinational corporations. As I said, most of those are in trouble and come to us too late. But in the last three years, something has happened in our client engagements. Even though the earlier clients were largely international corporations, until three years ago, none of them sent us outside the United States. In the last three years, only one multi-national corporate client has failed to send us all over the globe. Something has changed the opinion of top management in major corporations about the need for a globalization of ethics, along with the globalization of the marketplace. Indeed, what we are learning internationally is causing us to look very hard and very critically at how we can best serve the needs of our clients.

Among the critical lessons that we have learned from our client work, I want to give you just one visual this afternoon. I'm going to talk about the principal causes of serious misconduct in organizations – and I offer this slide as a simple typology of misconduct.

Starting in the upper right-hand corner, there is, of course, the intentional misconduct that benefits the self. That's people who have their hand in the till. They're people who are embezzling from you, stealing corporate resources.

Then, in the upper-left quadrant, there is the unintentional misconduct that benefits the individual. Think for a minute about how smart suppliers have become. They know that in a good corporation, they can't easily corrupt a buyer. Buyers are subject to professional stan-

dards of ethics, special training, and intensive oversight and auditing.

So what do they do? Forget the buyer. They go around the buyer to the design engineer, and they wine and dine that engineer. The next thing you know, the engineer has written specs that can only be met by one supplier. Well, that poor design engineer didn't realize what was happening, perhaps.

Maybe he doesn't deal with buyers very often; didn't get the code of conduct that the buying people got; didn't get the training that the buying people got; and now, he has managed to compromise the process, benefit personally, and is still ignorant of his misconduct until somebody brings him up short.

Down in the bottom right quadrant, we find the unintentional misconduct whose principal beneficiary is the organization itself rather than the individual. That's the familiar tale about the sales or marketing person going to the trade association's annual convention and exposition, and coming back on the plane, finding the competitor's five-year strategic business plan hanging out of a seat pocket ahead as they deplane. They didn't know they were doing anything wrong when they made 50 copies and distributed it around the corporation. They thought everybody was going to win.

It is the fourth, remaining quadrant that I want to talk about. It refers to corporate misconduct which is intentional, witting, and intended to benefit the organization, rather than the individual. Misconduct in this quadrant characterizes many of the problems that bring our clients to us for help. It is the area where we provide the greatest value for our clients, and it is the area which is the most difficult to manage effectively. And it is perhaps the least positively affected by any programmatic attempt to improve ethics and business conduct.

This quadrant includes such things as bribery because, “In this part of the world, how else are you going to do business?” The last several years, as I've mentioned, I've spent a lot of time overseas, particularly in Asia/Pacific. I've talked to over 300 foreign national country managers for U.S. and other western multinational corporations. And I have spoken with numerous expatriate executives in charge of Asia/Pacific for their vast corporations. Most of these folks, indeed virtually all of them, say that the best thing they can do in that part of the world is hire an agent and try not to know what they do with their commission. Of course, they admit that they do know. They just don't want to have any incriminating knowledge.

Bribery is an example of intentional misconduct intended to benefit the corporation. Mischarging, fraud, cutting costs by cutting corners often are intended to help the corporation achieve cost-cutting goals or profit and performance objectives that otherwise are beyond reach.

The first three quadrants in this diagram are addressed quite directly, and can be addressed quite effectively, by ethics and compliance programs. For instance the two unintentional quadrants: if you have good codes of ethics and well-drawn corporate policies and procedures and you train people to them and you provide an ethics office for advice and interpretation, you ought to be able to deal with most uncertainties and ambiguities and prevent most unintentional misconduct. You've got people informed; any misconduct, then, should at least not be unintentional.

In the third quadrant, ethics and compliance programs can also be helpful to reduce the intentional misconduct that benefits one's self. Companies have their audit and security departments, and in addition, line management to deter and detect such misconduct. Additionally, by the creation of an environment where employees are less willing to tolerate the misconduct of others and where they can easily and even anonymously report it, the ethics and compliance office can also have an impact here.

But in the fourth quadrant, we have found conduct that is most likely to result in serious damage to an organization and its reputation and to expose it to serious legal sanctions. Stated differently, the paradigm of unethical conduct in large organizations today is decent people who come to believe that to do their jobs or keep their jobs, they have to do something they absolutely know to be wrong.

These are not people who need a compliance training course; they've had it. They know what the law is; they know what corporate policy is; they've memorized the code of conduct. They know that what they are doing is forbidden. The problem that they have is that they really do come to believe that their misconduct is expected by their management and will be rewarded.

In our experience, these employees are almost always wrong. Now, they are not always wrong. Occasionally bad actors make it very high in some companies. But, generally speaking, employees who draw those inferences are almost always wrong.

We talk to these employees if they're still in the company after they made the decision that put them in the wrong section of the newspaper. If they're gone, we talk to their peers. We ask them how those decisions could have been made and why. They tell a common tale. They woke up one day and couldn't get to the numbers – again. They looked around for signals. They saw that people who hit the quarterly profit and performance objectives succeeded. They went up the ladder; they were promoted. People who didn't were plateaued, shoved off into staff positions, or gone. They understood that message.

They looked around a little more, and they saw Joe, Pete, and Sally, people who cut corners to get ahead, and the system didn't pick it up. Look where they are today. They wondered if there was a message there as well.

They looked straight ahead into the mirror, and they saw somebody 35 years old, smart enough to run the company someday if they could just get the chance. They would not come up short again. Or they saw somebody 55 years of age, with three kids in college and two mortgages. They could not come up short again. Who would need them?

These men and women did what they knew to be wrong, and they rationalized their misconduct because it was expected, and because it was necessary in order to achieve objectives that had been set for them. They became what we describe as morally schizophrenic: people who regard themselves as decent human beings, who take care of their families, volunteer in the community, and care about all the right things. When they go to work, they park their character and their conscience with their car, because "in business you do what it takes." For such people, there is such a thing as business ethics, and it is not as good as their own personal ethics. For

them, business ethics permits, even requires, what is “necessary.”

Examples abound: the Sears automotive centers. In the face of increased competition and declining revenues, management increased performance objectives for sales and service personnel and created incentives for the sales of particular products and services. The result? Widespread consumer complaints and allegations of fraud and the sale of unnecessary parts and services. Did management intend the result? Surely not.

Giant telephone companies were facing increased competition in their primary markets from competitors, competitors who were spared the cost of maintaining aging infrastructure. They tried to increase their own efficiency and expand their sales simultaneously. The strategy? Introduce aggressive quotas for service calls answered per hour and transform service reps into sales reps to sell additional services to residential and business customers when they call for help. The result? Unhappy customers whose service complaints were not properly recognized and met; customers who were billed for additional services that they did not authorize; and the false reporting of time for restoration of interrupted services.

In another example, a large financial services organization called me to address their 150 top executives. They knew about the National Business Ethics Survey; in fact, their CEO wanted that report presented to their people, and they decided it would be interesting if they themselves took the survey during the meeting, storing their responses, and then comparing them to the national data. There wasn't time to administer and discuss all 48 questions. So we gave them ten. Consider now the first two of the questions that we asked, and the answers that they provided.

The first question was, which you will recall from Rebecca's report in the morning session: “Do you ever feel pressured by other employees or managers to compromise your company's standards of ethical business conduct in order to achieve business objectives?” Among the national sample, 29 percent say that they feel those pressures; half of them say that they feel such pressures regularly. Among the 150 top executives in this financial services firm, 52 percent said they felt those pressures.

Next, we asked them if they had witnessed misconduct in the last year that violated the law or their company's standards of conduct. Nationally, 31 percent say they have. Among these 150 top executives in the financial services firm, half of them reported that they had seen such misconduct.

The group became basically unglued at that point. We took a break. We were scheduled to come back and discuss a hypothetical case study. They decided their time could be better spent by talking about what they had just learned about themselves and the culture of their organization. We put a clear transparency on an overhead projector, and we elicited from those executives the reasons why they felt such tremendous pressure to engage in misconduct to achieve business objectives, and the reasons why they witnessed so much misconduct in their own organization.

And the number one reason? The strategic planning process. It wasn't the lack of a code of ethics; it wasn't the lack of ethics training; it wasn't the need for an ethics office or a



hotline. It was the strategic planning process itself. It seems, in that firm, as in too many other of our clients, data is sent up to the top for strategic planning purposes and then, in effect, placed on the shelf. And the real strategic planning begins. And the goals and objectives are set. And, as we learned with this particular client, and as we have heard from others, objectives are too often determined by such things as the desired earnings-per-share outcome. Let's figure out what we've got to make, and then we'll back into what we've got to do, and never mind the information that we requested and got from our field sales organization, our marketing executives, and the external market research that we did.

The second most important reason for the pressures felt by these executives? The incentive and reward system that they had created that rewarded the achievement of those objectives and appeared to be indifferent to, or at best uninformed about, the methods by which those objective were achieved.

What concerns me about that client's experience and what concerns me about the limitations of what the Ethics Resource Center and other good organizations have attempted to do programmatically with standards of conduct, training and ethics and compliance offices, is that we run up against a wall, a limit to program effectiveness. I found the National Business Ethics Survey information when it came into us initially both exciting and disheartening. It's exciting because it seems to demonstrate that investing the time and the effort in the standards and in the training and in the ethics office has a positive and measurable impact across a whole array of variables.

But it's also disheartening because you see not only how much change has occurred, but also what the limits to change are, no matter how high the confidence in the integrity of management. You see that even with a comprehensive ethics program, still nearly half of the people are unwilling to report misconduct. One cannot help but be discouraged. And I guess my message for the audience here today is that we have not done enough, and we may not be doing the right things. This is not to say that we should not have standards, training and ethics offices; I think all those are essential. But I feel that while they are necessary, they still are not sufficient to preserve the integrity of good people in aggressive, competitive environments.

In an era of downsizing and restructuring, reengineering, delayering, and taking the cost out (you know all of the euphemisms), spans of control for many managers have increased beyond their ability to provide the guidance and the oversight necessary for their people. Heightened anxiety about job security combined with increased pressures to reach more aggressive objectives with fewer resources have created in many companies an internal environment that overwhelms and discredits corporate messages about ethics and compliance. What is needed is not more policy; what is needed is not more training, oversight, or sources of advice. What is needed is certainly not another program to prevent misconduct.

What is desperately called for is honest and serious attention to the most basic tools and systems for management. That attention has to come from the very top. It is not enough for ethics officers, for general counsel, for external experts to care. What is needed is for top management to examine the tools they have, to use them honestly, to recognize that not *intending* the consequences does not provide them an *excuse* for them for the consequences. Indeed, serious misconduct may be inevitable when senior management denies the reality of a

competitive environment, when planning is driven by the financial markets instead of the marketplace, and management tries to grow the business faster than the market will allow.

The failure of senior management to provide effective leadership on ethics is not a failure of intent. It's not a failure to give enough speeches about ethics and compliance, and it's not an unwillingness to spend money on compliance programs, on corporate values, credos, and codes of ethics. It's simply a failure to recognize and own their own complicity in inadvertently and unintentionally creating internal environments that undermine the best intentions of their good people and cause them to believe that the price of success is their integrity.

Make no mistake. I'm very proud of the work of the Ethics Resource Center, and I'm encouraged that the sentencing guidelines are causing more companies to address ethics and compliance in more formal and more programmatic ways. But all such efforts are, if not flawed, then severely limited by their inability to penetrate some of the most important drivers of misconduct, the very tools of management itself.

## QUESTIONS & ANSWERS

MS. DIDIER: Thank you. I have a couple of questions. Mr. Goldstock, what will prevent IPSIG personnel from filing *qui tam* suits based on the results of their audits?

MR. GOLDSTOCK: It's an issue that we have looked at. There is, in fact, an IPSIG association, and it meets regularly and addresses the kinds of issues like that, which are of concern to IPSIGs and corporations that would use them. We believe the best way of doing it now would be to have contractual provisions when the IPSIG deals with the corporation. It would state that the IPSIG has a responsibility to report any wrongdoing to the corporation, or, if it's inappropriate, to some outside body, and that they may not file a *qui tam* action, and the employees would have to sign onto that contract.

The only question I see is whether or not that would be void for public policy. If it is void for public policy, then, of course, it's problematic, but no more problematic than the issue of any employee of the corporation filing a *qui tam*, even if that person isn't part of the compliance program process.

MS. DIDIER: This question is for Mr. Edwards. Do the limitations on ethics imposed by the strategic planning process in turn point outside the organization to the nature of financial markets and other external factors?

MR. EDWARDS: Oh, you know they do. There are reasons why executives worry about earnings per share, and they are myriad. They need help; they need help at the board level. They need some assurances that serious strategic planning for the future, the long-term future and profitability of the organization will be rewarded. And they need courage.

We had a client a couple of years ago who had a stranglehold on certain parts of its market and was very successful. But they were in a business whose demand was very predictable. It increased, but it increased on a straight line over time. If you looked at their financials, what you would see was not a straight line but a series of "hockey sticks" every quarter. And we found that curious, and asked about it. And what we found out was that in trying to achieve short-term financial objectives that were increasingly aggressive, the salespeople were consistently pulling forward sales from the future into that quarter from both their direct customers and their distributors. They would use significant price discounts to talk their distributors into warehousing products not yet needed. And that, of course, meant that in the next quarter, sales were nonexistent until you got near the end, and they were suddenly in a panic again, and they had to keep pulling sales forward, and discounts kept creeping upwards.

Well, the company was concerned. They didn't necessarily think it was unethical to discount their products to get sales at the end of the cycle. It probably wasn't meeting the shareholders' best interest, but they didn't think it was deeply dishonest. They were concerned, though, their people were telling them that they were reaching the limits of their ability to persuade distributors to put additional products in their warehouses. And they were afraid that they were going to come to a quarter when they couldn't get to the numbers by pushing more out the door, pulling sales forward, and, then, people were going to get truly creative and do things that were not only dishonorable but criminal.

They decided they had to change what they were doing. They had to quit cold-turkey, basically, and get back to trying to match their sales to the real market demand.

Well, the immediate concern was what this was going to do to the short-term performance of the company. What’s the impact going to be in the financial markets? Their strategy was to sit down with the analysts and explain the reason why their performance was going to suddenly be flat, giving assurances that, in the future, it would not only be back up, but that sustainable growth would be achieved by meeting their market demand, instead of trying to outrun it. I believe the company is making the right decision and that the market will not punish them for it.

Yes, the external forces are tremendous. But if we cannot run our organizations in a way that benefits our customers and our employees without over-reacting to short-term pressures from analysts, we’re going to have a corrupt society of people who believe they have to lie, cheat and steal just to do their jobs and to keep their jobs.

We have watched corporate profits take off in recent years. We have watched the stock market reward those profit surges. Some of those profits have been achieved by extraordinary cost-cutting, the removal of people from their jobs, and increased sales and performance pressures that are put on those who remain. Some of that corporate performance is hollow and cannot be sustained into the future. So we’re going to hear from the market on some of our top corporate performers, and, I think, quite soon. They can’t just keep getting more with less.

MS. DIDIER: This question is for Mr. Goldstock. Because IGs are essentially internal affairs cops, how does an IPSIG avoid the fear and apprehension that is associated with most dealings with internal affairs? Isn’t their apprehension a poor and ineffective way of achieving employee compliance?

MR. GOLDSTOCK: I mean, I think that, in fact, they are not at all like internal affairs cops. I would describe them as – I don’t know what the opposite of an internal affairs cop is, but I think they have very little to do with that. They are made up of people with a variety of backgrounds and skills looking at the processes within the company, the corporation, the union or whatever organization happens to be involved, including, for example, a police department, to see how things are done in order to make them less likely that criminal activity, unethical activity, illegalities will occur.

I mean, I agree wholeheartedly with Gary Edwards. I thought we were going to have a bit of a distinction in what we said, and I must say that I believe that what he was saying is precisely the issue. An IPSIG ought to be taking a look at what the corporation does, how it does it, what the bonus plan is, what contractual provisions there are, how they rate individuals, what the quality of the work is, how the decision making process occurs, in order to put into place incentives to do the right thing and disincentives to do the wrong thing.

The idea is not to catch people committing crimes; it is to stop people from committing crimes. The emphasis ought to be on prevention and to encourage people within the company to value integrity and let the company benefit from that.

MS. DIDIER: This question is for Mr. Edwards. In light of your remarks about top management responsibility for pressures on employees to engage in unethical conduct, can you recommend three specific actions that top management might take that differ substantially from current practice? As an aside to that, what can be done to reduce short-term pressures on corporations and CEOs.

MR. EDWARDS: First, some actions for top management that might be different than their most recent past. With respect to the strategic planning process first – and if this shoe doesn't fit, if you've got yours right, fine. But if you don't have it right, and you're your driving your strategic plan by earnings-per-share or some other externally driven factor other than what your products, services, and market match, try backing away from that and building your strategic plan based on the information that comes up, supplemented and tempered by the external market research that you do.

I know that if you bring the planning information up in an organization, there's a natural tendency for everybody to say they can do less than they know they can. If they tell you exactly what they can do, and then you task on top of that, they fear they will fail. So they'll tell you they can do less than they can do, expecting you to add onto that, and then, maybe, they can succeed. That is a problem of dishonesty in the flow of information upwards that is fed by a history of dishonest actions at the top of the organization in disregarding the information that is provided.

So start by doing a strategic plan from the bottom up; listen to your people; try to get the most honest information you can; and temper it with external market research, that reflects what the customer market will bear, not what the financial market its analysts wish.

Second, look at the incentive and reward systems. I'm not suggesting you ought to have a bonus for being good, but we do get what we create rewards for. So let us think about the specific responsibilities of management and the specific activities of management that will help to create and reinforce an internal environment where decent people will challenge misconduct, will challenge pressures to do the impossible, will challenge dishonest objective setting. Create incentives and rewards for the kinds of behaviors you want to see in your management, behaviors that will create and re-enforce an environment of integrity. Look at your performance management system. What are you identifying, measuring and rewarding? Are those the actions that are going to create the right kind of environment internally?

MS. DIDIER: The next question is addressed to both of you. If aggressive goals and rewards systems can create incentives for misconduct, how do you provide incentives for employees to stretch themselves without such systems?

MR. EDWARDS: That's a reasonable question. You don't want everybody walking around like it's Monday morning all week long. You do want, in the words of the Army, to help people be all they can be, and the stretching is a good idea.

Stretching is one thing; ripping people apart is another. If you start with good information, and you rely on the good information you have, then you know what it is to stretch people's performance. But if you disregard the information, both from your people and from

your external market research, and drive it by the financial markets, you’re not going to wind up stretching people; you’re going to wind up pulling people over the edge.

You want to inspire people; you inspire them with your rewards and incentives systems, but you also inspire them with other kinds of recognition, and the best companies know how to do that. But to get stretch without getting rip, you have to build on honest information.

MR. GOLDSTOCK: I sort of have the same kind of problem answering, but let me sort of attack it from a different approach, and it’s based on the question that was asked before about internal controls in police departments.

I mentioned that a private inspector general could do well within a police department, because I think what they do is different from internal affairs. Internal affairs generally looks at police who are engaging in misconduct and tries to catch them doing that. It seems to me that an IPSIG in a police department would look at how the police department operates, how it enforces certain corruption-type crimes – bookmaking, narcotics, what the spans of control are, and what kinds of policies and procedures are followed in filling out reports and in testifying in court.

The systems are critically important to an inspector general. It seems to me that one role that the inspector general can play is in thinking about stretching the employees’ capabilities, which is important to the programmatic side, and building in the kinds of controls that are appropriate to the stretch. If you are going to ask, for example in that same analogy, for police officers to do more and do the kinds of things where they might cross the line, then the span of control has to drop from an arbitrary 6-to-1 to 4-to-1.

The same thing is true within corporations. To the extent that you encourage employees to do things that approach the line, then internal controls have to increase. To the extent that they are low-risk, non-stretching areas, then they can be relaxed.

MR. EDWARDS: Ron’s concrete illustration of the police reminds me that specifics are better than generalities. In the financial services industry, as an example, there is a huge problem of sales force management. It is a problem in other industries too, but I have had clients struggle with it in financial services. If you take your best salespeople and you make them field office managers, you’ve got one big problem and two responses, both of which are wrong.

The big problem is that you can’t pay them enough. You can’t pay them as much as they can make selling. Yet, you want them to manage the sales force because they understand selling. So what do you do? Well, too often, you give them a book of business to keep so they can sell while they’re managing, and you know what that does for where their attention goes. Second, you give them a rake on the sales of everyone else in the unit. You know what that does to the intensity of their oversight of the practices of those other people. If others are churning accounts, and it’s not too egregious, you don’t want to be too harsh on them; you’ll lose what you’re getting from that, and you may lose them. They’ll fly to a less critical environment and take their accounts with them.

Well, what can you do about that? E.F. Hutton, before the check-kiting scandal, years ago, tried to address that and tried to develop a cadre of professional, salaried sales force managers. Unfortunately, Hutton didn't survive long enough for it to work.

My point is that you should look at the very specific drivers of particular risks in given functions within your organization and see if you can't deal with the unintended incentives toward misconduct and pull them back and restructure and reorganize the function and re-incent the behavior.

### QUESTIONS & ANSWERS – WRITTEN

*Gary Edwards*

Q. Have you identified any causes of variation in the personal ethics and integrity of CEO's (*e.g.*, age/generation)?

A. I have not noticed differences among CEOs that correlate to age, nor in terms of personal ethics or integrity, nor have I seen any remarkable differences from one industry to another. I have a concern, however, for the rising managers of today who aspire to be the chief executives of tomorrow, they, like most young Americans today, are products of a culture and an educational system that have largely abandoned responsibility for the inculcation of moral virtues. Great executives will need first to be great people, and a lack of moral preparation may leave them ill-suited for the leadership required in a globally competitive economy.

Q. Can you cite specific examples of reward system solutions that work?

A. If your objective is to create and maintain an ethical business environment where decent people make good decisions, make them for the right reasons, and never come to believe that they are expected to violate conscience or company standards, the keys for achieving that objective are leadership, communication, and proper incentive/reward programs.

The requirements of leadership are not only of the CEO but also of every manager. And the requisite leadership is more than speeches. It goes, again, to strategic planning and proper management systems.

Communications about ethics require that managers talk about company values and standards at the beginning of each year when they go over the year's goal and objectives for each of their employees. When they sit down with their employees to review performance on a quarterly or other regular basis, they should again speak of the company values, its standards, and the necessity of achieving its business objectives consistent with them. And on those exceptional occasions when performance has gone off the rails and management

must intervene, it is critical to communicate that the now more difficult to achieve objectives may only be reached ethically. This practical linking of a subject most managers never talk about, ethics, to the subject they constantly communicate about, performance, can help maintain the proper balance in the attitude and performance of employees.

The incentives reward system is a major driver of behavior; therefore, managers' own compensation ought to be significantly linked to their leadership on ethics. Practically speaking, this means that the linking of communication about ethics and performance objectives that I just described must itself now become an explicit responsibility of each manager, with contingent compensation tied to its accomplishment. Additionally, managers should be required on a regular basis, perhaps monthly, to discuss the ethic issues facing their part of the business. Those meetings must be regularly scheduled and their content documented. Again, significant compensation should be contingent upon meeting such obligations. Furthermore some part of compensation could be tied to the upward evaluations of managers with respect to their ethical leadership, their openness to ethics questions, and to the timeliness and objectivity of their investigation and discipline of misconduct.

- Q. You hit the nail on head: Profit is a necessary condition of the corporation but not the reason for the corporation; goods and services are. This is a deep-seated issue of culture in the corporate sector and society. Corporations reflect social values. Where do we begin? Are we diminishing our social capital as Francis Fukuyama contends in his book Trust?
- A. The modern corporation is a creature of the state. It provides a means for capital formation with limited risk and limited liability in order to produce goods and services. Whether the production of those goods and services will yield a profit is what business management is about. Poor products or excellent products without a market are already ethical failures on the part of management, for it has failed on its responsibility to shareholders or owners. When managers attempt to overcome poor planning, market research, design, manufacturing or distribution problems through dishonesty, cutting corners, failure to test or inspect, they undermine the trust of their own employees and, ultimately, their customers and the larger society. Trust in the goodwill and honesty of business people must be earned, and where it is absent the state intervenes to protect and to regulate. So the cost of a failure of trustworthiness is both inefficiency and loss of autonomy in making business decisions. These are costs which increasingly affect competitiveness in a global economy.
- Q. The federal False Claims Act provides a financial incentive for employees not to report misconduct but accumulate evidence, file a secret lawsuit (*qui tam*), and make money. How can a corporation foster the climate and culture you describe in the face of this powerful incentive?
- A. It was the collective wisdom of Congress that substantial financial incentives



- Q. How does senior management draw the line between “stretch goals and unrealistic expectations”?
- A. With honest information brought up from the field and tempered by external market research. Companies can create a much more honest flow of information simply by rewarding it and punishing the self-serving misinformation when it is put into the system. For many companies, this will require an utter transformation but, however daunting, it is both achievable and absolutely necessary to have honesty in the planning, budgeting, and reporting process in order to build and sustain an ethical culture within a company.
- Q. Do you believe that the guidelines emphasize techniques that are inherently limited? If so, how can the guidelines be improved?
- A. My principal concern about the guidelines lies not in their techniques but in their focus on compliance as the objectives and compliance training as an important means for achieving the objective. I recognize that the guidelines are richer than this characterization, and that they fully expect that mitigation will require an “effective” program. Although I believe that the Commission is wiser than this, I find that too many of my clients understand the task to be the provision of lectures on legal and regulatory compliance. Such training may be necessary, but it is not sufficient and, in the experience of our clients, it is only minimally relevant to achieving compliance. Again, in our clients’ experience, most serious misconduct is not the result of ignorance of the law or its penalties. It is, too frequently, intentional misconduct undertaken on behalf of the corporation in order to achieve aggressive business goals. Those who engage in such conduct know that it is wrong and believe that it is expected of them and necessary for success. Compliance training misses the mark by not addressing the systemic nature of the pressures and incentives that drive misconduct. It is **not** ignorance. I am not certain how to improve the guidelines other than to encourage management and, finally, judges to attend the management systems and leadership that ultimately drive behavior within the organization.
- Q. In light of your remarks about top management responsibility for pressures on employees to engage in unethical conduct, can you recommend three specific actions that top management might take that differ substantially from current practice?
- A. First, honest strategic planning informed by customer need and market demand. Communicate honestly, internally and externally, and quit trying to drive planning by desired earnings per share. Second, share responsibility for failure. Don’t necessarily punish the employee who fails to reach objectives. The fault may lie with what his or her manager said could be done with the resources available. If so, take the measure of that manager and of that manager’s manager who failed properly to review the plan and its assumptions. If goals were unrealistic and poorly informed, then, just as the rewards for

success cumulate to the top, so should the penalties for failure. If the company fails to meet the plan because the plan was fundamentally dishonest, every higher level of management that approved that plan is increasingly responsible. Third, compensation plans for senior management should be reviewed and restructured, as necessary, to reward honest planning and communication and their contribution to the long term success of the company.

*Ronald Goldstock and Gary Edwards*

- Q. If aggressive goals and reward systems can create incentives for misconduct, how do you incent employees to stretch themselves without such systems?
- A. (Ron Goldstock) Internal controls are designed to stop bad people from doing bad things; they invariably present hurdles when good people want to do good things. The IPSIG is invaluable for the corporation which seeks to save its honest employees from seeing those controls as obstructions; it can serve as an independent and objective mechanism for waiving certain constraints and monitoring the activity of the corporate activity operating under such waiver. Appropriate sole source contracting under IPSIG oversight in one such example.
- A. (Gary Edwards) In an advanced service economy the key to productivity and to quality lies in the ability of employees to identify their own values and aspirations with those of their company – in effect, to bond to the company, to so care about its performance that they will make every effort to ensure its success. Incentives and reward systems are still of importance but let them be tied well to behavior that advances and secures those values deemed critical for success.

*Ronald Goldstock*

- Q. What will prevent IPSIG personnel from filing *qui tam* suits, based on results of their audits?
- A. The issue of *qui tam* suits is, of course, problematic for any company which provides its employees or contractors access to internal documents and procedures. It may, however, be possible to contractually provide that while the IPSIG has an obligation to notify the government of its losses through fraud, it may not itself profit from doing so.
- Q. Because IG’s are essentially “internal affairs” cops, how does an IPSIG avoid the fear and apprehension that is associated with most dealings with “internal affairs”?
- A. IPSIG’s are not “internal affairs cops” as that term is commonly understood, *i.e.*, to have as its primary function the investigation of employee wrongdoing

with an eye towards criminal prosecution. The IPSIG's goal is to work with the host organization and its employees to develop and implement internal controls which will prevent the commission of criminal activity and to promote efficiency and effectiveness. Given its emphasis on IG toleration and its independence of the traditional corporate culture, the IPSIG tends to promote trust and win employee confidence.

- Q. I can see why a company would welcome an IPSIG if it is in trouble and needs to convince the government it can be trusted. Can you briefly summarize the advantages for a company that is not in trouble?
- A. The advantages to the host corporation are numerous, but the specifics frequently depend on the specific issues that confront that organization and the economic and regulatory environment in which it operates. In general, the IPSIG can be used to protect the host from dishonest employees and unethical vendors and to maintain or regain both the fact and image of organizational integrity and corporate citizenship. It clearly serves as a model compliance program for sentencing guideline purposes, and, because the properly utilized IPSIG promotes economy and efficiency and controls waste and abuse, it provides substantial financial savings.

***[Note: This completes Day One of the Symposium. Please download files for Day Two of the Symposium from [HTTP://WWW.USSC.GOV](http://www.ussc.gov) (Research/Reports Library) to complete the entire proceedings book.]***

*Day Two*

## **An Update on Cases**

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**John Scalia, Jr.**, *Research Associate, U.S. Sentencing Commission*

**Kirk S. Jordan**, *President, Compliance Systems Legal Group*

*Moderator:* **Commissioner Michael Goldsmith**, *U.S. Sentencing Commission*

## **CASES SENTENCED UNDER THE GUIDELINES**

COMMISSIONER GOLDSMITH: Our next session deals with cases sentenced under the organizational guidelines. Our next panel will provide a preliminary look at this topic.

Because answering the question, “What do the cases show?” requires a two-part answer, we have two speakers: John Scalia of the Commission’s research staff, and Kirk Jordan of the Compliance Systems Legal Group.

The reason for this two-part approach is as follows: The guidelines have thus far been applied only to cases involving more recent conduct; and, second, bigger cases typically have a longer gestation period. Sentencing Commission data, on which John Scalia will report, may not tell the full story of the guidelines’ impact, especially on larger companies. Kirk Jordan will therefore provide a fuller picture of the relevance of compliance programs by talking about criminal cases that, while technically pre-guideline, appear to have been influenced by guideline factors. He will also talk about civil cases in which compliance has proven to be relevant.

John Scalia, Jr., is a research associate at the U.S. Sentencing Commission. In this capacity, Mr. Scalia has served on numerous working groups dealing with white-collar crime and organizational defendants. He was responsible for collecting the past practice sentencing data on organizational defendants. These data were used to inform the development of the Chapter Eight guidelines for organizations. He continues to oversee the collection of data on organizational sentencing pursuant to the guidelines.

Kirk S. Jordan is the President of Compliance Systems Legal Group, a law and consulting firm in Warwick, Rhode Island. Compliance Systems Legal Group designs and implements compliance programs for organizational clients and is a leader in the development of interactive, computer-based ethics and compliance training applications. Before founding Compliance Systems Legal Group, Mr. Jordan was associated with the law firm of Skadden Arps. Mr. Scalia?

MR. SCALIA: Thank you, Commissioner. When the Commission began developing the organizational guidelines, no comprehensive database of past sentencing practices for organizational defendants existed. Consequently, the Commission did extensive empirical research on organizational sentencing practices in the federal courts.

The Commission’s study revealed that a very small proportion of the federal caseload actually involved organizational defendants. Of the approximately 40,000 criminal cases sentenced each year, fewer than 400 involved organizational defendants. Chart 1 indicates that the number of organizations sentenced each year is fairly stable, between 300 and 400 cases a year.

Since the organizational guidelines went into effect in 1991, 208 organizations have been sentenced pursuant to Chapter Eight according to documentation received by the Commission as of June 30, 1995. The Commission received an additional 72 organizations that were sentenced pursuant to the former antitrust guideline that was in place prior to the Chapter Eight guidelines. Chart 2 describes the number of organizations sentenced each year pursuant

to the guidelines.

Why so few cases? Most of the organizational cases are rather complex frauds or market allocation agreements that involve lengthy investigations before charging decisions can be reached. Second, even though the Chapter Eight guidelines took effect in November 1, 1991 (and according to statute should be applied to all sentencings that occur on, or after, that date), the Department of Justice has instructed prosecutors, in light of relevant court decisions, the guidelines should only be applied to offenses that occur on, or after, November 1, 1991. Therefore, consistent with the Commission's expectations, the majority of the organizations sentenced over the past four years are sentenced pursuant to pre-guideline rules. Of the 197 organizations sentenced during fiscal year 1994, only 106 (or 54 %) were sentenced under the guidelines.

The Commission's data indicate that the majority of organizations sentenced for criminal offenses are closely held organizations. From its study of pre-guideline practice, the Commission found that approximately 90 percent of the organizations sentenced involved closely held organizations. Under guideline practice, approximately 97 percent involved closely held organizations. Openly traded organizations, public traded organizations, typically account for a relatively small percentage, approximately nine percent of past practice and only three percent of guideline practice.

Why are we seeing a significantly smaller proportion of publicly traded organizations? These cases tend to be larger and more complex, and it often takes longer for them to work their way through the system. Secondly, prosecutors may be opting to pursue these cases civilly rather than criminally. (Kirk Jordan is going to talk about the civil cases and large non-guideline criminal cases.) In time, we should see more publicly traded organizations sentenced under the guidelines.

Consistent with the fact that most of them are closely held organizations, owners and top management are frequently named as co-defendants and convicted in tandem with the organization. Of the 264 closely held organizations sentenced thus far, an owner or top executive was convicted in approximately 51 percent, or 134, of these cases; 189 owners or top executives were convicted in all.

Consistent with what Bill Laufer found in his study, the organizations sentenced under the guidelines typically employ fewer than 50 people. Chart 3 indicates that the overwhelming majority, 56 percent, employed fewer than 20 persons, and another 23 percent employed between 20 and 100 people. A very small percentage employed fewer than 500. Under the Small Business Administration criteria, those organizations employing fewer than 50 people would be classified as extremely small organizations.

The organizations sentenced under the guidelines tend to be fairly new. Fifty percent have been in business for less than 15 years. Antitrust defendants have typically been in business or significantly longer, about 37 years. Most of the organizations continued to operate after indictment and conviction; however, many had ceased operations or were experiencing financial stress at the time of sentencing. Chart 4 indicates that 22 percent went out of business sometime around indictment or before sentencing; three percent were undergoing bankruptcy;

ten percent were undergoing some other financial stress; and 65 percent remained solvent and operating.

The guidelines provide for a corporate death sentence for organizations identified as criminal purpose. Under the guidelines, an organization that is defined as criminal purpose is divested of its assets. Fourteen organizations have been sentenced under this provision of the guidelines.

Chart 5 indicates that the majority of the offenses for which defendants were convicted are either antitrust offenses, representing 32 percent of the offenses; fraud offenses, about 30 percent; environmental, 12 percent; tax violations, 9 percent; and food and drug violations, 3 percent. As Rusty Burress pointed out yesterday morning, the environmental and the food and drug violations are not covered by the guideline fine provisions.

With respect to the fraud offenses that have been sentenced, the loss to the victims is relatively modest. The loss is typically less than \$30,000. In only seven of the cases did the loss actually exceed \$1 million.

With regard to the antitrust offenses, the volume of commerce that was affected by the offense was typically less than \$4 million; however, in nearly a third of the cases, the volume of commerce did exceed \$10 million over the course of the offense.

The culpability score is an essential part of assessing the organization's blameworthiness with respect to the offense. The most significant culpability factor has been level of authority and the size of the organization. Chart 6 describes the application of this factor. Because most of the organizations are small receive no enhancement or only receive a one-point enhancement for this adjustment: 46 percent received no enhancement; 38 percent received a one-point enhancement; and only one organization, which would be a 5,000-person organization, received a five-point enhancement.

Some of the other culpability factors, such as prior history, violation of an order, and obstruction of justice, are rarely applied. According to past practices, these factors were rarely present in those cases.

Four defendants apparently have sought credit for having a compliance program, but credit for a compliance program has only been awarded in one case. While the defendant did receive credited for having an effective program, the unique facts of this case limit its usefulness as a model – especially for larger companies. The defendant was in the business of selling smoking paraphernalia. Due to the nature of the products sold, the defendant recognized the inherent risk of selling those products: the products could be used as drug paraphernalia, which the sale of is prohibited under federal law. In order to prevent violations of the drug paraphernalia laws, the organization produced a training video to instruct employees that they should refuse to sell items to any customer who inquires about drug paraphernalia or indicates that the items will be used as such. The court felt that given the small size of the organization, a videotape in conjunction with verbal instructions issued by the owner represented an appropriate degree of formality to prevent and detect violations of the drug paraphernalia law. The organization was credited with having an effective program.

In the three other cases in which the defendant claimed to have a compliance program, credit was denied. The court cited the following reasons for not applying the mitigation: (1) The corporate president was actively involved in the offense conduct; (2) the corporate president, while not actively involved in the offense conduct, was aware of the illegal conduct; and, (3) while the parent organization had an effective program, the program was not in effect at the time of the offense at the newly acquired subsidiary where the offense actually occurred.

The last culpability factor is self-reporting, cooperation, and acceptance of responsibility. Chart 7 indicates that 87 percent of the defendants received credit for accepting responsibility to some degree. Chart 7 also indicates that most defendants received two points for cooperation; others received one point for acceptance of responsibility. Three defendants did receive the full five points for self-disclosure of the offense. In each of these three cases, the defendants were under investigation. As the defendants conducted their own internal review regarding the nature of the infractions, the defendant informed the government of the pertinent facts.

Under the guidelines, approximately 80 percent of the organizations received a sentence that included a criminal fine. The average fine imposed was \$376,000. Chart 8 indicates the average fine imposed on the organization by offense type. It indicates that the highest fines were paid by antitrust defendants and fraud defendants.

Just as an aside, there was one racketeering defendant and it was sentenced as a criminal purpose organization – the organization was divested of its assets.

Chart 9 compares guideline practice with past practice. The chart indicates that the fines have increased significantly, mostly as a result of the antitrust and the fraud cases.

Restitution was ordered in about 33 percent, or 68, of the cases. The average amount of restitution was nearly \$300,000.

In promulgating the Chapter Eight guidelines, the Commission emphasized the importance of probation as a sanction. Because probation provides a means of maintaining control over an organization following an offense, the guidelines require probation under certain circumstances.

Under the Chapter Eight guidelines, probation has been ordered in 61 percent of the cases. Consistent with the directive in Chapter Eight, this represents a significant increase over past practice. Under pre-guideline practice, probation was ordered in only 21 percent of the cases. The data indicate that probation was imposed in 72 percent of the cases primarily to secure payment of monetary penalties; however, in 14 percent of the Chapter Eight cases, the defendant was ordered to implement a compliance program to prevent and detect future violations. The case documents, however, provide no detail on how the program should be implemented.

The Commission’s data is available through the University of Michigan. There are four data files, two for past practice and two for guideline practice. You can contact the Commission on how to specifically obtain that data. Thank you very much.



## COMPLIANCE CRITERIA IN CONSENT DECREES

MR. JORDAN: Good morning. In the fall of 1993, C. R. Bard, Inc., a medical device maker, settled civil and criminal charges arising out of the company's manufacture and shipment of allegedly defective heart catheters. Part of Bard's plea agreement included a far-reaching compliance program. In reading that agreement, and in particular, the compliance program imposed on Bard, I was struck by how closely the compliance program tracked the organizational sentencing guidelines' seven due diligence criteria. This was true even though the Bard case technically was not covered by the organizational sentencing guidelines – because the conduct at issue had occurred prior to the effective date of the guidelines and, of course, the case had pled out prior to trial.

After the Bard compliance program came down, we undertook an informal review of other consent decrees and plea agreements entered since the guidelines became effective, in which compliance programs or portions of compliance programs have been imposed. Some of these pre-dated Bard, and many have come after. To date, we have looked at about three dozen such compliance programs and plea agreements.

Our survey was not exhaustive. As you might expect, it is difficult to track all of these down. Many are unreported. However, I think we have a representative sample here in the three dozen, and I think we have most, if not all, of the major cases in which compliance programs were imposed.

As the data reflect (*see* charts following John Scalia's presentation), since the guidelines became effective, compliance programs have been imposed by a cross section of regulatory agencies in connection with the settlement of a variety of underlying civil and criminal offenses. It is important to remember that technically none of these cases falls under the organizational sentencing guidelines for the reasons I mentioned about the Bard case; either the conduct at issue occurred prior to November 1, 1991, or they're civil settlements. Nevertheless, the compliance programs imposed in these cases provide some guidance on what the government is looking for in an organization's compliance program.

I would like to make a few general observations about the consent decrees and then highlight some of the main compliance criteria contained in these consent decrees and plea agreements.

First of all, a few general observations. Several of the compliance programs closely track the organizational sentencing guidelines' due diligence criteria. Bard is one that I have already mentioned. Bard was primarily a criminal case. The Grumman case is another. It was a civil settlement intended to head off the filing of criminal charges against the company. And the Lucas Aerospace case is another one that is a criminal case but closely tracks the organizational sentencing guidelines' requirements.

The National Medical Enterprises (NME) case and the Caremark case – we heard about NME yesterday. Both settled health care fraud and related charges, and the compliance programs imposed are very similar to each other. Those two programs also incorporate a fair portion of the organizational sentencing guidelines' due diligence criteria.

I would like to make a couple points in particular about the Bard, Grumman, and Lucas cases, and these points do apply to some of the other cases on the table.

First of all, the Bard, Grumman, and Lucas cases all closely follow the guidelines. In fact, the Grumman and Lucas cases almost lift the language verbatim from the due diligence criteria section of the guidelines. All three involve large companies – I think they’re all public companies – which may be at odds with some of the information we have been talking about earlier and the information contained in last week’s Wall Street Journal article. And all three of these would have been organizational sentencing guideline cases if the conduct had occurred after the effective date of the guidelines and the cases had not pled out prior to trial and conviction.

The second point is that several of the more detailed compliance programs, including, for example, the Bard case, Grumman, Lucas, and the Caremark case, are designed to prevent and detect violations of all laws affected by the company’s business operations, not just the type of violations at issue in the underlying settlements. For example, the Grumman and Lucas programs are supposed to prevent all “improper business conduct.”

The instances where compliance programs have been imposed cut across the enforcement agencies and involve both civil and criminal prosecutions of a variety of underlying offenses. If we discuss these cases by agency, we see that the Department of Justice has been the most active, both through its Criminal Division and its various Civil Divisions. In fact, the Department of Justice Civil Antitrust Division was responsible for settling the largest single group of consent decrees in which compliance programs were imposed. There are approximately 15 antitrust compliance settlements. The compliance programs imposed in connection with those settlements tend to be the same one to the next. The language is almost identical.

The Department of Justice, with respect to criminal cases, usually collaborated with one of the regulatory agencies. For instance, in several cases DOJ’s criminal division collaborated with the EPA to settle environmental offenses, and, in many cases, there were parallel civil and criminal prosecutions.

In the environmental area, we see that there is not much distinction between the compliance programs imposed in cases settling civil versus criminal allegations. As an example, I point you to the Louisiana-Pacific case, which was a civil settlement of a Clean Air Act violation in which a rather rigorous compliance program was imposed, and compare that program to the Consolidated Edison case, which settled criminal charges arising under EPCRA. In the Con Edison case, a court-appointed monitor is directed – as part of probation that the company is put under – to develop and implement an effective program to prevent and detect violations of environmental laws under the standards established by the organizational sentencing guidelines.

The Department of Justice also collaborated with the Department of Health and Human Services on two major health care fraud cases: the National Medical Enterprises cases and the Caremark case. We heard about the NME case yesterday from John Meyers. The compliance programs imposed in connection with these two settlements are very similar. And, as John

Meyers pointed out yesterday, the NME case, which was the first of the two, is expected to be a model in this area.

A legitimate question from all of this is: Are there any trends? The consent decrees and plea agreements that we have seen show some similarities across offenses – that is, if it is an antitrust offense, you have a good idea what your compliance program is going to look like. Similarly, if you settle health care fraud charges, you know that you are going to have a consent decree that imposes a compliance program like the one in the NME and Caremark case. And if you work in the FDA-regulated area, you would want to take a look at the Bard case. But I think it is too early to identify any specific trends that cut across the enforcement agencies.

It appears that the consent decrees and plea agreements reflect little, if any, policy coordination across the various enforcement agencies, and I think this would be very useful to companies. It would give companies some predictability because companies' operations obviously cut across enforcement agencies. And perhaps we can hear a little bit about this from the enforcement community later today.

Having said all that, and although there doesn't appear to be any direct policy coordination across the enforcement agencies, there are certain elements that tend to recur in these compliance programs, that are worth noting. The first, and one that appears to be very significant to the government, is the establishment or reaffirmation of strong compliance oversight, and management systems generally involving the appointment of a compliance officer, senior management involvement, and active participation of the board of directors.

For example, all of the antitrust compliance programs require the appointment of an antitrust compliance officer to be in charge of the company's antitrust compliance program. In the Bard case, we have the appointment of a compliance coordinator to oversee the company's entire compliance program. In Caremark, we have a compliance officer. In Grumman, there is a vice president of audit and ethics.

The government does not appear to be too concerned, at least in these cases, about who the compliance officer is. He or she clearly has to have sufficient power and authority to meet the guidelines' requirement, but doesn't necessarily have to be a lawyer; in Caremark's case, it is the CFO; in Bard's case, it is the vice president for scientific affairs.

Another feature of many of these compliance programs is the creation or reconstitution of board committees to monitor compliance within the organization and to interface with compliance officers. These committees are often made up entirely of outside directors or a majority of outside independent directors. These committees are expected to take an active role in the compliance efforts, reviewing codes of conduct and other policy statements, interfacing with compliance officers, getting reports on a regular basis from compliance officers. And I point you to the Bard case, Grumman, NME, and Summerville National Bank, among others, as examples of cases where strong board committees have been appointed.

Also, we see in many cases the reconstitution or creation of new senior management committees to take some responsibility for compliance and to give overall corporate direction to the company's compliance program. The compliance officer is usually a member of these

committees.

Several of the consent decrees discuss the issue of the delegation of substantial discretionary authority. The Bard, NME, and Caremark cases have language treating this issue, and in a related provision, several of the programs, including the health care fraud compliance programs and the Grumman case, require that managers and supervisors’ efforts to promote adherence to the company’s compliance program be an element of the manager’s performance appraisal process.

Many of the consent decrees also require companies to continue, update, or adopt new codes of conduct or similar written compliance policy statements, and also call for the drafting of additional written policies and procedures which are designed to prevent the recurrence of the misconduct underlying the settlement.

A majority mandate some form of training. The antitrust compliance programs require an annual briefing on the antitrust laws to key employees. The more detailed programs typically require some training of virtually all employees. These would include the Bard, the NME, Caremark programs; Denny’s, which was a civil case settling public accommodation laws violations; and Grumman and Lucas also appear to require such training. Several make it clear that the training must be administered on an annual basis to all employees.

To the extent that the programs treat the issues of monitoring and auditing, two features seem to be emphasized: misconduct reporting systems – and where these are stressed, the feature that the employee be able to report it without fear of retribution is very important. Audits are also emphasized. The important factor there is that the auditor should be independent of the facilities or personnel they are auditing – not necessarily an outside auditor, but independent.

Few say much about enforcement. The most substantial is the Bard case, which tracks the guidelines language by requiring the creation of an organization-wide consistent disciplinary system for compliance violations.

To the extent that the decrees treat the issue of appropriate responses after an offense, three things are emphasized: conducting investigations, halting any ongoing violations, and requiring the reporting of substantiated offenses to appropriate governmental agencies.

Finally, these cases make one more point: if a compliance program is imposed, the government and the courts can be expected to be intimately involved in the company’s subsequent compliance efforts, and in the company’s actual business operations. Virtually all the decrees have one or more of these features, and they’re very similar to the probation provisions of the organizational sentencing guidelines. You have court appointed monitors to oversee the company’s compliance program. You have consultants who have full and unfettered access to books and records and to people in the organization. Also, companies are often required to get approval for all or part of their programs from the government or the courts. Many of the companies must give regular reports to the government or the appropriate regulatory agency, in some cases as often as every four months. The lesson here is, to echo what John Meyers said yesterday, a company is much better off voluntarily putting a

compliance program in place rather than having one put in place in response to a consent decree or a plea agreement. Thanks a lot.

## **QUESTIONS & ANSWERS**

COMMISSIONER GOLDSMITH: Mr. Scalia, you have indicated that only four organizations had sought credit for a compliance program. The questioner says, "I thought the Sentencing Commission had reported that 31 organizations sought credit between November 1991 through 1993, and eight in other cases in 1993 to 1994."

MR. SCALIA: No. In our annual report, in the past two years we have only reported four. The first year we had the drug paraphernalia case, and then last year we reported that three cases didn't receive credit for their programs.

COMMISSIONER GOLDSMITH: Mr. Jordan, you mentioned officer and board involvement. Can you comment on director and officer liability?

MR. JORDAN: Well, I think actually Richard Gruner can speak to that at length. As some of you may know, under the ALI corporate governance principles, board members and senior management are subject to potential personal liability if they have not instituted adequate compliance controls and procedures, particularly in a public company.

I think the government's intent here with respect to the establishment of strong compliance and oversight structures at the top is to involve the highest governing bodies in the organization with the company's compliance program.

COMMISSIONER GOLDSMITH: Mr. Scalia, have any companies been found to violate probation? If so, what happened? Have any assistant U.S. attorneys verified compliance with probation requirements, especially those dealing with compliance programs?

MR. SCALIA: Unfortunately, the Commission doesn't collect post-sentencing information, so we don't have any way of knowing to what extent companies violate probation.

## **QUESTIONS & ANSWERS – WRITTEN**

### **UPDATE ON CASES PANEL**

*Kirk Jordan*

- Q. You mentioned officer and board involvement. Can you comment on director and officer liability (1994 A.C.I. Corp. Governance)? Discuss affirmative duty.
- A. The imposed compliance programs suggest that the government places great importance on the establishment of strong compliance oversight and management systems, including senior management and board involvement. Thus, in examining organizations' compliance programs, the government is likely to take a hard look at whether officers, senior managers, and, particularly for a public company, the board of directors are active in overseeing and

monitoring the organization's compliance programs. At the same time, emerging standards of liability, in such pronouncements as the 1994 ALI Principles of Corporate Governance and the 1994 Corporate Director's Guidebook, suggest that officers and directors have an affirmative duty to ensure that the organization establishes adequate compliance systems and controls. These pronouncements suggest that officers and directors may face personal liability for failing to do so.

- Q. It seems the government is seeking different compliance requirements in different cases. Do you have insight into why? Are you persuaded these differences make sense?
- A. There appears to be little, if any, policy coordination among the Department of Justice and the assorted regulatory agencies that have imposed compliance programs since the guidelines became effective. However, two points should be emphasized: The compliance programs imposed for the same type of offense tend to be very similar. For example, the imposed antitrust compliance programs are almost identical, and the programs imposed in the National Medical Enterprises and Caremark cases, both for health care fraud and related violations, are very similar. Second, certain elements tend to recur across the consent decrees and plea agreements in which compliance programs were imposed. These elements generally track – and, more importantly, flesh out – the guidelines' due diligence criteria: strong compliance oversight and management structures, including the designation of specific personnel to oversee compliance; the creation and communication of compliance standards and procedures; monitoring and auditing systems, such as hotlines and independent auditors; and violation response systems.

*Day Two*

## **Carrots and Sticks Amid Overlapping Enforcement Schemes and Policies: Finding Government’s Message**

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**The Honorable Eleanor Hill** , *Inspector General, U.S. Department of Defense*

**Bruce L. Drucker** , *Deputy Assistant Inspector General for Criminal Investigative Policy and Oversight, U.S. Department of Defense*

**William B. Lytton** , *Vice President and General Counsel, Electronics Sector, Lockheed Martin Corporation*

**David N. Yellen** , *Assistant Professor, Hofstra University Law School*

*Moderator:* **Win Swenson** , *Deputy General Counsel/Legislative Counsel, U.S. Sentencing Commission*



**COORDINATING ENFORCEMENT UNDER THE DEFENSE DEPARTMENT'S  
VOLUNTARY DISCLOSURE PROGRAM**

MR. SWENSON: Good morning, again. At yesterday's lunch, Senator Kennedy spoke of the guidelines' promise of reduced penalties for companies that act as good citizens. But he also cautioned that if collateral, non-criminal penalties that a company might face do not turn on the same good citizenship criteria, the value of the guidelines' promise – and the policy that underlies that promise – may be diminished.

When it wrote the organizational sentencing guidelines in 1991, the Sentencing Commission recognized that companies facing guideline penalties might well face other kinds of collateral sanctions. However, the Commission determined that the question of coordinating criminal and other penalties was largely beyond its jurisdiction and control. The guidelines do permit courts to take collateral penalties into account in choosing the fine within the allowable guideline range, but that is really the extent of coordination of penalties under the guidelines.

Today we reopen the discussion, without taking a position on it at this point, but with a significantly broader view because coordination issues really go beyond the question of whether guideline penalties should better account for other sanctions. Coordination issues fundamentally include the question of whether the many enforcement tools and policies used by the federal government are in sync. I think that was the thrust of Senator Kennedy's remarks yesterday.

Exploring these issues this morning will be three distinguished speakers with distinct backgrounds: one from government, one from a large corporation, and one from academia.

Our first speaker is the Honorable Eleanor Hill. Since March 1995, Ms. Hill has served as the Inspector General of the Department of Defense. In this role, she oversees what might be considered the largest and best established government coordination policy: the Defense Department's Voluntary Disclosure Program. This program will be the focus of Ms. Hill's remarks this morning, and in keeping with our policy of trying to keep the train running on time, I'll refer you to the program book for a full description of Ms. Hill's most impressive bio. But let me say here that she has had a remarkable career in a relatively few number of years, spanning work in Congress, as a federal prosecutor, and a trial attorney.

Before calling on Ms. Hill, I should note that due to the press of other obligations, she is going to have to leave following her remarks. However, we are pleased to have Bruce Drucker here to answer questions that you may have in the wake of Ms. Hill's remarks. Bruce is the Deputy Assistant Inspector General for Criminal Investigative Policy and Oversight, and I guess in practical terms, Ms. Hill's point person for the voluntary disclosure program.

On that note, it is my very great privilege to introduce the Honorable Eleanor Hill.

MS. HILL: Good morning, and thank you for the opportunity to be with you here today. I am particularly pleased to be even a small part of the efforts of the Sentencing Commission to work with you on the very important issue of corporate crime in America. As Win mentioned, I have been Inspector General at the Department of Defense for only about six

months now, so I am still relatively new in dealing with the Defense Department’s voluntary disclosure program. However, in my prior life, both as a federal prosecutor and as a staff member in the U.S. Senate for almost 15 years working a lot on crime issues and law enforcement issues, I can tell you that I am very familiar with the issues you are looking at – corporate crime, the issue of compliance, corporate good citizenship.

In fact, in the Senate I can remember – only too well, perhaps – the many long hours of work that went into drafting and negotiating the final passage of the legislation that gave birth to the Sentencing Commission. I can tell you that many people worked very, very hard to get that legislation passed and to get it done in what they felt was the best way. So I am particularly pleased, and it is very reassuring to me, to be here many years later and see that the Commission is not only a leader in reforming the sentencing process, but is also working very hard with the private sector in forums such as these on other issues, including corporate compliance and corporate good citizenship.

I have been asked this morning to talk about the voluntary disclosure program in the context of the concept of the good citizen corporation, which I understand is the subject of this forum, as well as the need for improved corporate accountability. Both of those concepts, I believe, necessarily imply developing an increased sensitivity to what is and what is not appropriate behavior in the corporate arena. That task is never easy, often thankless, but nevertheless always critically important.

In the rush to compete and to achieve, our society’s focus on ethics has too often been too little and too late. General Omar Bradley once commented, “The world has achieved brilliance without conscience. Ours is a world of nuclear giants and ethical infants.”

The Department of Defense voluntary disclosure program in my view is our effort to energize an active corporate conscience of sorts in the defense industry. Discussing the voluntary disclosure program could, indeed, be a topic for an entire day’s seminar by itself. Fortunately for you and for me, the schedule this morning doesn’t permit us to do that.

Briefly, I am going to try to give you some idea about the program’s genesis, about the processes under which it operates, and our best estimates as to its effectiveness and what our experience indicates it tells us about contractor efforts at self-governance in the defense industry.

In the early and mid-1980s, both the defense industry and the government faced an important, serious dilemma. There was a need to responsibly address reports of widespread fraud in defense contracting. The media had widely publicized cases of investigations of defense contractors for such offenses as cost mischarging, defective products, false statements, and false certifications. At the same time, the government and the industry needed to maintain a stable, cooperative, and productive relationship. The challenge for both was to do this while, in an oftentimes adversarial process, closely scrutinizing and investigating allegations of fraud in the industry. And that is not an easy task because there are natural tensions, obviously, when you get into the investigative mode.

During the same time period, the Department of Defense realized the need for a better

and a more coordinated approach to fraud investigations, an approach that balanced in the most productive way possible all the available remedies – criminal, civil, administrative, and contractual.

The department to do this created something called the coordination of remedies program to ensure that all of those remedies were considered in a balanced and timely fashion. The approach encouraged the exchange of information between independent remedies authorities while attempting to also ensure that an action by one entity would not adversely affect the ability of another to use other available actions. As a result, the number of indictments, convictions, monetary recoveries, suspensions, and debarments all rose dramatically. Unfortunately, although this was beneficial to the government in one sense, it also inevitably increased tensions in the industry between the industry and the government.

Recognizing the need for a new approach, President Reagan created the Blue Ribbon Commission on Defense Management, commonly referred to as the Packard Commission after its Chairman, David Packard. The Commission, among other things, was established to find better ways to manage the business relationship between industry and government. The Commission's report, which was issued in 1986, recommended, among many other significant things, that contractors establish ways to implement stronger industry-wide principles of accountability. Even more specifically, the Commission report recommended that contractors disclose to the government irregularities that they discover in the course of their own accountability procedures.

The Commission recommended that the Defense Department also implement its own program, with appropriate incentives to encourage contractors to, in fact, voluntarily disclose this type of information to the government. To their credit, the major defense contractors acted almost immediately upon receipt of the Packard recommendations. The Defense Industry Initiative for Business Ethics and Conduct was established, and along with it there was an adoption of principles which, in fact, endorsed aggressive self-governance in industry and voluntary disclosure of violations of federal criminal and civil procurement laws.

The Department of Defense, not to be outdone, also reacted, both in response to the Commission's report and to the disclosure of some 14 matters by contractors to the department. Deputy Secretary of Defense Taft signed a memorandum in July of 1986, not only encouraging contractors to make disclosures to the Defense Department, but also establishing the procedures that were to become the voluntary disclosure program.

The program continues to operate today, with both my office and the department's senior management strongly committed to its success. It provides a formal framework in which self-governance efforts by contractors interface with government compliance and remedies programs in the department. It is not a means for excusing contractors for improprieties or illegalities; rather, the program encourages contractors to demonstrate to their employees their commitment to ethical business practices by helping the government to hold individuals accountable for improprieties.

Under the program, matters of potential criminal or civil fraud relating to the contractual relationship between the department and the industry can be brought to the Inspector

General at the department by a contractor. Matters of administrative oversight, for instance, accounting issues, costing, pricing, et cetera, which do not involve any knowledge or intent to defraud, are brought instead to the administrative contracting officer or to the Defense Contract Audit Agency.

I want to take just a minute to discuss what the program does and does not do. First, the voluntary disclosure program is not an amnesty program. Action can be taken against corporations as well as individuals that are involved in matters that have been disclosed. On the other hand, good-faith cooperation and disclosure by the contractor is certainly considered favorably by the government in determining what action should be taken.

In reality, the program rests on three premises. First, that the department would be hard pressed if it found that it could no longer do business with a large number of its largest contractors, and, in fact, in the worst-case situation that could happen, particularly in an instance where a contractor, a large defense contractor, had a second or third conviction. Once beyond the first conviction, it gets harder to escape the possibility that that contractor might, in fact, be suspended or debarred, and thus end, at least for a time, the relationship with the department.

The second premise is that the department must make every effort to eliminate the perception – particularly the public perception, which was at a height probably in the mid-1980s – of the defense programs and industry as inefficient and corrupt. That certainly does not help the industry, and it does not help the Department of Defense in its justification of its programs to the Congress and to the President.

Third, a contractor is better off reporting problems rather than running the consequences of independent detection by the government, and I will tell you a little bit about what we do in the program to support that conclusion.

The program offers contractors several advantages: one, expedited investigation and audit of a matter; two, early identification of the DOD component which is designated to make suspension and debarment decisions in the matter. This, of course, serves to facilitate contractor communications from the outset regarding possible remedial actions by the government. And, three, an agreement that the Department of Defense will advise the Justice Department of the nature of the disclosure, the extent of the contractor's cooperation, and the types of corrective action that have been taken by the contractor. This last item is perhaps the most attractive to industry.

A corollary of probably equal benefit to the industry is the nature of the Justice Department process for handling voluntary disclosures under the program. It is not the usual prosecution and investigative process which is carried out in most cases that are not handled under the program.

In effect, the Justice Department has removed the uncertainties and the inconsistencies that would otherwise be inherent in the possible exposure to any number of different United States Attorney's offices in the country by identifying the Defense Procurement Fraud Unit in the Department of Justice as the central point for the Criminal Division in addressing the

criminal aspects of these cases. So, in other words, there is one unit in the department that handles all the decisions on those cases as opposed to being handled by individual different prosecutors with different impressions in the field, so to speak.

While the program certainly offers advantages to contractors, on the other hand it also requires that contractors do certain things. First, to gain the benefits of the program, a contractor must make a disclosure of a matter voluntarily and not because of a belief or a knowledge that the facts of the case have been known or are about to be discovered by the government. Prior government knowledge of the facts does not necessarily preclude acceptance into the program as long as there is no evidence that the contractor knew of the government's involvement. In other words, obviously a contractor who is doing something wrong and realizes that the government or someone is about to find out about this cannot head it off, so to speak, by then going to the voluntary disclosure program. Good-faith cooperation is always viewed more favorably than its absence. We, along with the Justice Department, will evaluate a contractor's cooperation in any matter in determining the nature and degree of remedies appropriate for the case.

Two, the disclosure must be made on behalf of the business entity and not be made as admissions by individuals, officers, or employees. In other words, the corporation, the entity itself, must make the disclosure, not the individual.

Third, appropriate action, including appropriate corrective and disciplinary action, as well as restitution to the government, must be taken by the contractor. So, in other words, the contractor must do something to correct the problem. Also, it is not a strict requirement, but in many of our cases, the contractors themselves will actually conduct their own investigation of the allegations. Sometimes that's done before they bring the matter to the department because they obviously want to verify it, and sometimes they, in addition, follow up with a more detailed investigation after that, which we then review and can supplement if we feel it needs to be supplemented as we are reviewing the whole issue at the department.

And, fourth, the contractor must agree to cooperate in any ensuing audit or investigation. As with any new and innovative approach, the implementation of the voluntary disclosure program has not been without its problems. I believe participating contractors and the government have been able to mutually address many of the major problems that have arisen to date and hopefully will continue to do so in the future. I have to admit that I read with interest the outline that was prepared for Bill Lytton's remarks next here this morning. As I understand it, he is going to speak to you about the need for greater coordination, particularly his thoughts on inconsistent government policies in the areas of voluntary disclosure, *qui tam* suits, and hotlines, et cetera.

I have to confess that I smiled broadly when I read, as one of his lessons learned, that "There is no grand government strategy." I can tell you, having worked for many years both in the executive branch and probably even more pointedly in the legislative branch, in the Senate, that he is absolutely right. There is none.

The diversity and the sheer size of this government, which I believe reflects to a large degree the diversity and the size of this country, makes it, in my view, extremely unlikely, if not

impossible, that we will ever have any comprehensive "grand strategy" of sorts in the U.S. Government.

That's not to say we haven't tried. Certainly parts of the government have tried. For example, I can remember working very hard to try to get legislation to come up with a grand strategy, so to speak, in the anti-drug area when the drug problem was at its height. And we worked on that for years and got some legislation, and I am not convinced we still have a grand strategy, but we have tried it in areas, and no doubt we will continue to keep trying. But it is, in my view, a very difficult goal, and it is a goal that is difficult because of the nature of this government and the nature of this country. It is a diverse government; it is a huge government that does many, many different things, and trying to perfectly coordinate it all into one single strategy is an admirable goal, but I'm not sure it's a realistic one.

The good or, at least I should say, the encouraging news is that at least in the Department of Defense, which in and of itself I can tell you is a huge organization and a diverse one, we have made real progress in getting closer coordination, if not a grand strategy, among the players involved in potential remedies, sanctions, or other responses to voluntary disclosure cases. Moreover, we try to coordinate with the Justice Department and with other known government players who may have an interest in these kinds of matters. The trick, of course, is knowing who the players are early on and coordinating and talking to them early on.

It is important to note that particularly where criminal activity is alleged, our coordination, as good as it is with the Justice Department, does not and cannot mean that we control their final decision on the matter, which is, of course, made independently of our office. So there are limitations even on how much we can coordinate, obviously, in certain areas.

In short, we have not solved all of the problems that Mr. Lytton is going to point out to you and that I think we recognize exist in the area of inconsistent policies and lack of coordination. But we certainly are aware of them, and we are working on them, and we will continue to work on them.

In any event, we do believe that the voluntary disclosure program has been successful and beneficial to both the government and the contractor community in providing a mechanism for addressing problems identified in self-governance programs. A few statistics demonstrate the extent to which the program has accomplished its purpose.

As of the quarter ended June 30, 1995, there have been 344 disclosures made to the Inspector General's Office, of which only 27 have been denied admission into the program for any number of reasons. Of the remaining 317 disclosures, 131 have been completed and closed, ten are in preliminary processing, 17 in the preliminary stages of acceptance, and 159 are actively being pursued for resolution.

A total of 145 corporations, including, I might point out, 48 of the top 100 contractors, have made the 344 disclosures. The program has resulted in a return to the government of approximately \$297 million. There have been three corporate and 54 individual convictions as a result of the program, and only two contractors – two – have been suspended or debarred as a result of their disclosures. And I might add that the convictions of the corporations and the two

that were suspended or debarred were cases where there were, in fact, aggravating circumstances that, in the minds of those making those decisions, justified those sanctions. But that clearly has not been the usual scenario once the disclosure is made in good faith and there had been good-faith cooperation.

Those results and the program's success have not gone unnoticed in other parts of government. The Department of Justice has issued prosecutive guidelines regarding voluntary disclosure in the area of environmental crime and a corporate immunity program for voluntary disclosures in antitrust cases. Recently, the Department of Health and Human Services, confronted by growing public concern and congressional concern over the problem of health care fraud, has announced the establishment of a pilot program for voluntary disclosure in that area.

Finally, my office has been approached by several other executive branch agencies who are considering developing similar programs in their particular areas of concern. And my own view is that with the probable or very likely ongoing reduction and downsizing of government resources over the next several years, it is very likely that you will see an increased interest in many parts of government in enacting and establishing voluntary disclosure programs, because as the government's resources lessen in the areas of audits and oversights and investigations, clearly programs like this that allow industry to help the government take a short-cut on some of these investigations by coming forward voluntarily. That is seen as a help to the government in the way of resources. So I think you are going to see more of this, and we continue to work with the other agencies, including HHS and those that are starting up, to give them the benefit of what we have done in the area of defense.

In sum, at least in the area of government contracting – and I recognize that your interest goes beyond just government contracting – voluntary disclosure programs do help to ensure not only fair and balanced government oversight, but also reliable contractor internal controls. Their goals should rightly be to make government oversight more effective and more efficient, not necessarily to eliminate, reduce, or downgrade such oversight. If these programs succeed, we all, both industry and government, stand to benefit.

On a broader scale, the success of our voluntary disclosure program demonstrates that the concept which you are looking at this morning, the concept of good corporate citizenship, is in my view, alive and well and hopefully growing in corporate America. It shows that good can come from government and industry working together to ensure accountability and ethical conduct in business as well as in government.

I see my time has just about elapsed, so I want to thank you again for the opportunity to be with you, at least for a few minutes here this morning, and just close with the thought that I hope that our experience in the Department of Defense – and we do have some in this area – can at least be of some help to you in working to develop many, many more “good citizen corporations” across the country in all of your areas. Thank you very much.

**THE CASE FOR GREATER GOVERNMENTAL COORDINATION:  
CIVIL SANCTIONS AND THIRD-PARTY ACTIONS**

MR. SWENSON: Our next speaker, Bill Lytton, is one of those people who makes you wish you wrote your Rolodex in pencil. He began his career as a prosecutor and more recently, in 1989, he became the General Counsel of G.E. Aerospace and served in that capacity until G.E. Aerospace merged with Martin Marietta.

At the new Martin Marietta, he served as Vice President and Associate General Counsel until Martin Marietta's merger with Lockheed in March. In the new Lockheed Martin Corporation, Bill is a Vice President and General Counsel of Lockheed Martin Electronics.

Over the last few years I have heard Bill Lytton talk on a range of topics and always very impressively. His theme for today is something I can recall chatting with him about probably at a DII best practices forum a couple of years ago, and I think you will find that, despite his naturally shy demeanor, he has a lot to say. Bill Lytton.

MR. LYTTON: Thank you for the introduction, Win. I will remember that. I should start off with a disclaimer that my comments today are personal, based upon my personal experience. They do not necessarily represent the views of my corporation, whatever the name of it is today.

We have done a couple of things as a result of all the mergers. Number one, I don't order business cards in groups of more than five, and number two, those are now coming out in slate and chalk so that we can keep up to date.

I have been asked to address a provocative subject and to be provocative in doing it to give the perspective of the big corporation – not the big house, I might add, for those of you who are old 1930 movie buffs.

I want to talk about the guidelines. I think they have been a catalyst for organizations in many areas. They have forced a lot of us to re-examine the commitment we have to lawful and ethical behavior, and they have also helped us establish or modify policies and procedures that ensure compliance with legal and ethical standards. And in that regard, I believe the guidelines have had a salutary effect.

I also want to congratulate the Sentencing Commission for sponsoring this public forum and for being open to comments and criticism. It is not a group that has declared victory and gone home; rather, it is a group that has tried to critically examine what they are doing and see what changes might be made. And continuous improvement itself, I think, is somewhat unusual in the government.

Perspective is important. I saw a sign on a marquis a couple of weeks ago that said, "We do not see things as they are. We see things as we are." Obviously we filter what we see through our own eyes. And so what we see is obviously influenced by where we sit, and the challenge we face is to try to see it from the point of view of others. And this type of candid – hopefully candid and hopefully understood to be that – discussion I think is only helpful.



As an optimist, I see the guidelines as a work in progress, one that will improve. As a lawyer, I, of course, admire anyone who has the ability to speak out of both sides of their mouth at once. But I stand in unabashed awe at the ability of the United States Government to promulgate so many different policies, practices, and procedures that are absolutely inconsistent, and to do it all simultaneously.

Let me give you a little bit of an overview. I start with the premise that the guidelines are government policy. They are a specific, integrated, and articulated government policy that rewards a certain type of organizational behavior and punishes other types. So seen in a vacuum, the choice of an organization is clear. You modify your behavior to conform to the guidelines.

Organizations, however, act through human beings who need to be trained and encouraged to conduct the affairs of the organization in a manner consistent with that organization's commitment to conform to the guidelines. To the degree that these human beings are given conflicting or confusing directions, the ability of the organization to achieve its goal of conforming to those guidelines will be jeopardized; and to the degree that the organization's ability to conform to the guidelines is jeopardized, the goal of achieving conformity to this government policy is likewise jeopardized.

The United States Government, through legislation and executive branch actions, has institutionalized other policies which, at best, cause confusion and, at worst, are inconsistent with the guidelines' policy. And this conflict and confusion, I think, may be one of the single most important impediments to the goal of achieving that underlying policy that we all, I think, support with the guidelines.

So organizations sometimes find themselves in a Catch-22 situation where their employees' actions necessarily put them and their organizations at risk because of other government policies. In these cases, both the organization and the government, it seems, suffer.

Now, if the government is serious in wanting to promote the public policy underlying the guidelines, it needs to understand these conflicting policies and to address them, and that's what I have been asked to help do today.

The guidelines talk about a number of things that are important, characteristics that can be mitigating factors if and when a corporation finds itself standing in front of a judge about to be sentenced after having been found guilty of federal criminal conduct.

One of them is internal reporting. The existence "of a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution" is an important goal of the organization. This plays into a second important mitigating criterion, voluntary disclosure – part of what Eleanor just addressed – where the organization discloses to the government something that went wrong in the organization, and the company is encouraged to fully cooperate in the investigation and to affirmatively accept responsibility for its criminal conduct.

Most companies, I believe, certainly the large ones – and God knows I’ve been with a lot of them the last two years – have embraced the guidelines, have worked hard to encourage its employees to self-report, to have trust in their companies, to provide for anonymous reporting, and otherwise to develop audit and other processes that will discover relevant information. Hotlines and ombudsmen are only the most visible and obvious of these efforts.

But there is some inherent resistance to this type of self-reporting process. For instance, some company lawyers that I have known in the past may have difficulty in confessing to a crime that may not have been discovered and, indeed, may not even have been committed. A second impediment may be it is not in human nature in America to be a “snitch,” and we sometimes find a lot of difficulty with our employees in encouraging them to tell us if they observe a problem caused by a fellow worker. One only has to look at the most recent case of Archer, Daniels, Midland and the reports that have been in the Wall Street Journal about what has happened in that case and the reaction to the executive who reportedly was acting as an undercover agent, an informant for the government.

I note that a member of the Illinois Christ Lutheran Church said, “Why didn’t he just quit? That’s what I would have done. I’m not about to be a spy.” And the co-owner of Nick’s Auto Body said, “The fact that the Feds spy on the community frightens me. They’re about as underhanded as anybody. And this guy’s not an upright citizen, or he wouldn’t be ratting on his boss.” So obviously the guidelines’ policy has not yet affected the culture of some religious and auto repair organizations.

To the degree that our employees do not report what they see or suspect, and thus deprive the company of the opportunity to make a voluntary disclosure and to cooperate, that may be seen under the guidelines as evidence of an ineffective corporate program and perhaps an inadequate corporate commitment to compliance and ethics. And I’m not sure that is necessarily the conclusion that one should come to.

One of my favorite topics: *qui tam*. The same Congress that set up the Sentencing Commission has also established the *qui tam* or whistleblower statute, which provides that someone who files an action alleging a fraud against the government may recover up to 30 percent of the ultimate recovery, which itself can be up to three times the amount of the loss to the government.

The *qui tam* laws are premised on a central and very powerful idea: greed. And if it’s not greed, then why do we need all that money to make people do it?

Money is not normally required to make people do the honorable thing. The theory is that if enough money is offered, employees will turn in their own mothers or at least their own bosses. And added to this greed factor is this wonderful, powerful interest of lawyers who see their opportunity of getting one-third to one-half of the bounty hunter client’s reward on top of their counsel fees. I used to be in private practice, and I know how attractive that is.

In the case of an ongoing fraud, the longer the *qui tam* relator waits to file his *qui tam* case, the more money the government stands to lose, and the more money he or she stands to

gain. I think this highlights the fact that the statute's concentration is on making money for the relator and the lawyer and not on stopping fraud, waste, or abuse.

This lure of the big bucks is a powerful incentive for employees to seek out their local plaintiff's lawyer rather than their ombudsman when they see a problem in their corporation. These whistleblowers are then applauded, of course, as courageous people who have put the interest of the country above their own well-being. The media has a field day with it, and the client and the lawyer begin to consult financial and tax experts and advisors. You might even hear that their very lives were in danger. Spare me.

The motive behind these cases, I suggest, certainly a large number of them, is exactly what Congress has or should have anticipated, and that is greed. And there are other types of bounty hunter laws that are being adopted or proposed or considered, including in the environmental area. So a corporate employee has two choices when confronted with possible wrongdoing in his company: be a good and honorable employee and report it internally, or take the money and run.

The fact that employees don't take the greed route all of the time is, I think, a wonderful surprise, but when it happens to you and your company – and those of you who deal with the government will find it happen – it is not very pleasant.

When they file these types of cases, I think it is predictable; it is human nature. But when we are able to go to an ombudsman and then follow a voluntary disclosure route, that happens in spite of, not because of, the *qui tam* policy of the United States Government.

This is more than a theoretical issue. Consider the following hypothetical. A company auditor discovers that your company has overbilled the government by \$1 million. If he does what he is supposed to do and reports it internally and allows the corporation to make a voluntary disclosure – I checked with Win on this because he's the expert on this stuff – he says the fine could be as low as \$50,000. If the same auditor, however, instead of reporting it internally decides to call up the plaintiff's *qui tam* bar and lets it go on and then we don't get a chance to discover it because we thought that's what the auditor was doing – indeed, the auditor may even lie to us, or maybe he just resigns because he knows he's going to make a lot of money – then the corporation can be fined up to \$1 million.

So even though the facts of the crime are exactly the same, the decision made by the auditor could affect the size of the fine by a factor of 20. Such an arbitrary and capricious result cannot be the result of a conscious, coordinated government policy.

I think that if we as a people in this government want to encourage the voluntarily disclosure of problems to the government, why not require that a prerequisite to filing a *qui tam* action by an employee is that he or she first has to go to the appropriate person, whether it's the CEO or the ombudsman, and tell them. And if the company doesn't do anything for 60 or 90 days, then you can file it.

Do you know what's going to happen if some employee comes to me and says, "I've got a problem and if you don't do something I'm going to file a *qui tam*?" I'm going to call up

Bruce Drucker. And you're going to have more disclosure. What would happen? The plaintiff's bar would lose a lot of money, and the relators wouldn't get up to 30 percent of the money.

I think these are ideas that take greed out of the equation and that would enhance the underlying policy of the guidelines for voluntary disclosure. And such a policy and such a change would be perfectly consistent with the guidelines.

There is also a second government practice or policy that can be inconsistent, or at least cause confusion. Government agencies often encourage and sometimes require that posters be prominently displayed with a hotline for calling the government when an employee is aware of fraud. I think this is confusing. Their quite reasonable rationale for having it is that in some cases employees will not feel comfortable to report it internally. They may not have a system that would work, or maybe they're dealing with a company that is just a bunch of crooks. So I think there's a good reason for it. I don't deny that. And the other reason they would do it is they're not aware of the whistleblower statutes and all the money they can make.

But when an employee does call the government hotline, once again a corporation is deprived of the opportunity to make a voluntary disclosure. I think what we have to do is at least realize that in such cases it is not presumptive evidence, if you will, that we had an ineffective policy. I think there needs to be some consideration that the government would give credit to a corporation for what would have happened if they had made a voluntary disclosure – if this guy had called the inside person rather than the outside person. And I think sometimes this does happen in the DOD IG's office. I think they are willing to do that. But as we expand throughout the government, I think you need to watch out for that because our employees are being encouraged not to call us. They are being encouraged to call lawyers or the government, and the policy of the guidelines says that if they don't call you, that is not good – it doesn't say something good about you.

The voluntary disclosure program that Eleanor talked about is, I think, one of the real success stories in the United States Government. I think the DOD IG's office and Bruce Drucker do a wonderful job, and a trust has built up over the years between industry and government in this, and that is why it has been so effective. But let me talk about the process of making the decision to make a voluntary disclosure.

It is rarely a clear-cut, easy decision. The reasons for making it are compelling from a corporate point of view. You significantly reduce, if not eliminate, your chance of being criminally prosecuted. And if you are prosecuted, at least under the guidelines your penalty will be less severe than if you hadn't. But the circumstances in which the decision is often made are difficult, stressful, and ambiguous.

When I was a federal prosecutor in Philadelphia, we had a bank robbery. It was a wonderful case. The bank robber is in line. He robs the bank. A beautiful 8-by-10 glossy photograph of the bank robber comes out of the surveillance camera. The dye pack explodes, and standing behind him in line is an FBI agent. This is all true.

The closing argument of the government prosecutor was: “Ladies and gentlemen, are you familiar with the expression ‘caught redhanded?’ This guy was caught redhanded. Thank you very much.”

Now, that’s a dead-bang case, and, by gosh, if that happens, you know what to do. But the reality is in corporations, when you are dealing with fraud instances or potential fraud instances, you rarely see it with that sort of clarity. And while you’re trying to get the clarity, you must recognize that hesitation or delay may be fatal to your ability to get into the program and to get the benefits thereof.

Clausewitz, I think it was, somebody like that, talked about the fog of war, and that’s what happens when you are sitting on the inside and somebody comes to you with a potential problem. In a defective pricing case, you don’t need a primer on this, but it often turns on the intent of the individual. That is your typical white-collar case. There is no question as to what the person did. But did he or she intend to do something wrong? A conscientious, good-hearted internal investigator who believed in the presumption of innocence might look at that and conclude that the person did not intend to do something wrong.

That same investigator having gone to Bruce’s school and having been trained with a little booklet they have – I believe it says “Think Fraud” – believes that the presumption of innocence is a nice thing for the books, but it does not really apply. (I think once when I was with Bruce, I asked for a show of hands from the agents. I said, “How many of you really believe in the presumption of innocence?” Not one hand went up.) The investigator might now conclude with the same facts that the guy intended to do something wrong.

So while you are sitting there trying to make these decisions, very difficult decisions, you recognize that the clock is running. If you make the decision too late, you may be out. If you make it too early, you may disclose actions that you later determine upon further investigation are not fraud. And while I think I can convince Bruce on that, when I end up at the DOJ, I have another problem because the Department of Justice Civil Division believes that a filing of a Voluntary Disclosure is the moral, if not the evidentiary, equivalent of a confession of fraud. And if you later go to them and say, “Well, it was all a mistake, we looked into it further and it is not fraud,” that might be construed as lack of cooperation, backing off, failure to accept responsibility, et cetera, et cetera.

So I don’t know how much of a counter-balance the risk of significant civil penalties – because the DOJ comes in talking trebles and maybe you can get them down to doubles of whatever the loss to the government is – may or may not be to make voluntary disclosures. I don’t think it is for the larger companies, but I think that with smaller companies it may well be, and you should keep that in mind.

I understand there is going to be somebody later talking about the self-audit privilege and I think this is another example. One of the things that results from the guidelines is the effort to find out if you’ve got a problem. So we conduct internal audits and investigations, and we like to keep those things kind of secret – for a number of reasons, many of which are legitimate.

Just like you have the FBI not wanting raw FBI 302s to be out there, we don't want our investigative files to be out there. Why? Because there's another group of lawyers called the plaintiff's security firms. I used to be in one of those, and what they do is every morning they look in the Wall Street Journal, and companies whose stock went up or down find themselves in trouble. They file a class action suit. There's a number you call in Wilmington, and if you're the first one, you're the lead counsel and you get most of the money.

It's very well organized – talk about sentencing guidelines for organizations. There's one you ought to look into.

We would rather not show all of this stuff to the plaintiffs who are going to try and blackmail us to settle the case. I don't mind sharing it with the government so much. They're not my biggest concern. But when we assert a privilege, I think there is a knee-jerk reaction of the government to say: a privilege – lack of cooperation. I think the government should think more carefully about when it's going to challenge an assertion of the self-audit privilege, because the more you challenge it and the more there is no privilege, the less internal investigation there is going to be; the less internal investigation, the less things we find out.

Let me talk for a second about suspension and debarment. The government very rightly doesn't want to have companies working for them that are crooks. Let me give you an example, though, of what government are we talking about.

We had a case where one of our employees pled guilty when I was with G.E. He was actually an old RCA employee. He got sentenced, to I think, a year. The government prosecutor and the defense lawyer said, "That's too much. We really would like for this guy to get work release. He's not a bad guy. He's cooperating."

They came to us and said, "Will you put him in some sort of commercial job just so he doesn't work for the government anymore so we can go in on a joint Rule 35 motion for reduction of sentence to have him put on work release?" I did it. They went in. He got reduced.

Flash forward, I'm now in front of the government suspension and debarment authority a couple of months later, and they said, "Why is this guy still working for your company?" I said, "The government asked us to keep him employed." He said, "What government was that?"

I said, "It was the Department of Justice." They said, "That's not our government." And then he gave me an example. He said, "You know, we had a paraplegic we caught stealing two aspirin. We fired him." I said, "That's not my company."

The government is not a homogenous single organism. It is a hodgepodge of people who rarely share the same ideas or agendas. What are the lessons we can learn? First of all, you are listening to people who have been involved in the defense contracting community. So why is that relevant? Well, a couple of reasons. Number one, our past is your future. The government is coming after everybody. We just happened to go first. Environment, health insurance, safety, everything is coming under the gun. The cross hairs of the government are very tightly focused. They are coming.

The guidelines are in large part consistent with, and I think some parts, even modeled after the DII guidelines. So we have lived under them for ten years, and, therefore, we might have some insights that help you.

What have we learned? Simple, yet profound. We've got dozens of departments and commissions, hundreds of agencies, hundreds of thousands of people. They're not singing from the same hymn book. They don't even know there are others in the choir. And when they do, they don't really care. So what you get isn't the complex harmony of a Mozart, but the cacophony of a construction site in downtown Chicago or New York City.

And as Eleanor stole my punch line, the reality is that there is no grand government strategy. The fiction we indulge in is that we have to act as if there were such a strategy. And therein lies the risk for companies and the challenge for government. Government could not only make the private sector's life a little easier if it tried to reconcile these discordant policies, but would probably be a lot more successful in helping us all achieve some fundamental and worthwhile goals that are embodied in the sentencing guidelines. If only we could all agree what those goals are. Thank you very much for your attention.

## **OTHER COORDINATION ISSUES AND PROPOSALS**

MR. SWENSON: Our next speaker is David Yellen. David is an associate professor of law at Hofstra University and, accordingly, represents a somewhat different perspective than our prior two speakers. But I think it would be wrong to assume that his is the perspective of an ivory tower because David has been a very active participant in policy issues, both in his prior life as an assistant counsel to the House Judiciary Committee and more recently, while at Hofstra, through a number of policy-oriented writings, including a very interesting law review piece on the coordination issues that he is going to talk about. David also served as an advisor to the Clinton transition team on some of these same issues. David Yellen.

MR. YELLEN: Thanks, Win. Several years ago, I was the reporter to a special ABA committee that was set up to study the collateral consequences of organizational convictions, and we came to some conclusions that are not very surprising to anyone in this room, and certainly not after hearing Eleanor and particularly Bill. We found that there is a panoply of overlapping, sometimes inconsistent, unpredictably enforced civil and criminal sanctions that are available when an organization, a corporation, has committed some kind of misconduct. There really isn't a great deal of coordination between the different parts of the government. Despite what Bill said, I still think of it as one government, but there isn't a lot of coordination. And the sources of that lack of coordination are pretty straightforward as well.

First of all, you have Congress, which is not well-coordinated just on its own. Congress has become increasingly in love with criminal penalties in the last 10, 20 years. I guess de Tocqueville wrote many years ago that, in America, all issues of public concern wind up being matters for law and courts. Nowadays you can modify that to say that virtually all issues of public importance wind up being matters of criminal law. And Congress has gone way too far in criminalizing conduct that probably could be better handled civilly. When something is a crime already, Congress loves to just pile on additional penalties. And when that isn't enough, Congress loves to pile on mandatory sentencing laws.

I don't want to give them any ideas, but in some ways it's surprising that there hasn't been an effort to come up with some kind of mandatory minimum sentencing laws for white-collar and organizational crime as well as drug crime, where it principally resides. And then you add to that – so that's the Congress side. And then, of course, the agencies, we've heard a lot about the way, just how difficult it is for an enormous agency like the Department of Defense to coordinate its own efforts to enforce the various laws, let alone to expect any reasonable amount of cooperation and coordination across agencies.

One thing that did concern me about what Eleanor Hill said was in terms of an earlier effort where all the different parts of the Department of Defense that had responsibility for criminal and civil – all the different sorts of enforcement – when they did start talking a lot more, if I heard her right, she said that the great result was that every single type of enforcement action went up and there was more recovery of every kind. To me, that's not necessarily the goal of an effective coordination policy. It may be that you want less of one kind, more of another, more focus, more principles underlying what exactly the government is going to do.



So our conclusion was that there were problems with the lack of coordination from Congress and from the agencies and that more coordination was necessary. In particular, we focused on punitive sanctions. Obviously, criminal sanctions are punitive, and a great many sanctions that are denominated as civil are, nonetheless, punitive. And after the Halper decision from the Supreme Court a few years ago, it is necessary for courts to think about whether sanctions labeled as civil are, in fact, punitive to avoid double jeopardy problems.

In addition, we thought that theories of punishment that I will talk about a little bit also called for greater coordination in the sanctioning of corporations, and we called upon the government in general to start thinking more carefully about those issues. I don't think a lot has really come of that in the intervening years. As Win mentioned, I did a little bit of work advising the Clinton transition team on white-collar crime enforcement policies, and I talked a lot to them about this kind of coordination issue, these issues, and I haven't seen a lot of evidence of any real change in that area.

Also, I think the Sentencing Commission, which ought to play a central role, being a smaller, more well organized entity than something as sprawling as, say, the Department of Defense, the Sentencing Commission can play a crucial role in encouraging greater coordination of sanctions. And I think this is one area, although they have done a tremendously admirable job in many respects with the organizational guidelines, I think they missed an opportunity here. In one of the earlier drafts before the final guidelines that were promulgated, there was a provision that authorized judges to consider when imposing a criminal fine on an organization whether there had been or were likely to be punitive civil fines imposed; and if so, to have some kind of offset. And without any real explanation, that provision was dropped from the final guidelines that went into effect. So I think there is more the Commission can do as well.

I am not going to try and solve these problems, the broad, massive problems of coordination of all the government's enforcement efforts today. I really want to talk about compliance programs and address the question of whether our treatment of compliance programs can have a positive effect in encouraging the government in all its forms to engage in more coordinated sanctioning activity.

Before getting to that precisely, let me start with some fundamental questions about compliance programs that have been addressed only slightly in this conference. We all assume that it is good and proper for the Sentencing Commission in the organizational guidelines to give a very serious reward to companies that have had an effective program in place. Why is that? Why is it that we think it is right to do that – because what we are really doing is rewarding failed efforts at compliance. That may be a little bit unfair to say. If a compliance program reduces dramatically the amount of crime committed by its employees overall it's not a failure. But we are not talking about rewarding corporations for the crimes that weren't committed. Rather, we are talking about rewarding them when a crime has been committed and reported and investigated and prosecuted.

So why should we do that? You might say that individuals don't get an opportunity to stand up there and say to a judge, look, Judge, I really tried hard to not break the law, I wrote myself notes every day, I talked to my spouse, and I just couldn't stop myself.

Individuals don't get to do that, so why do organizations get to do that? And we could also say a little more seriously, why shouldn't effective compliance programs be their own reward? In other words, if companies can come up with truly effective compliance programs, truly effective means they're going to significantly reduce the misconduct by their employees. Why shouldn't we let the marketplace work and say, you know, let that be your own benefit, that you have less exposure to government enforcement actions, as well as the psychological benefit of feeling like you are doing the right thing.

Well, I think that at least as far as criminal liability for organizations goes, that is not the right answer. I think that is the wrong approach, for a couple of reasons. And to answer that, we have to first consider the two main rationales for criminalizing corporate misconduct. I do not want to sound too much like the ivory tower law school professor that Win, thankfully, said I am not, but a little background on the elementary purposes of criminal punishment is appropriate here. The main ones that are applicable to organizations are deterrence and retribution. Deterrence obviously plays a major role in punishing corporate misconduct. We punish companies so they won't do it again and so other companies will learn the lessons and they won't do the same kind of things.

Retribution ought to, in theory at least, have a much lesser role in sanctioning organizational misconduct. A company is not a person. As Professor Coffee from Columbia wrote a long time ago, citing an old case, it doesn't have a body to be kicked or a soul to be damned, so why do we think about punishing organizations for punishment's sake?

But I think clearly in modern times, with the attention that has been paid to corporate misconduct, people think about a need to punish companies that have done wrong, whether it is Exxon with the oil spill or lots of other situations as well. So these twin aims of the criminal law are really in force in how we deal with corporate misconduct.

So let's consider briefly the relationship between these goals and compliance programs. First, deterrence and compliance programs. As I mentioned, we might want to say, we could think about saying that good programs will be their own reward, and why should we give any additional benefit to companies that have put in place a program but the program hasn't worked on this occasion? That argument would have one benefit, I think, which would be to make companies focus exclusively on programs that really work and not at all on a real problem, which is programs that look good whether or not they really are going to have the kind of effect that we hope they do.

On the criminal side, though, this is inadequate. That deterrence argument that economists might make I think would not work, and that is because of a couple of things. First of all, how infrequent corporate prosecutions are. We have heard a lot of talk about – you saw a chart earlier today before the guidelines and under the guidelines. There are just a couple of hundred convictions a year in federal court of organizations. So if you were a rational corporate executive trying to decide simply in terms of your criminal liability, despite what the sentencing guidelines offer you for having an effective compliance program, you might, especially if you are a large corporation who has a very small chance of being prosecuted criminally, you might decide it is just not worth the effort and the money. It is very unlikely we are going to ever be

prosecuted for a crime, and it is just cheaper in the long run not to bother with a compliance program under those circumstances.

Well, we as a society really want to encourage the kinds of efforts at compliance that we have heard a lot about here in the last two days. So I think it is entirely appropriate that, even despite what cost/benefit analysis might say, we come up with a way to strongly encourage companies to make serious efforts at compliance with the law.

We could do that in two ways. One way would be to increase the frequency of criminal prosecution or to increase the severity of the sanctions that are imposed when companies are prosecuted and convicted. The other way to do it would be to reward good efforts at compliance. From a deterrence standpoint, it really doesn't matter which way you go. Either way could conceivably have the same kind of effect. And that's where retribution comes in. You know, to put it in terms of the title of this conference, why should we choose carrots over sticks? And I think the answer is because we and government law enforcers believe that companies that have made a strong good-faith effort at complying with the law are less culpable than companies that haven't done that, and they ought to, in a sense of justice and fairness, receive a reward for their compliance programs.

Now, that is somewhat at odds with the *respondeat superior* principle which says that a corporation can be criminally liable for the acts of any of their employees within the scope of their employment. So we're saying you can be prosecuted for anything any of your employees do, but we are not going to do it when you have taken steps to comply with the law. The *respondeat superior* principle is very troublesome to those of us who believe that the criminal law ought to be used when necessary but no more than necessary. And, in fact, I think the Sentencing Commission has stumbled across – I am not sure this was completely what they had in mind – but they have come to a really good middle ground between the *respondeat superior* principle that prevails in federal court and the position urged by the Model Penal Code, on the other hand, which is that companies can only be criminally liable when there is high managerial involvement.

In fact, I think it could be argued that the Sentencing Commission should have gone further. If they really believe in their principles, as I am sure they do, they could have gone further and said, for example, that a company that has a truly effective compliance program, maybe they should receive no fine whatsoever, no criminal fine at least. And, similarly, the courts – there was a Rutgers Law Review article written recently by two New Jersey lawyers – I am sorry I cannot remember their names at the moment. It was a very good article, and they argued that there ought to be a criminal defense based on an effective compliance program. And I personally am very sympathetic to that. So I think the role of compliance programs in criminal prosecutions should, in fact, be even greater than it is today.

The more difficult question is: what should the role of compliance programs be in affecting punitive civil sanctions? It is always hard to define what component of a civil sanction is, in fact, punitive, but we have an obligation to try and do that already under *Halper*. My own view is that an effective compliance program should not result in no punitive civil sanctions being imposed. I think both the deterrence arguments and the retributive arguments are

different when you are talking about non-criminal prosecutions. But I think they ought to have a serious effect on reducing the company's exposure.

What we would wind up with, then, is great benefit criminally if you have an effective compliance program, a good but lesser benefit in terms of punitive civil sanctions, and probably no real benefit in terms of purely remedial civil sanctions.

One of the benefits of this approach, I believe, would be to steer government regulators further towards punitive civil sanctions as opposed to criminal prosecution because they would not be faced with the likelihood of getting no fine for a company that had a truly effective compliance program. And I think that would be a good result for the reasons that I stated about the over-extension of the criminal law.

Now, how should this come about? I think, again, there ought to be a role for Congress to play in this in not simply passing a hodgepodge of laws, whatever seems to be a concern at the moment, and pile on some sanctions; rather, Congress ought to do a better job of thinking about what their goals are in having various kinds of sanctions. I am not too optimistic about that, having worked in Congress, even less so today than when I worked there eight or nine years ago. The agencies themselves have an obligation to do their best, and some agencies are really working hard at this, at least internally within their own structure. But, again, as we heard from Eleanor Hill, with a vast government bureaucracy across many agencies, that is very hard to do. But there needs to be more effort.

Again, the Sentencing Commission should really take the lead, as they are trying to do with this kind of conference, to define what is an effective compliance program, to talk about what ought to be the effect not just in criminal cases but on the civil side as well of a truly effective compliance program.

My hope is that if that effort comes out of this conference and the other things the Sentencing Commission is doing, we might begin to see the way out of the lack of coordination mess that you have heard about from this panel. If we can come up with a better way to coordinate the effect on various sanctions of an effective compliance program, that will have the effect not only of encouraging better efforts, more productive efforts at companies complying with the law, but maybe the government regulators and Congress and the Sentencing Commission can learn more about ways to come up with broader standards of coordination on all of the issues that we have been talking about today. Thank you.

## QUESTIONS & ANSWERS

MR. SWENSON: Thanks to our whole panel. I must say I think those were very provocative and helpful comments. We do have a number of questions from the audience. Let me ask one to Bruce Drucker first.

The question is: could you respond to Bill Lytton's suggestion about requiring whistleblowers to go to the company's ombudsman – let's just say not necessarily the ombudsman, but to the company – before filing a *qui tam* suit? And we had a second question which maybe Bill can keep in mind, and, Bruce, you might want to respond to it as well, which asked about a company policy and whether this might be enforceable, that would require employees to go to a company hotline 60 to 90 days prior to going to the government to file a *qui tam* action. Did I get the waters too muddy?

MR. DRUCKER: No, that's all right. I think I'm there. With respect to Bill's comments about a requirement for a corporate employee to notify the company, actually there have been similar proposals put forward with respect to whether government employees could be *qui tam* relators or not because there was a similar problem within the government. I believe in both instances that the opportunity to advise, in the case of a government employee, the appropriate officials in the government and, with respect to corporate America, advising the corporation of the problem would be, in fact, an appropriate means. I think it is entirely consistent with the intent of the *qui tam* statute. It would provide no bar to the employee or additional counsel ultimately making the government aware of the issue. This gives both the government and the company the opportunity to approach it in a voluntary disclosure mode, a less adversarial mode, if you will. And I think both interests are served.

The *qui tam* statute was created at a time when there was not sufficient government investigative and prosecutive resources to find all these things, so its concept was to get the public to participate on behalf of the government. Well, now we do have far more resources, and there is a relationship, a framework within which we can operate. So I think it would be a positive step.

MR. SWENSON: Bill, do you have anything you want to add to that? It sounds like you have worked out a deal.

MR. LYTTON: I am glad that Bruce has finally seen the light. No, I don't have anything to add. I don't see why we don't do it.

MR. SWENSON: Why don't we do it?

MR. LYTTON: Well – you want me to get political here – because there's a very powerful senator who thinks it is a great idea. There is a very powerful group of lawyers who bring these types of actions who make a fortune off of it, who have done a very effective job of lobbying, and because the media loves whistleblowers. And any effort that is perceived to be something that would reduce the ability of whistleblowers to blow the whistle – which I don't think this would be – gets jumped on.

So we are swimming upstream because whistleblowers get a lot of attention. And when you really get down to the nitty-gritty and try and deal with reality, a lot of people just don't want to hear it.

MR. SWENSON: I think bringing the political dimension into this is pretty useful. David, you spent some time as a congressional staffer and have seen this up close. Do you have some perspectives on this narrow issue but also more generally?

MR. YELLEN: Well, actually, I want to ask Bill a question. I haven't talked to a lot of people who have filed *qui tam* actions, but I assume it is a pretty hard step for an employee to take. I mean, you are hoping that you are going to make enough money to buy a house in the islands and retire, but you are taking some real risks in doing that in terms of your employment with your company.

What if it turns out that your claim is wrong and you get nothing? What is your future like at that company? So I think it is probably a pretty hard choice.

I wonder, have any companies – or is there any legal reason they can't do this – have any companies tried to offer financial incentives to employees to report things internally rather than going the lawsuit route? Assuming that Congress is not going to do what you want, why don't companies take some steps to try and encourage it?

MR. LYTTON: Two things. When I was with G.E. Aerospace, I proposed that we have a compliance award that we give out to people who had done exemplary things, not that they had necessarily turned in people, because there is a political problem internally if you are going to offer a bounty if you turn in your buddy. But I was trying to make it as pure as possible. I said, "Let's give awards to people who are exemplary, who come up with new processes, or who reduce the emissions or something like that." I talked about this at several of our plants. I did this in Camden, New Jersey. And the leader of the union there was outraged that I would suggest that we reward people for doing what they should be doing anyway. So that was a very interesting reaction that we had.

On the other hand, we did institute a type of program like that, and I will tell you an example. We gave a plaque to an employee down in Daytona, Florida, for having done something positive, and I sat with her at the lunch table when the award was given out. She was very proud. And I said I would visit her when I was next down at Daytona, which I did. And I went to her work spot, and her plaque wasn't there. And I said, "Where's your plaque?" She said, "I took it to my church." And the impact that that had had on her and how proud she was really something.

So I think you can do things to encourage employees to do the right thing, but remember – and to your point about whether a compliance program is successful or a failure. We are asking companies and organizations to do that which the family, the churches, and the society have failed to do. We want to have a zero defects society in our organizations, and we don't have it. And the fact that we have one or two or 15 or 50 employees who violate the law is not remarkable. Indeed, I did some studies once that showed that if you were a Department of Defense civilian employee, you were up to 20 times more likely to violate the fraud statutes than

if you were a General Electric employee, based upon people who had been tried and convicted. It does not say that DOD is a bad group. It does not say that G.E. is a bad group. But I think we need to view this all in a larger perspective.

MR. SWENSON: I think it is the case that there is a lot of interest in whistleblower incentives on the Hill. I guess there is one particular senator who has been a prime sponsor of the *qui tam* actions, but there also have been bills introduced more recently to expand the bounty concept. We have a couple of questions about *qui tam* and those kinds of laws.

If I can sort of merge them together, one of them really just says that these statutes have done very nicely in terms of recovering dollars that would otherwise not have been recovered.

And a second question asks your thoughts on real, actual, not hypothetical cases in which an employee or agent of a company charged with undertaking compliance didn't first go to the company. I guess the suggestion of the question is there have been a number of cases where somebody did go to the company first, didn't get a response, and that that's the more typical example. Is your understanding different?

MR. LYTTON: The first question you asked was, you know, these have produced results that would not have otherwise occurred. Yes, I think that is right, maybe, but we don't know. But my proposal, I think, would produce as much or more.

It is really not my proposal, by the way. I didn't think of this. As Bruce mentioned, there have been many suggestions on this. I have plagiarized this, as I do most good ideas that I have.

If you want real-life examples of where people have filed *qui tam* where they did not go to the company first, the famous G.E. aircraft engines case involving Israel and General Remi Dotan I think is a perfect example of where an individual by the name, I believe, of Chester Walsh observed the fraud against G.E. and the United States Government and against the Government of Israel, did not go to his company because he said he was afraid of being killed – Jack Welch is a well-known gunslinger – and instead went to a plaintiff's *qui tam* lawyer, and they watched the case grow, I think from a \$12 million to \$40 million fraud during the couple of years that they sat on it, and they only filed a *qui tam* when Remi Dotan was arrested in Israel, and they immediately filed the lawsuit. So that's one example. I think there are any number of examples.

Now, where an employee comes to us – and this has happened to me – you get a letter that says Joe Blow's a crook, and he's ripping off the government, and you better do something about it or else I will.

Well, I've got to figure out who is Joe Blow, where does he work. Now, in this company, I have 170,000 employees. When I was with G.E., I had 240,000 or something like that. Who is this guy? Does he have anything to do with the government? And now I've got to investigate it. When I was a federal prosecutor, you know, the FBI has the luxury of investigating these things for three, four, five years sometimes. I've got a couple of days, and if I don't do something immediately, I may be in jeopardy.

So what I typically do is I call Bruce Drucker, and I say, “Bruce, I don’t know what I’ve got here, but I’m letting you know that I’ve got this, and if it turns out to be something, I’ll be back to you.” And as I say, DOD IG works great. Whether that’s going to work with other agencies like that, I don’t know. But I think there are certainly examples – and I think the Dotan case is perhaps the best example that I know of – where a *qui tam* relator went to his lawyer rather than to his company. The damage escalated geometrically, and he made a lot of money. So did the lawyer, by the way.

MR. SWENSON: Bill, you made the point in your direct remarks that when companies voluntarily disclose to the Defense Department, part of the final resolution of the case – assuming that they don’t fall into that statistical anomaly of actually getting criminally prosecuted or suspended, very few cases there – but they still may end up paying substantial double or treble damages under the False Claims Act.

Bruce, do you think there should be more accommodation for sorting out the good citizen corporations among the voluntary disclosures – for example, companies that have committed to strong compliance efforts versus those that haven’t?

This is not directly your bailiwick, but what do you think the policy ideas are behind having double to treble damages for companies that, let’s say, voluntarily disclose and also meet additional mitigating criteria – fully cooperate under the program, maybe to the nth degree?

MR. DRUCKER: Well, I think that a part of the theory that is used, the policy approach that is used in dealing with resolution of voluntary disclosure cases is that the statute itself provides that in the case of a truly voluntary disclosure, which is one where a company finds wrongdoing and within a period of 30 days investigates it, identifies it, and fully cooperates with the government in resolving the issues in the case, that the statute itself calls for a double damage application in lieu of a triple damage application that would be provided for in a non-voluntary situation, an adversarial situation, if you will.

So I think part of the thinking that goes into the application of the double damage, even in a voluntary disclosure, is that the case is being settled under a statute that itself provides a reduction – a sufficient statutory reduction. Whether or not that is, in fact, a true incentive to disclose, *i.e.*, that it is double versus treble damages in a situation where a company is fully cooperative, as you put it, to the nth degree, there have been cases that I am aware of in disclosures where we have ended up with resolutions of settlements for singles. I am not saying that that is the norm, but it has occurred where the Department of Justice is willing to negotiate for what the single damage amount plus interest was as a resolution of the matter financially.

There is a judgment factor involved there I think that needs to stay, and that is the extent of cooperation, the extent of participation, varying levels of responsibility within the company.

Bill alluded earlier to and I believe one of the other speakers mentioned the concept of *respondeat superior*. Well, it depends on whether it is Joe Smith that Bill alluded to earlier that is a line supervisor at the production plant at Fort Swampy or it’s Bill sitting at corporate headquarters that knew about and participated in the scheme. And that is where I think we have



got to give greater credence to how do we temper what action we take with respect to the corporate liability, *i.e.*, how much was the corporation involved; and if it does cooperate, does it have a strong compliance program, did voluntarily disclose and it is at very low levels, I think we have to take that into account in determining double or single damage.

MR. SWENSON: But your policy at this point – there is no concrete written policy that can be pointed to?

MR. DRUCKER: No, there is not.

MR. SWENSON: Do you think that the Defense Department should move in that direction?

MR. DRUCKER: The problem that we have is that in resolutions of these cases, particularly with the damage aspects of it, the Department of Justice is, both by its mission and by the agreement that we have with Justice as to how the program is administered, responsible for those determinations. We have open discussions with DOJ at very high levels of both the Department of Defense and Justice in how we are and have been administering this program. So I think that is one of the issues that is going to be looked at, is the approach to the monetary resolutions of the case. We may well come out with a final policy.

MR. LYTTON: Could I just comment on that? I think that the DOD's mission is different than DOJ's. DOD's mission is to stop the fraud, clean up the companies – a laudable mission. DOJ's policy is to get money. Prosecutors suffer from a prosecution complex. As one former prosecutor said, "It's an unnatural act not to prosecute somebody." He's now a defense lawyer and, of course, has seen the light, has had a lobotomy, as we all have. But I think in terms of settling civil cases, in my experience dealing with the Department of Justice, less attention is paid by them, in terms of the amount of the fine, to what type of compliance program you have than what you would normally have in any civil settlement; they pay more attention to the strength of the case. And if you can convince them they don't have a strong case, you're much more likely to get those damages down than if you go in and say we're really good guys. So I think that where you get the lower damages as an agreement in a settlement, it may be more as a result of the weakness of the government's case rather than the strength of the company's compliance program.

MR. SWENSON: We have a number of more questions, but we really have run out of time. So I would like to thank the panel and say that I think some of the issues that have just been raised are a nice segue into our next panel, where we will have representatives of the Justice Department talking about what their current policies are. Our thanks to the panel.

#### **QUESTIONS & ANSWERS – WRITTEN**

*Bill Lytton*

Q. Could an early disclosure to the government, if it erroneously reports an alleged crime by an employee, lead to a later civil action by that employee? How do employee rights figure into decisions to disclose about employee actions?

A. Almost any employee can sue his or her employer for anything. It is possible that an employee who was the subject of a disclosure that turns out to be incorrect could sue the employer. However, the employer should be able to argue that it acted in good faith, with a belief as to the truth of the matter asserted, and there may be an argument that that type of communication has a limited privilege which would shield it from being the basis for a law suit.

I am not aware of any such lawsuit having been filed, so I can only speculate on what the result would be.

Q. In your experience, how does the government see “full cooperation”? Does it mean full agreement with the government’s position (*e.g.*, your cartoon)? What does full cooperation get you and what does it not affect?

A. “Full cooperation” is in the eye of the government. It is a very subjective standard. The assertion of a privilege, the existence of a joint defense agreement to which the corporation is a party, a disagreement about the ultimate resolution – civil or criminal – can all be viewed by the government as a lack of cooperation. And, some prosecutors or enforcement personnel would be willing to use this as a threat – explicit or implicit – to obtain a result that they otherwise might not be able to obtain. The thing to remember is that this is not a level playing field that one might encounter in normal civil litigation. As a rule of thumb, it is not a bad idea to assume that some government personnel will construe lack of full agreement with the government’s position as a lack of cooperation.

“Full cooperation” can obviously be important if your company is being sentenced under the guidelines. In the more normal circumstance, it will make your life a lot easier, since the government may be less inclined to take a full pound of flesh, and will probably be more willing to concede that the company is “presently responsible,” and thus can continue to do business with the government.

Q. As a former Assistant U.S. Attorney and a current Defense Department (DOD) employee, I would be interested in the study you referenced as showing DOD employees 20 times more likely to violate criminal statutes than GE employees. Where may we find your study?

A. There is no formal study. The statistics were pulled together for me about five years ago by a paralegal. The statistics themselves are not important. The point is that the fact that a member of an organization, whether large or small, government or private industry, violates the law does not necessarily lead to the inescapable conclusion that the organization is evil. Unfortunately, this is the

conclusion that some in the media and in the government jump to when they learn that an employee of a corporation has committed a crime.

Q. Why is the *qui tam* statute inconsistent with the sentencing guidelines and their promotion of compliance — if an employee discovers grounds for a *qui tam*, compliance has failed, right? A meritorious *qui tam* action is a sign that a company needs to work harder to incorporate compliance into its culture. Comment?

A. The guidelines are inconsistent with the *qui tam* statute because while the guidelines encourage and reward a company for having an internal reporting system that results in the making of a voluntary disclosure, the *qui tam* statute offers an employee a huge financial incentive to avoid the internal reporting mechanism that a company has established. The government should not actively seek to undermine a corporation's efforts to comply with the guidelines.

The fact that an employee may think he or she has knowledge of a crime does not mean that a company's compliance program has failed. No institution in our society — the government, the churches, or the family — has been able to produce a perfect society. Zero defects is the goal of every organization. The fact that it is not achieved does not mean that the program failed. It may simply be a reflection of basic human nature. If a vaccine can reduce the incidence of a deadly disease from 30 percent to five percent, does that mean that the vaccine is a failure?

Q. *Qui tam* with its bounty inducement has yielded many times more dollar resources to the public fisc than has the industry-controlled company self-governance programs voluntarily disclosed through the Defense Department's Voluntary Disclosure Program. If bounties work, then what is your problem with *qui tam*'s obvious success?

A. *Qui tam* actions have resulted in many millions of dollars being recovered by the government. It has also made some private bounty hunter lawyers multi-millionaires, and it has been a windfall for the bounty hunter employees. Every dollar these bounty hunters get is one dollar less for the taxpayers.

We need to reexamine what our underlying policy goal is here. Are we trying to encourage vigorous compliance programs and effective self-policing by corporations who tell the government when the government has been cheated and pay the money back? Or are we interested in perpetuating a system where greed and bounty hunting lawyering are more prized? The present system encourages a game whereby rich lawyers become richer. That seems to me to be awfully hard to defend.

If we were to adopt a procedure such as I proposed whereby a *qui tam* action could not be filed until 60 or 90 days after an employee has brought the alleged

crime or fraud to the attention of the company, the obvious result would be more voluntary disclosures. A company would have to be nuts or awfully confident of its legal position not to notify the government in such a circumstance. The result would be more disclosures, more money to the U.S. Treasury, and more bounty hunter lawyers looking for some other line of work. Sounds like a win-win-win solution to me.

*Day Two*

## **The Experience and Views of the Enforcement Community**

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**Robert S. Litt** , *Deputy Assistant Attorney General, Criminal Division,  
U.S. Department of Justice*

**Ronald A. Sarachan** , *Chief, Environmental Crimes Section, Environmental and  
Natural Resources Division, U.S. Department of Justice*

**Gary R. Spratling** , *Deputy Assistant Attorney General, Antitrust Division,  
U.S. Department of Justice*

**Eugene M. Thirolf** , *Director, Office of Consumer Litigation, Civil Division,  
U.S. Department of Justice*

*Moderator: Commissioner Wayne A. Budd* , *U.S. Sentencing Commission*

**ROBERT S. LITT**

COMMISSIONER BUDD: Ladies and gentlemen, over the last day-and-a-half, we have been talking about the organizational corporate guidelines, the developing of effective compliance programs and standards, and the experience that various corporations have had. We have talked about carrots and sticks. We have speculated as to what the government wants, what the government is looking for. And now I suppose we will hear firsthand of the experience and the views from the perspective of the Department of Justice, which, as you know, is the principal and I suppose the ultimate law enforcement authority in the United States.

So what are the approaches? What are the policies of the Department of Justice regarding these guidelines? How does the government view or treat the good citizen actions, for example, voluntary disclosure, cooperation, and a strong compliance program? How does this come to play in charging decisions? When does the department decide to pursue a case perhaps civilly rather than to go criminally? And whether or not the various divisions within the Department of Justice approach these things in the same manner, or do they treat them differently? Does the Department of Justice speak with one voice?

I am going to start our discussion this morning with Bob Litt, Deputy Assistant Attorney General in the Criminal Division of the Department of Justice. He graduated from Harvard College, and he topped that only by attending the Yale Law School. He did clerk for Justice Potter Stewart of the United States Supreme Court. Between 1978 and 1984, Mr. Litt served as an Assistant United States Attorney in the Southern District of New York. He was for a while a partner in the well-known firm of Williams and Connolly here in Washington, D.C. So as our lead-off speaker in this morning's panel, I would like to call on Bob Litt.

MR. LITT: Thank you, Commissioner Budd. I do welcome the opportunity to address you all this morning and talk about the Criminal Division's views on corporate compliance and criminal law enforcement. Just to anticipate what you will learn in response to one of the issues that Commissioner Budd mentioned, I think you will find that some of the divisions of the Department of Justice have somewhat different approaches to these problems. I don't think there is necessarily anything wrong with that. It develops out of the different enforcement issues that we have and the different kinds of communities that we deal with.

But I want to begin by thanking and congratulating the Commission for having this symposium. It is all too rare for us to have an opportunity to exchange views, not across the table where somebody is representing a client in a litigation context, but rather, in a more informal and academic setting. And I am pleased that we were invited and able to participate in this.

In recent years, the Department of Justice has come to focus more and more on the importance of prevention and compliance, as opposed to enforcement and punishment, as a means of effective law enforcement. If you want to police an entire industry's practices, you frequently have to enlist the industry itself in helping you. And so we are looking for ways to encourage corporate self-policing. By this, I mean requiring or inducing corporate management to take more responsibility itself for preventing and detecting employee misconduct. This includes implementing comprehensive and effective compliance programs to prevent corporate

crimes, and it also includes voluntarily disclosing criminal activity to the government when the company discovers it.

Some of the other sessions of the conference are talking about some of these issues, and particularly the sentencing guidelines aspect of them, in greater depth. I would like to describe for you what the Criminal Division views as an effective corporate compliance program and also to talk to you a little bit about the principal means that federal prosecutors have for inducing corporate self-compliance, namely, prosecutorial discretion, voluntary disclosure programs, and I will talk briefly about the sentencing guidelines.

One question that prosecutors are often asked is: what do you consider to be an effective compliance program? Or to put it a little bit differently, what is it that you want us to do?

There is no pat answer to that question from the viewpoint of the Criminal Division. We don't have written guidelines, unlike the Sentencing Commission, for what constitutes a good corporate compliance program. In our view, any successful compliance program has to accommodate and be founded on the particular business that the company is in, as well as the existing corporate structure of the business. At bottom, the question that any prosecutor is going to ask about a compliance program is: does it work? Is it effective in this particular company?

Any prosecutor is going to recognize that no compliance program can ever prevent all criminal activity by rogue employees. We are not going to expect guaranteed 100 percent perfection out of you. Moreover, because each business and each situation is unique, we don't expect somebody to come in and match their compliance program up against the compliance program of another company and say, well, since Company X did this and we did it, therefore we should be treated like Company X.

What we want you to do, if you are ever faced with a situation where you have to deal with a prosecutor and talk about a compliance program, is come in and explain to us how your compliance program works for your company and why it is effective.

Although we don't adopt a cookie-cutter approach to compliance programs, there are certain overall principles about effective compliance programs that can be drawn from the Department of Justice's experience. The most important is that it is not enough simply to publish a corporate compliance program. We have seen all too many instances of companies which have a nice compliance program with a little gold seal at the bottom and a frame around it, and the company's officers and employees go out and violate the law anyway because the program is not an effective one.

At a minimum, to be effective a compliance program has to have the active and full support of a company's top management. The program also has to have concrete and specific measures to inform all of the company's employees of the program and to convince them that top management is committed to it. Finally, it has to be adequately staffed with people who are able to carry out the program to investigate, analyze, and report violations when they occur.

There are many different ways of achieving these goals. I am sure you have heard in other programs about some of the kinds of steps that companies have taken: ombudsmen, review boards, internal audits, written standards of conduct, ethics training programs, hotlines, newsletters and so on.

We are not asking you to adopt any particular one or combination of these features. What is important, as I said, is that at the bottom line you are able to come to a prosecutor and say, “Here’s what we have done and here’s why this is really effective.” Even though – if you are in a prosecution context – somebody committed a crime, here’s why our compliance program is good nonetheless.

Now, prosecutors have long taken the existence of a corporate compliance program into account in determining whether or not to bring criminal charges against the corporation itself. As you all know, a corporation can be held criminally liable for the acts of its employees within the scope of their employment and undertaken for the benefit of the corporation. That does not mean, however, that we are going to prosecute a corporation every time one of its employees commits a crime.

A good corporate citizen, one that is devoted to an effective compliance program, is much less likely to be prosecuted itself for the acts of its wayward employees than a rogue corporation with a culture that encourages or condones misbehavior. And, once again, I do want to caution you that prosecutors have broad discretion in making their prosecutive decisions, and the exercise of this discretion is going to depend on a wide variety of factors in each case. Corporate compliance is just one of the factors that we will take into account.

But it is true that in deciding whether or not to prosecute a corporation, most prosecutors will take a look at the compliance policies, take a look at the preventive and reporting procedures that the company has adopted, judge whether they were effective and appropriate given the company’s size and type of business, and give a company credit for that in determining whether or not to prosecute.

In addition, it is also common for prosecutors, in making an agreement not to prosecute a company, to require that the company promise in writing, to establish a compliance policy if it does not already have one, or to strengthen its existing policy and to report periodically to the government on how it is working. In other words, even if you don’t have a compliance program at the time you come into the prosecutor’s office, you ought to think about setting up an effective one and offering this up as part of a plea bargain or an agreement not to prosecute the corporation.

For example, within the last year, one United States Attorney’s Office declined to prosecute a major corporation in a fraud case. The company, when it learned of the wrongdoing, promptly fired the responsible employees, made an agreement to settle by paying restitution, and agreed to adopt a compliance program in writing that required it to report to the government any allegations about which it learns concerning potential criminal conduct involving government contracts. In other words, this company got credit in the prosecutive decision for, among other things, agreeing to set up an effective compliance program.



In addition to the issue of compliance programs, prosecutors will also consider what the company did when it learned of the wrongdoing. The strength of any compliance program and of any corporate commitment to good citizenship can be measured in part by whether the corporation acts promptly and diligently in detecting and correcting employee misconduct. While voluntary disclosure and cooperation with the government do not guarantee that a corporation will not be prosecuted, prosecutors often will give them great weight in making that decision.

In general, if a company promptly discloses wrongdoing, makes full restitution to the government, and takes swift disciplinary action against the employees engaged in the misconduct, a prosecutor may conclude that the federal interest in prosecuting the corporation under these circumstances is significantly lessened. And this is also something that you can see in many cases that you will read about in the papers, in which companies have come in, they have cooperated, they have reported themselves, and ultimately whatever action the government takes against the individual wrongdoers, the government does not prosecute the corporation.

In certain areas, this prosecutorial consideration of voluntary disclosure has been formalized in voluntary disclosure programs, such as the Department of Defense program discussed this morning, which has been operating since 1986. More recently, the Department of Health and Human Services and the Department of Justice have undertaken a pilot voluntary disclosure program.

Each of these programs provides significant incentives for corporations to disclose violations and to put into place programs to prevent violations in the future.

Generally speaking, a voluntary disclosure program follows a well-outlined path. Companies disclose wrongdoing by submitting a report to the enforcement arm of the investigating agency, which details the wrongdoing and provides the results of their internal investigation. If the agency determines that the disclosure is voluntary, that is, it is not prompted by the threat of discovery, the company and the agency will sign a written agreement that sets forth the parties' rights and obligations. Companies that are admitted to the program are expected to cooperate fully in the government's investigation and to take appropriate corrective and remedial action.

One of the hallmarks of a voluntary disclosure program is that the prosecutive decision made by a United States Attorney's Office is also reviewed centrally in Washington to ensure a certain degree of consistency and uniformity in whether these prosecutions are brought or not. From the corporation's point of view, the corporation expects that it will be afforded leniency both in the prosecutive decision and in any determination whether to debar the company.

I would just emphasize what I am sure is familiar to most of you: that these voluntary disclosure programs apply – at least those that the Criminal Division administers – only to the corporation itself and not to any individuals involved in the wrongdoing. Even if there is an agreement not to prosecute the corporation, corporate employees or officers can still be prosecuted.

Generally speaking, in determining whether or not to prosecute a corporation that is participating in a voluntary disclosure program, the prosecutor is going to consider factors such as the candor, completeness, and promptness of the disclosure, the extent of the fraud, the pervasiveness of the fraud, the level of corporate employee involved in the fraud, the cooperation that the corporation gave during the government’s investigation, and the remedial action taken by the corporation, including disciplinary action, restitution, and changes in or the institution of a compliance program.

Some of these factors can be more or less important in individual cases, but I think that in most cases two factors are the most important for prosecutors. One is the nature of the disclosure. Was it timely and candid and complete? Prosecutors are really going to take a look at whether the corporation came in at the outset and made a full disclosure of what was found, or whether the corporation came in with an attitude of, “Let’s disclose a little bit, let’s see what we can get away with, let’s resist and try to make the minimum possible disclosure.”

Prosecutors will also examine the circumstances of a disclosure carefully to make sure that it was, in fact, a truly voluntary disclosure and not one that was prompted by the issuance of grand jury subpoenas or a whistleblower or *qui tam* action.

The second critical factor that a prosecutor is usually going to consider in determining whether to prosecute a company under a voluntary disclosure program is the extent and nature of the company’s cooperation during the government’s investigation. A company will get far more credit for taking prompt and effective action against its own wrongdoers and for demonstrating in concrete ways its commitment to ensure that justice is done than for reluctantly or unwillingly aiding the government while secretly trying to protect its officers and employees. I recognize that this can be a painful process for a corporation, particularly when high management is involved in the offenses; but if a corporation wants to get credit from the government for good citizenship, it has to demonstrate its commitment to compliance when compliance is painful as well as when compliance is easy.

In assessing the extent of a corporation’s cooperation with an investigation, prosecutors are frequently going to require that the corporation produce documents to government, including internal investigative reports, audit reports and work papers, memoranda and notes of interviews of employees, descriptions of what files have been reviewed, technical assistance in auditing or contracting or other matters, and basically anything else that the prosecutor wants. I recognize that those of you who are corporate counsel probably are chilled by this idea. You are not used to the idea of turning these kinds of files over to the government. It goes contrary to your very nature. But we want to encourage corporations to commit themselves fully to compliance and cooperation with the government.

Bill Lytton earlier talked about some of the calculations that a corporation may go through – “Well, I might not get caught, or the cost of compliance and restitution may be great.” You can make those calculations if you want to, but don’t expect us to give you credit for them when you get caught. Half-measures by a company will not get full credit from the government in our prosecutive decision-making.

I believe that for most corporations, and in particular for publicly held corporations, the alternative of an indictment, a trial, and a conviction is far more damaging than the choice of cooperation with the government.

Finally, the operation of the new organizational sentencing guidelines offers further inducements to corporations to adopt effective self-policing and disclosure programs. As you no doubt have heard from others, the guidelines do provide a specific listing of factors to be taken into account in determining whether a compliance program is effective.

You can probably tell from the remarks I have made so far that these sentencing guideline rules in many respects are consistent with our own views in the Criminal Division. Over the years, prosecutors have gained substantial experience in identifying the characteristics that determine a corporate good citizen. In light of the paucity of prosecutions under the organizational sentencing guidelines, it is still too early to predict the extent to which these guidelines are going to influence prosecutors in their own determination of what is or is not an effective compliance program. However, I can probably predict that there is nothing in those sentencing guidelines that is going to be inconsistent with the views that prosecutors are going to take of what is an effective program.

Each of the factors that is included in the guidelines can be an important factor in an effective compliance program. In specific cases, some may be more important than others, and some may be less important. We hope over time to work with the Commission and its staff to refine the guidelines and our own approach in the light of our mutual experience. But we do believe that, in principle, the consideration of these factors of an effective compliance program for sentencing purposes will provide additional encouragement for you all to induce the adoption of effective compliance programs in your companies. In the long run, the most important result of this will not be the benefit that you get at sentencing or in prosecutive decisions, but the benefit that you get from instituting an effective compliance program that stops people from violating the law.

I have discussed several ways in which the law and law enforcement encourage the concept of the corporate good citizen. We want to increase compliance and enforcement by enlisting the help of you all to prevent crime before it happens rather than using the much blunter tools of the criminal law to punish crime after it happens. Corporate self-policing in the long run will reduce your costs and our costs as well. By presenting concrete incentives to companies to come in and establish compliance programs and to voluntarily disclose their wrongdoing, in the long run we hope to benefit law enforcement and society as a whole. Thank you.

**RONALD A. SARACHAN**

COMMISSIONER BUDD: Our next speaker is Ron Sarachan. Until about a year ago, Mr. Sarachan was the section chief of major crimes at the U.S. Attorney's Office for the Eastern District of Pennsylvania. Most recently, he has been holding down the position of Chief of the Environmental Crimes Section of the Environment and Natural Resources Division at the Department of Justice. But Ron didn't come to this job without experience in the environmental area.

While in Philadelphia, he co-founded and chaired the Philadelphia Environmental Task Force which coordinated federal, state, and local prosecution of environmental crimes. Prior to joining the Department of Justice, Mr. Sarachan served as a special assistant to the director of the Rhode Island Department of Environmental Management. He also had a stint in the private practice of law in New York City.

Ron Sarachan received his bachelor's degree magna cum laude from Brown University in Providence, Rhode Island, and he took his J.D. degree from the University of Michigan, also magna cum laude. With that, I would like to bring to the podium Mr. Sarachan. Ron?

MR. SARACHAN: Thank you. Thank you for this opportunity to speak and particularly for this format where, as Bob Litt said, it is nice to be able to talk about these issues when we are not thinking strictly about a specific case.

I will focus on environmental crimes, of course, and build on the comments that Bob Litt made. In the environmental area, as in other areas, we are very concerned about voluntary compliance and compliance programs, and I will try to explain why.

The Department of Justice has had a formal policy for four years to encourage self-auditing, self-policing, and voluntary disclosure of environmental violations by the regulated community, and I will address that policy in more detail.

I will try to cover three topics. One is violations in the context of existing compliance programs. By that, I mean cases in which crimes are committed when an organization has a compliance program and how federal prosecutors look at that. The next topic is compliance programs that are imposed as part of sentencing. In other words, there is no program or no effective program and one is imposed as part of an organization's sentence. It is a separate but very important issue under the guidelines. And, finally, I will address some brief observations about environmental crimes in Chapter Eight.

First, let me put some issues in context. Let me ask folks here: how many of you have represented an organization that has been prosecuted criminally in federal court for an environmental crime?

A few hands. That is actually consistent with my experience. The vast majority of environmental violations are not handled criminally. The government response ranges from informal contact by regulators, formal administrative action, civil enforcement, and, finally, criminal enforcement. And it is a pyramid with a very broad base. So the majority of violations

are going to be handled by the regulatory agency. Criminal prosecutions, as you could see from the very small number of people raising their hands, are the tip of that pyramid, and a small tip. And that is appropriate. Criminal enforcement is one tool. It is only one tool. It should be reserved for egregious cases.

In addition, as other speakers have said, there is no way for the government to be everywhere to monitor everything. That is certainly true in the environmental area given all the facilities subject to regulation. Environmental laws rely in a fundamental way on self-reporting and the honesty of the regulated community and the openness of the regulated community. As a result, the environmental laws, as you know, impose many mandatory disclosure and reporting requirements. They create a structure in which a central feature is the flow of information from the regulated community to government officials, the theory being that those government officials can review that information, make sure that environmental problems that could affect the public health and welfare are fixed, and act to prevent future harm. The system depends on the honesty of the regulated community to provide truthful and complete information.

As good corporate counsel out there know, when you are making the decision about making a voluntary disclosure, you don't think about making it to the Environmental Crimes Section or the Criminal Division of a U.S. Attorney's Office. If you did that, you would be defining your own problem as a criminal problem. The vast majority of voluntary disclosures in this area are made to the regulatory agency, with the hope, reasonably, hopefully, that it will remain an administrative matter.

As a general rule, in the criminal business we don't see the good corporate citizens with the good compliance programs. An organization with an environmental problem that is honest about it, that reports it to the regulatory agency, that works with the agency and is doing its best to fix that problem, the regulatory agency is not referring that kind of case to us. Chances are we never see that sort of thing, and if we do get it, those are all reasons to decline that case criminally.

Let me address one definitional issue that was touched on yesterday. When we speak of an effective program to prevent and to detect violations of law, how do we take into account the small companies, the ma and pa companies? The small companies, as people said, are unlikely to have a formal compliance program. However, they may still have the functional equivalent of those seven steps that you need for an effective program as set out in the guidelines. The kind of questions we would ask in the environmental context, in the criminal context, are: do the company's employees receive training needed to properly handle the chemicals used in the production and the waste generated? Do the employees have the necessary equipment? Are sufficient funds budgeted to do the job? Are supervisory responsibilities for proper handling of these materials clearly defined? Do employees know who to talk to about environmental problems? And do the supervisors have adequate authority?

Has the organization made its commitment clear? Are employees instructed to report problems, and does management respond appropriately, without retaliation? There are two sides to this. People who don't act properly, are they disciplined? And is proper environmental compliance incorporated into the standards by which employees are evaluated? It should work both ways.

Is day-to-day supervision adequate to quickly detect violations? Are there plans for emergencies? In general, does the corporate culture support compliance? A small company can have or do all those things. It can have the systems to do those things without any sort of formal program. If you ask its employees, "Does it have a compliance program?" they would say no. Nonetheless, the company can still do those things. And that raises a very difficult issue for the government and for the Sentencing Commission in dealing with different size companies.

The guidelines recognize that issue when they say that the larger companies will necessarily need to have a more formal program. But what do you do with the small companies? You need flexibility. Otherwise, the small companies are going to be left out of this whole process, and we're going to have a system that can benefit and encourage compliance with big corporations and ignore much of the business community.

On the other hand, if you define it too loosely, you dilute the standards for what these programs or systems are all about. You encourage after-the-fact rationalizations, with people claiming they had the systems, inventing it, after the crimes, and you add to litigation at sentencing.

When I talk about this in the rest of my remarks, when I talk about a program, I'm thinking of a system with enough flexibility to include the small companies. Let me address the department's July 1991 policy.

So far, what I have talked about are case referrals and the importance of compliance programs, and they are centrally important. Now we are talking about charging decisions. The Justice Department's July 1991 policy addresses charging decisions. It makes voluntary compliance an important consideration in those decisions. It specifically encourages prosecutors to take them into account in ways that will encourage self-auditing, self-policing, voluntary disclosure. It's always those things together.

The factors under the policy are similar to the factors you see under other policies and that the guidelines talk about: voluntary disclosure, cooperation, preventive measures and compliance programs. The policy also talks about additional factors that are considered especially important:

Pervasive non-compliance. If there's a claim that there is an effective program but we're seeing pervasive non-compliance, that's very strong circumstantial evidence that there is not an effective program.

Internal disciplinary action is critical. Subsequent compliance efforts are also extremely important in the environmental area, given the catastrophic harm that can be caused by these crimes.

No single factor is controlling, and we look for all three steps. You can do a beautiful audit of the company, and if it sits on the shelf and there is no follow-through, it is not doing anyone any good. There has to be an audit; there has to be disclosure; there has to be correction.

Different factors can be more or less important in any particular decisions, but we're looking for each of the steps.

Now, let me talk about the application of the policy and my own observations. Our experience in criminal cases is that typically the policy has not been at issue because there has either been no program or because there has been a completely inadequate paper program in our cases. Let me explain that and describe our cases.

Most of the environmental crimes, many of them, fall into two categories. The first are defendants who misuse the regulatory system for criminal purposes, often to commit fraud. The second are defendants who make a deliberate business decision to break the law for a business reason. They break the law to save a buck.

Not only can it pose a serious threat to the environment and to the public health when that happens, but it also puts competitors who are playing by the rules at an unfair disadvantage. Rather than trying to describe all the factors that go into what makes an environmental violation a crime, what I always try to do is take some of the last cases that I have personally been involved in, because I think a picture is worth a thousand words.

First of all, as far as a defendant who misuses the regulatory system to commit fraud, we recently had a case against a company in North Carolina. The company held itself out as being in the business of reclaiming waste oil and properly disposing of industrial waste water. Other businesses would come to this company and pay it money to properly dispose of their waste. The company would routinely take the waste and put it down the sewer without proper treatment. It included waste with heavy metals, other toxic and hazardous substances. To avoid being caught by the regulators, the company tampered with the monitoring devices.

So here is a company taking money, saying that it would comply with the environmental laws. It only was able to exist because the environmental laws impose these requirements, and then it didn't follow through with what it had promised. So it is a straight commercial fraud as well as an environmental violation.

As far as the other kinds of crimes, we recently this summer finished a trial against an electroplater in Texas. This company generated a couple kinds of hazardous waste: sludge from its giant tanks, plating tanks, as well as waste water. This company disposed of its hazardous waste water by pouring it on the floor. It typically had six inches of this waste water on the floor. The workers had pallets, for as long as they'd last, sitting on the waste water, and they would stand on these wooden pallets. There were drains in the floor, and the waste water went down the sewer.

When things go down the sewer, the treatment works, the sewage plants, aren't typically built to handle this material, so it in one way or another gets through the plant and ends up in the environment in one form or the other.

Also, with six inches of waste water on the floor, sometimes it wouldn't go down the drain fast enough, so the company would pump it out into the street or employees would take brooms and sweep it into the back alley.

The authorities in Texas did everything they could to get the company into compliance. They showed remarkable constraint. They brought administrative actions, civil actions. There was a federal civil action. This went on for ten years until the criminal case was brought. The president, vice president and plant manager, and corporation were convicted.

A compliance program was not really an issue in that kind of case, although the company did charge a five percent surcharge for its products for its compliance program. I don't know what that was.

When you think about it, though, it's outrageous. The people who worked in that plant were likely working there because they didn't have any other place they could work, and they're standing over liquid hazardous waste all day long.

Another case recently, this summer, in Massachusetts, ended in a guilty plea by a major corporation. The corporation discharged oil and grease into the Charles River from one of its facilities for 15 years. It was done chronically; it was done knowingly. Its own contract lab sent its reports for a while on a weekly basis showing that it was in violation of its permit, sometimes by 30 times, when it had a permit.

Internal corporate memos show that some officials in the company knew that the pollution control equipment never worked and that it was being bypassed.

Again, that's not a case where we're dealing with a compliance program at the time of the crime. That's a case where as part of sentencing we are seeking to have the compliance program imposed.

Where there have been compliance programs in cases, my observation is that federal prosecutors have taken it very seriously. They have followed the policy. They have bent over backwards to give companies a break in order to encourage compliance. And, again, let me give you an example from a recent case. There aren't a lot of examples. It has not come up a lot.

This is a case against PEPCO in Maryland. The company had been violating the Clean Water Act for five years on almost a daily basis. There was an open investigation by the U.S. Attorney's Office, but it was for commercial bribery. They were not aware of the environmental violations. The discharge was from a 600-acre flyash storage site, and it included extremely acidic water and water containing heavy metals which was being pumped illegally into a swamp, but the swamp would then flow into a river. And it was done surreptitiously at night by one company employee, who would then order other people to do it.

The company came forward. The government made no promises at the outset but asked for cooperation. The company was fully cooperative. It did all the sorts of things that Bob Litt was talking about. It gave summaries of employee interviews. It gave the internal investigative report. It gave consent to search and access to facilities. Employees were made available for interviews. The company identified possible employee witnesses as well as possible employee subjects of the investigation. The company took disciplinary action, and eventually the U.S. Attorney's Office prosecuted the plant manager for commercial bribery and for violations of the Clean Water Act and agreed that it would not prosecute PEPCO. There was a civil action.



The prosecutor applied the department's 1991 policy. There had been disclosure. Both the guidelines and the DOJ policy talk about the key being promptness, that is, disclosure before the person making the disclosure knows about the government investigation. Here it was very timely. PEPCO acted quickly when they discovered it.

There also has to be full cooperation. There was very good cooperation here. This is a very difficult area. I've seen it a little in the environmental area. I've seen it more in fraud cases and other cases in the context of full cooperation, because what happens a lot is you end up sitting down at a table and the prosecutor's on one side, corporate counsel, defense counsel, maybe outside counsel, are on the other side, and there is a discussion about whether the company is being cooperative, whether it has fit all the criteria to get the break or to get some consideration.

What happens is, to the prosecutor it looks like the company is holding back, and when you look at the other side of the table, counsel is looking very frustrated at the prosecutor. Typically, in my experience, what is happening is they're operating from very different facts; the witness who is being interviewed as part of the internal investigation with corporate counsel present is not saying the same thing when that whistleblower employee is calling up the FBI and spilling his guts. And so what's happening is the prosecutor perceives the limited information as a company holding back. In fact, what may be happening is corporate counsel is saying everything he or she knows, but doesn't know as much as the government knows, or knows different things. Many of the disagreements over what appear to be applications of policy really arise because the factual world view of both sides is completely different.

Finally, preventive measures and compliance programs – PEPCO did have a program in place, and it fit what the DOJ policy talks about as being a regularized, intensive, and comprehensive program rather than the phrase “effective program” that you see in the guidelines. Perhaps it was not a super policy, but there was something in place.

Probably most importantly, it was adopted in good faith. It appeared to have been established in a timely manner. And as Bob Litt pointed out, we see all too many times instances where suddenly there's a compliance program after a company knows it's being investigated. That's something that we get very cynical about.

I have talked about the first two screens where compliance programs apply: case referrals and charging decisions. Let me move on to sentencing. As I have said, we have not seen this come up in a lot of sentencings because those first two screens are at work.

In addition, I have to make a disclaimer. As you know, Chapter Eight, the fine provisions, do not apply to environmental crimes except for criminal purpose organizations. So our experience with the fine part is in a pre-guideline setting.

What I want to suggest is that in the environmental area, compliance programs are not merely important; they are necessities. You have to have a compliance program. Employees must know what they have to do to handle dangerous materials and waste, and management needs some sort of system to ensure that the standards are being met. The guidelines appear to recognize that. The guidelines say if an organization handles toxic substances, it must have

established standards and procedures designed to ensure that those substances are properly handled at all times.

Given the importance and the essential nature of compliance programs, what I want to suggest is we may be past the point where, as a matter of sentencing, there should be simply a benefit if a defendant has a program. Compliance programs perhaps should be the baseline. And if a defendant has an effective program, it should get a benefit. But if it has nothing, then there should be a penalty attached to that. We are past the point where we can ignore this area.

Let me talk briefly about compliance programs as part of a criminal sentence. Reflecting our strong interest in these kinds of programs, in a number of recent and important cases, compliance programs have been a very important factor in plea agreements. Recent cases include Palm Beach Cruises, Crescent Ship Services, Ketchikan Pulp Company, and ConRail.

The catalyst for this really comes from the guidelines for organizations. If you speak to the prosecutors handling these cases, they point to the guidelines. While the fine provisions don't apply to environmental crimes, the organizational probation provisions do, and they talk specifically about seeking compliance programs as part of sentencing.

Common terms in these plea agreements are five years organizational probation, an independent auditor, and a very detailed program that must be approved by the court. More recently, we're looking for an assessment of the problems before sentencing. It not only helps speed things along, but it's a real aid to the court at the time of sentencing. The first couple of times, we didn't do that. At sentencing what we had basically was a commitment to do the plan or the program. The result was a necessity for hearings after sentencing to get the same job done. It is more efficient to try to get a head start.

A specific corporate executive is named as being directly responsible for managing the company's compliance with the program, quarterly reports to the court and the government, and then periodic inspections by government personnel and private consultants.

Again, let me suggest that in looking at these compliance programs, specifically in the environmental area, it's important to look at the guidelines and, in some instances, to make adjustments. Just as an example, the provision which authorizes examination of books and records in order to monitor compliance programs is a great provision, 8D1.4(c)(4). In a financial sort of program, that may well be enough, but for an environmental compliance program, inspecting books and records doesn't go the whole way. The government needs to have opportunities for sampling, opportunities for site inspections, if these programs are really going to be monitored. So there's a need to make adjustments to take into account environmental crimes in these provisions.

My final observation is a general one about Chapter Eight and environmental crimes. This is really responding to the sort of comments we heard this morning from Bill Lytton and others about the need for consistency, or at least if not consistency, to look at the differences and see if the differences make sense.

This is just one example, and that's all. The guideline provision for self-reporting gives credit for self-reporting, cooperation, and acceptance of responsibility. There's no differentiation made on voluntary disclosure between the disclosure that is voluntary and the disclosure mandated by law already. So you could be required by law to make the disclosure, and you'd get the same credit, as I read it, under the guidelines.

Under the department's policy, a voluntary disclosure does not include a mandatory disclosure. So that's a difference, and there are arguments on both sides. Perhaps at this sort of symposium in the future, those sorts of considerations for environmental crimes and Chapter Eight should be considered, with each point looked at carefully. Anyway, those are some thoughts. I very much appreciate this opportunity to address you. Thank you very much.

**GARY R. SPRATLING**

COMMISSIONER BUDD: Our next panelist is Gary Spratling. Mr. Spratling is, of course, with the Department of Justice, and he serves as the Deputy Assistant Attorney General for Criminal Enforcement within the Antitrust Division. In that capacity – and you may have read about this in today’s paper – he led the way in obtaining a plea from a company by the name of Dyno Nobel, and that plea involved a \$15 million fine. It can only be described, I assume, as an explosives price-fixing case.

Gary has served as a prosecutor at the Department of Justice for some 24 years, and during that time he has received a number of professional awards and honors, including the John Marshall Award for the Supervision of Litigation and the Presidential Rank Award. Mr. Spratling is also very active in the Bar Associations across the nation, and currently he serves as the vice chair of the Criminal Practice and Procedure Committee of the American Bar Association’s Antitrust Section. Ladies and gentlemen, Gary Spratling.

MR. SPRATLING: Thank you, Commissioner Budd, and good morning. Let me begin by expressing my appreciation for the opportunity to address this group. It is an honor to be asked to join the distinguished group of speakers that this symposium has brought together. And now you get to hear the antitrust perspective, and it’s going to be different in a number of important respects from what you’ve heard thus far.

As a prosecutor, when I think of a good corporate citizen, I think of a corporation that has an effective compliance program, one that reports its violations whenever that program is not completely successful, and one that accepts responsibility and cooperates in any resulting government investigation.<sup>15</sup>

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<sup>15</sup> For prior discussions about compliance programs and antitrust enforcement, *see* “Antitrust Compliance Programs: Are They Worth It? Between Prevention and Sentence Mitigation – Don’t Forget Amnesty and Other Forms of Favorable Treatment by the Government,” paper by Robert Bloch, Chief, Professions and Intellectual Property Section, and Gary R. Spratling, San Francisco Field Office, Antitrust Division, State Bar of California Annual Golden State Antitrust and Trade Regulation Institute (September 9, 1993); “Corporate Compliance Programs, Antitrust Enforcement and the New Organizational Sentencing Guidelines: A Prosecutor’s Perspective,” remarks by Robert Bloch, before the American Bar Association Annual Meeting (August 10, 1992); “Antitrust Compliance Programs Under the Guidelines: Initial Observation From the Government’s Viewpoint,” article by Neil E. Rogers, Chief, Legal Policy Section, Antitrust Division, *Corporate Conduct Quarterly*, Summer 1992; “The Importance of Detering Antitrust Crime: Corporate Compliance Programs and Federal Antitrust Enforcement,” remarks by James F. Rill, then Assistant Attorney General, Antitrust Division, before the Symposium on Antitrust and Association Law (February 20, 1992); “Corporate Compliance Programs and Federal Antitrust Enforcement: A Cooperative Approach to Detering Antitrust Crime,” remarks by James F. Rill, then Assistant Attorney General, Antitrust Division, before the Symposium on Antitrust Enforcement (March 19, 1991).

However, as a comparison of Bob's and Ron's remarks would indicate, and as the addition of my remarks will make absolutely clear, the manner in which federal prosecutors take compliance programs, self-reporting, and cooperation into account at the various stages of investigation and prosecution can vary significantly from one component of the Department of Justice to another, and the sentencing guidelines don't resolve all the issues with respect to credit for those actions at the sentence mitigation stage.

Therefore, my purpose in this presentation is to address four issues regarding my postulated elements of corporate citizenship, that is, compliance programs, self-reporting, and cooperation, from the perspective of an Antitrust Division prosecutor.

First, what effect do compliance programs have on the operation of the Antitrust Division's discretion?

Second, what is the Antitrust Division likely to require in a compliance program before it acquiesces to a reduction in culpability score and a reduction in fine range for a corporation?

Third, is the sentence mitigation sufficient in antitrust cases to justify the effort required for an effective compliance program and the risk of the self-reporting and cooperation required for full credit in the guidelines?

Fourth, are there even more important potential benefits from a compliance program, self-reporting, and cooperation than exist in the sentencing guidelines? And in connection with that topic, I will discuss the Antitrust Division's amnesty programs, one for corporations and now one for individuals.

Lastly, I would like to discuss a not directly related issue, but in order to discuss the fine that Commissioner Budd mentioned a moment ago, I would like to discuss the impact of the sentencing guidelines on fines in antitrust cases.

Let's look first at the Antitrust Division's perspective on compliance programs and the exercise of our prosecutorial discretion. What if, in spite of a compliance program, a violation occurs? Will the corporation get credit from the Antitrust Division for having that compliance program in place at the charging stage, at the sentencing, or in both?

First, the charging stage. This is the bad news for corporations. The existence of a compliance program has a very limited role in how we exercise our prosecutorial discretion. Once a violation occurs, the compliance program can do little, if anything, at the Antitrust Division to persuade us not to prosecute the corporation.

During the pre-indictment phase of a grand jury investigation, we frequently hear from counsel representing the corporations that the corporation should be excused from criminal liability because of an individual employee's conduct that occurred without the knowledge, approval, or authority of the corporation, and, in fact, in direct contravention of the corporation's compliance program. This is the "rogue employee" argument, and we hear it in every antitrust case.

The argument is that, therefore, the employee’s conduct should not be imputed to the corporation. We also hear a related argument in antitrust cases that we should not indict the company because the minute the company found out about the rogue employee’s conduct, it instituted a compliance program to stop similar conduct in the future; and so since it has instituted that conduct to prevent similar violations from occurring, there is no further need for a deterrent effect.

The Antitrust Division does not give much weight to either of these arguments in the pre-indictment stage. To the extent that antitrust prosecutors allow failed compliance programs to excuse antitrust violations, we believe that we undermine our own efforts to deter crime. Were we to credit failed compliance programs at this charging phase, there would be less incentive for companies to make sure these programs work, to refine the programs, and to make them effective. The ultimate goal, after all, is a compliance program that prevents crimes, not one that excuses the corporation in the event that one occurs.

Although the existence of a compliance program will rarely prevent a corporation from being pursued criminally by the Antitrust Division, a sound compliance program may serve to reduce, and reduce significantly, the fine that a corporation has to pay upon conviction.

The Sentencing Commission has set out in detail what it means by an effective compliance program and has described the seven due diligence criteria as the minimum types of steps that must be taken in order to qualify as an effective compliance program. I’m not going to review those because by now you know them by heart.

If these seven requirements listed in the sentencing guidelines are the “minimum types of steps” that must be taken, that raises the issue of what, if any, additional steps federal enforcers believe should be taken before a company gets credit for a compliance program.

Bob talked about some of those additional steps, Ron talked about some of those additional steps, and the Antitrust Division has identified additional steps as well, largely consistent with those that Ron and Bob described:

- No credit if, after an organization becomes aware of a violation, it delays unreasonably in reporting it to the government authorities.
- No credit if high-level people are involved in the offense.
- No credit for paper programs. This is something that I think Bob referred to as empty programs, where there is no real commitment for detecting offenses.
- Lots of credit for affirmative steps to detect price fixing and bid rigging, and examples are set forth in the materials.

For credit, it is critical to have regular and unannounced audits of pricing and bidding personnel. For credit, the compliance program must be customized to the firm’s specific organization, operation, and personnel. And for credit, the compliance program should have

negative incentives for violations – loss of position, forfeiture of benefits and so on – and positive incentives for those that report violations.

If a firm does get credit for an effective compliance program, that credit could reduce an organization's maximum fine by more than 50 percent, which, of course, in the antitrust area can be many, many millions of dollars. But that's not the best part of a compliance program. The really good news has to do with all the potential valuable benefits to a corporation between prevention and the sentencing guidelines. And let me explain that.

In the antitrust area, there are two special antitrust-only provisions in the sentencing guidelines. The first provision is an instruction to use 20 percent of the volume of affected commerce in lieu of pecuniary loss in calculating the base fine. The second provision is that whatever an organization's culpability score, neither the maximum nor the minimum multiplier may go below 0.75. As you know, as the culpability score goes down for all other types of offenses in the sentencing guidelines, you can get down to 0.05.

The net result of these two provisions is that there is a floor in antitrust cases, a minimum fine of 15 percent of the volume of affected commerce. This has caused a lot of commentators to ask the question, "Is there a sufficient incentive in the sentencing guidelines for an antitrust offender to come forward?" Indeed, a firm that starts with an initial culpability score of, say, five can get down to very near the minimum multiplier for an antitrust case of 0.75. It can get down to 0.80 just with acceptance of responsibility – without having a compliance program, without self-reporting, and without cooperation.

Of course, the problem with that analysis is the wrong question is being asked. The question is wrong because it's looking to the effect of those activities at the sentencing stage of the enforcement process instead of looking to the beginning of the enforcement process when each of those actions – compliance programs, self-reporting, and cooperation – has its real benefit. That's where those activities may actually result in the corporation not being subject to the sentencing guidelines at all; or if it is, benefiting from very substantial reductions in the minimum fines set forth in the guidelines.

Early detection of a violation through a compliance program affords an organization the opportunity to consider the options of voluntary disclosure in the case of the defense procurement fraud area, self-reporting in the case of antitrust, and cooperation with the government at a time in the enforcement process far before conviction and sentencing when those actions had the potential for very favorable treatment for the organization, including complete amnesty, a pass from prosecution. And if amnesty isn't available, there still remains a whole range of disposition alternatives with substantial benefits to the organization, benefits which are unavailable to the organization that does not have a compliance program able to detect those violations early, and that is therefore unable to come in and be one of the first ones to cooperate with the government.

Let's look first at the amnesty program at the Antitrust Division. The Antitrust Division first announced its corporate amnesty policy, also known as the corporate leniency policy and corporate immunity policy, but most commonly referred to as the corporate amnesty policy, in October of 1978. That policy was in effect for 14-and-a-half years, and the policy

said that the Antitrust Division was prepared to give serious consideration for lenient treatment to organizations that voluntarily reported their illegal activities and came forward to us before the violations were detected by the division.

The grant of amnesty was not automatic, was based on prosecutorial discretion pursuant to a seven-factor test, and was available only to people who came forward or organizations that came forward before we had begun an investigation, which is still the case in the other divisions of the Department of Justice.

In 1993, the incoming and current Assistant Attorney General for Antitrust, my boss, Anne Bingaman, said that a corporate amnesty program made good sense, but that the long-standing policy of refusing to give amnesty to anyone, no matter what they could offer because an investigation was underway, was maybe denying the Antitrust Division valuable cooperation that would be in the public interest. So she changed the amnesty policy in several respects, making three important changes.

First, if a corporation comes forward before our investigation begins, amnesty is automatic. There is no prosecutorial discretion involved. It is a certain grant of amnesty, and the criteria are similar to conditions under the earlier policy.

The second major change is that if a corporation comes forward after our investigation begins, it may still qualify for amnesty. This is a discretionary grant of amnesty based upon seven criteria. The first two of these criteria are the threshold criteria. The first criterion is you have to be the first corporation to come forward. The second criterion is that at that point in the investigation we cannot yet have sufficient evidence against the corporation to result in a sustainable conviction. The seventh criterion establishes that the earlier you come in, the more likely you are to get amnesty.

The third major change is if a corporation qualifies for automatic amnesty – and this is different than any other division of the department – then all directors, officers, and employees who come forward with the corporation and admit their involvement and cooperate in the investigation will also receive automatic amnesty.

Note that whether or not an investigation has begun – that is, whether or not you are seeking to get automatic amnesty or alternative amnesty – you must be the first corporation that comes forward. There are no two bites here. Only the first corporation gets amnesty.

The number of corporate amnesty applications has increased significantly under the new policy. So Anne Bingaman was right. Under the old policy, we received, on average, one amnesty application per month over the course of 14-and-a-half years. Since the new policy went into effect, we started out at and we have continued and, in fact, in recent months it has gone up a little bit, but we are receiving on average one amnesty application – did I say before per month? I meant per year. We are now receiving one amnesty application per month.

In August of 1994, one year to the day after Anne Bingaman announced the new corporate amnesty policy, she announced the first ever individual amnesty policy. This is separate from coming forward with a corporation. After the corporate amnesty policy was



announced, some asked, “What about individuals who come forward on their own behalf? What if they don’t want to wait for detection by the corporation and wait to see what the corporation is going to do? What about individuals who want to come forward on their own after a corporation has detected the violation but has determined it’s not going to do anything about that detection?”

Many thought that such individuals that come forward on their own also ought to be eligible for amnesty, and so we have the new policy that provides that, one, if an individual comes forward before we have an investigation; two, reports with candor and completeness and then cooperates in the investigation; and, three, was not the originator or leader in the activity and didn’t coerce anybody else into doing it, then that individual gets automatic amnesty.

Even if an organization comes in and does not meet the amnesty requirements, it may receive a fine below, perhaps substantially below, the guidelines minimum for substantial assistance in the prosecution of other individuals and organizations. And if you come in, even the next step, if you come in and you are not yet in early enough to qualify for the substantial assistance reduction for cooperation, the government can still tailor a criminal settlement that is advantageous to that organization and favorable as compared to organizations that will come in later.

Since I have just been given the five-minute sign, I won’t go over those other types of favorable treatment.

To sum up my remarks on the first four topics, when a firm detects a violation early, especially before we have an investigation underway, it is time for that firm’s counsel to host “Let’s Make A Deal.” When counsel or the client detect a violation before we do, it is one of those rare times in our system of law that counsel for a corporation that has committed a felony is in the driver’s seat. Why? Because we want the information your corporation has to offer more than we want your corporation as a defendant, because your corporation is going to allow us to prosecute other culpable corporations and individuals. And so when you find yourself in that situation, don’t think about the sentencing guidelines. Think about: can we cooperate early? Can we report to the government, work in their investigation, and possibly qualify for amnesty and not be subject to the sentencing guidelines at all?

My last topic is fines in antitrust cases under the sentencing guidelines. In November 1990, the maximum Sherman Act fine for a corporation found guilty of a criminal violation was raised from \$1 million to \$10 million. The combined effect of this change in the maximum statutory penalty and the minimums established by the sentencing guidelines for antitrust offenses is now becoming very apparent.

In the past 14 months, six corporations have paid fines of at least \$4 million for single-count Sherman Act violations. Two weeks ago, an antitrust defendant agreed to pay and the court imposed the statutory maximum fine of \$10 million for the defendant’s participation in a conspiracy to fix prices and rig bids in the explosives industry. This was the first time that the maximum statutory penalty had been imposed under the Sherman Act.

And yesterday, as Commissioner Budd mentioned, a defendant agreed to pay and the court imposed a \$15 million fine on a company in that same investigation. A \$10 million maximum on the first count and a \$5 million fine on the second count, which involved an agreed-to upward departure by both the government and the defendant under circumstances that unfortunately I do not have time to discuss.

The \$15 million fine is the largest fine imposed on a single defendant in a criminal antitrust case. It is instructive to look at how that \$10 million was arrived at because it did not involve an extraordinary amount of commerce, and let me, in the interest of time, just focus on the first of those cases which is United States v. ICI Explosives.

The parties reached an agreement that the volume of affected commerce was approximately \$50 million. Following the guidelines instruction to use 20 percent of the volume of affected commerce in lieu of pecuniary loss, the defendant's base fine was \$10 million. The parties also stipulated that the defendant warranted a culpability score of seven, which would have been much higher but for its early cooperation with the government throughout the investigation, and, thus, its minimum and maximum multipliers were 1.4 and 2.8. That meant that the range of fines for the corporation was \$14 million to \$28 million. In this case, the division agreed that the calculations of double the loss and double the gain would unduly complicate and prolong the sentencing process and agreed that a \$10 million statutory maximum was appropriate.

As the calculation that I have indicated to you in this case should indicate, the \$10 million maximum in an antitrust case can be reached very quickly with volumes of commerce much less than \$50 million, especially for organizations that do not cooperate.

A concluding point: A Wall Street Journal article last week that suggested that the sentencing guidelines have been used, for the most part, only against small companies. At least in the antitrust area, such a notion is not true. There is nothing fundamentally wrong with the guidelines with respect to corporate fines. Statistically, of course, there are more small companies than there are large companies. Our investigations develop evidence of violations against small companies and against large companies, wherever that evidence exists. Proof of the larger conspiracies often take longer to develop; however, as a matter of prosecutorial discretion, you can bet that we are looking at the larger conspiracies and looking at the larger companies.

The average fine imposed on corporations in Antitrust Division cases has increased 170 percent between 1992 and 1995 to date. At the Antitrust Division, we try to be equal opportunity prosecutors, bringing cases against both large corporations and small corporations, as the \$10 million and \$15 million fine should confirm. And note that those large fines were imposed upon corporations that cooperated: ICI, which received the lower fine of \$10 million because it cooperated early in the investigation, and Dyno Nobel, which is cooperating now. Had those firms not cooperated, we would have sought higher fines. Thank you.

**EUGENE M. THIROLF**

COMMISSIONER BUDD: Our final panelist will be Gene Thirof. Mr. Thirof graduated from St. Louis University School of Law and spent some time in the area of legal services. After a few years in that capacity, he went to the Department of Justice where he was assigned to the then newly created Office of Special Investigations, which had as its charge the investigation and litigation of cases involving Nazis and Nazi collaborators who illegally immigrated to the United States.

In 1981, Mr. Thirof became a senior litigator with the Department of Justice's General Litigation and Legal Advice Section, where he prosecuted complex legal cases. Since 1992, Gene has served as Director of the Office of Consumer Litigation. In this capacity, he has had responsibility for both the civil and the criminal enforcement of the Food, Drug, and Cosmetic Act, the Federal Trade Commission Act, the Consumer Product Safety Act, among other statutes. Mr. Thirof?

MR. THIROLF: Thanks very much, Wayne. Thanks for the opportunity of appearing before you. Good morning. Over the last few years, I have spoken to a number of groups and associations about the consequences of sentencing guidelines on their organizations that were or could be facing criminal prosecution. I have heard defense lawyers, not unlike today, portray the sentencing guidelines and those of us federal prosecutors who do white-collar work as being more or less the villains in a Dickens plot in which the lives of executives and the fortunes of firms regulated by the government are ruined.

I'm not that bad a guy. But if being brought out in this sort of symposium to say that you'd better adopt a compliance program or the dogs will be let loose results in your adopting meaningfully successful compliance and ethics programs, then it's worth it to you and to me.

None of us takes any delight in the distress of others, be they corporations or individuals. We want you to make money. We want you to be prosperous. Indeed, the food and drug firms, which is a good part of our practice, have been very successful and innovative during the years that we have been involved. But most of all, we want you to stay out of trouble.

Our experience has been that guilty corporations do criminal acts that you would want punished, especially if they were your competitor, if it was not your case and if it was not your firm.

Ladies and gentlemen, we have been through this for a number of years because the food and drug statutes and some of the other statutes that we handle have imposed a self-audit, a compliance responsibility on responsible corporate officials for many years. And do you know what? We fight over, when we talk to potential criminal defendants, criminal defendants after they have been convicted, whether or not their compliance program was meaningfully successful, whether or not corporate officials at a high level were involved. Because there is an adoption of a program does not mean that it works and does not mean that it should be given credit when the process is underway. And, indeed, the guidelines contemplate that we are truth seekers in that endeavor as well.

When I encounter a corporation in a negotiation to settle a particular criminal matter, I feel a little bit like someone's spouse who has warned you about some misadventure, only to be saying later, "I told you so." Well, I have news for you. I have been in a number of these sessions, and at each one I have said, "I am going to remind you if you come in to see us that I told you so."

At the urging of Win Swenson and some other members of the bar, I am trying to explain to you why, in our experience over the years, sound management principles, good science, and good judgment, and now the over-arching discipline of the sentencing guidelines, can prevent you from getting into trouble in the first place and can even inure to your benefit if you are prosecuted by any one of these components of the Department of Justice.

To prove what you have been learning all week is common sense, let me quote from Judge Wolf's conclusion in an opinion accepting the \$61 million civil and criminal penalty in the Bard case. Bard was and is an innovator in medical devices and was prosecuted as a corporation. The individuals' trial was just completed recently, and three of those executives were also found guilty.

Quoting Judge Wolf: "The court finds that the agreed sentence provides just punishment for Bard. It should prevent Bard from committing comparable crimes in the future. It should also send a message to corporate officials and companies they personify that to subvert the Food and Drug Administration process, intended to assure the safety and effectiveness of medical products, is not just wrong, it is dumb."

Keep in mind that establishing accountability and ethical standards and having review and approval of all of that at the highest level of an organization is simple common sense and good business management.

I am not going to repeat what is in my outline, nor, I hope, repeat what you've heard among the other panelists this morning. We enforce both civil and criminal matters under the statutes that we enforce. I think that is somewhat unique in the Department of Justice as a litigating division, but it's true in every United States Attorney's Office.

Our job is pretty straightforward. We receive referrals from agencies. We analyze the cases, and our job in essence is to protect consumers from unfair practices and to protect those consumers who really are not in a position to protect themselves. If you go in for a heart catheterization procedure, you have to have confidence and believe that the medical device that is being used on your heart is, indeed, safe and effective, or our medical system isn't going to work as well as it has.

We have pursued a number of cases with unsafe biologics, drugs, and medical devices, and we have resolved a number of those cases with injunctions and civil settlements. Obviously you want to know how to get on the civil side rather than on the criminal side. Ladies and gentlemen, I submit to you, by the time the case gets to us, since you have gone through the regulatory agency either at the federal or state level, it's pretty much a closed question.

We have sought and obtained injunctions against blood banks, for example, for unacceptable collection and distribution practices and not proceeded in criminal ways for all sorts of reasons. But primarily when we are presented with fraudulent conduct, we pursue the fraudulent conduct. And if there is fraudulent conduct, I submit to you, as a matter of truth seeking, that compliance program, whatever it was supposed to be, was facially or, as applied, inadequate.

Now, there are some obvious concepts you need to have to understand how these guidelines have affected our practice. There is a disconnect, I know, and the outline says it. Organizational guidelines don't necessarily apply to our cases. Why do we use them?

First, the food and drug statutes have required a similar system of checks and balances as the organizational guidelines have for 50 years. We have been arguing about this with defense counsel for a long time. And, secondly, that has been specifically articulated as a ready set of principles to debate. The Supreme Court said in the Park case over 20 years ago that responsible corporate officials subject to the food and drug statutes have to operate with the highest standards of foresight and vigilance to detect in the first instance and to avoid violations in the second. Isn't that in essence what the guidelines are intended to do?

Our experience – and I'd like to focus a little bit, since I was asked to go into some specifics – involved the generic drug industry. Congress passed legislation in the 1980s to allow the public to pay less for prescription drugs that had passed off patent, that the pioneer product had gone on and served its function and now was off patent, and others could copy it and sell copies. When you go into your pharmacist, he says to you, "Do you want the generic?" And we prosecuted firms as they came on line. Sixty-seven individuals, 16 companies have been prosecuted since that began in basically 1990. More than \$30 million in fines have been assessed. What did they do?

Bolar is an example. One of the premier generic firms coming on the market, they're going to be first on the market because if you're first on the market with your drug product, the pharmacist will tend to suggest yours rather than someone else's. They had to prove at Bolar that their copy of the drug was equivalent to the pioneer drug that the manufacturer of that product had spent billions of dollars producing. In fact, they had to prove it in tests, tests on individuals and tests in the chemical lab. And they were on a rush. They wanted to be first on the market. What do you do? I've got a secret for you. Take the pioneer product, crumble it up, re-package it as your drug, and test it against the pioneer product. You know what happened? Their product came out comparable to the pioneer.

This is not rocket science. You do that sort of activity, you are going to get prosecuted. And if you're convicted, you're going to pay a substantial fine. And if you're at the high levels of that organization, you're going to go to jail. Those individuals were at the highest level of the corporation who were prosecuted.

One of the interesting segments of this – and I don't know if it's true of my colleagues' experience, but in each of the corporate pleas that we have been involved with in the generic drug industry, they have all wanted an 11(E)(1)(c) plea that says, conditionally, "Judge, this is how much we want to pay." So the negotiation between the government and the corporate

representatives ends up being a discussion of the guidelines. What else are we going to talk about? Because, indeed, when we talk about corporate responsibility, we end up talking about specific and general deterrence. We talk about what is fair or just punishment to the stockholders of this organization for the activities of its agents. We talk about the activity of the employee balanced before or after the guidelines in terms of whether the employee was trained, whether the employee was given incentives to do what the written policy said he would do.

Ladies and gentlemen, as we debate with corporations over how to control the wayward acts of their criminal defendants, I think in a sense we have merely formalized the rules of the debate in the guidelines. If you all like to debate – and I presume that anyone who has obtained a law degree enjoys that to some extent – let me give you a tip. When you come in to talk to us to say why your corporation should not be prosecuted, come in with particular evidence that shows why your compliance policy failed in spite of your best efforts. Let’s not just shout and complain to each other.

Believe it or not, in the generic drug industry many of the firms had written regulatory policies. Many of them had compliance officers. Some had regulatory affairs specialists. The policies were not used, were not enforced, were not trained, were not meaningful. A critical criterion for us and for most, as you have heard, is: did the corporation come in and blow the whistle and cooperate before dogs like me were at the door?

Our experience has been that, with but a few exceptions, these violations have been committed by individuals who were at the highest levels of the corporation. The experience is not new. Before the guidelines, before the fine provisions were so markedly increased, we prosecuted United States v. Hyland. The government proved during an eight-week jury trial that the highest corporate executives of a manufacturer and distributor of a drug, epherol, that was unapproved – intended for premature infants – had knowingly and continually marketed this drug despite reports from doctors that the intravenous drug was killing some of the premature infants it was given to.

We had a debate with the representatives of the corporation. These were wholly-owned subsidiaries. They pointed out in the debate that they had standards of conduct. They pointed out that they had a history of dealing with the Food and Drug Administration. They pointed out that they had some audit system at home.

We were able to show in that debate that there were no real standards of conduct for employees. Employees had never been disciplined. Employees had never been even trained what those standards were. There had been a long history of both firms pushing their business close to or over the line where the regulators drew it. And there was no check and balance system for the marketing of drugs. There was no particular audit process. It was inadequate.

It had some effect in the industry. We have now seen, for example, that the Association of Device Manufacturers, medical device manufacturers, has come out with an association policy that goes through such specifics as – here’s a particular possible violation of the law – failing to perform adequate complaint and failure investigations, trend analysis, and corrective actions with regard to your medical device. What is the preventive action? Read the regulatory requirements in the good manufacturing practice manual of the agency, have appropriate

standard procedures, train employees with each of those procedures, ensure documentation, allocate resources to prevent backlogs, follow up on significant product problems. If you do that, how is it going to occur that somebody is going to do something like put a drug on the market that has been untested for premature infants?

This is serious stuff. In reviewing the cases over the years – and you’ve heard from each of us – the amount of money has increased significantly. The consequences to the organization are very serious.

The Bard case is an example. Bard paid \$30,500,000 in criminal penalties, \$30,500,000 in civil penalties because the product was being paid for out of CHAMPUS, Medicare, Medicaid funds.

The guidelines didn’t apply to that case. It was prior to the guidelines. It was after the sentencing enhancements. It was a case handled by the United States Attorney’s Office in Boston, and we served in an advisory role. But, ladies and gentlemen, when the corporate lawyer began to recognize the possibility of exposure under these guidelines, they wanted to come to resolution. And the discussion focused on what their policy was. And after the discussion was over, one of the components of that settlement is a comprehensive compliance decree that says explicitly what Bard will do in the future to comply with the law.

Bard is successful. The food and drug firms in this country are some of the primary exporters of products that we have. It does not mean that if you have an effective, meaningfully successful compliance program you cannot be successful. Indeed, if you don’t have it, I wonder how you are successful.

I want to add two points, and then I’m going to finish. We, like the Environmental Crimes Section in the Criminal Division, but unlike Antitrust, rely on agencies to bring us cases. If you aren’t working with the agency on a regular basis and expect when you come to us to present your corporate compliance policy as a trump card on everything else, you’re kidding yourselves.

By the time that it comes to us, very serious analysis has already gone on. Your relationship with those agencies with whom you work is critical to success. If I don’t see the case, I can’t prosecute it.

Our goal is deterrence. We are responsible for a fairly esoteric group of prosecutions, and I want to just complete my thoughts here by saying that if you look over the 50 years in which the Federal Food, Drug, and Cosmetic Act has been in existence, in which there have been corporate compliance officers, in which there have been regulatory affairs officers, in which corporations have been trying to comply with a very strict standard, because you can be convicted criminally under the Food, Drug, and Cosmetic Act of a misdemeanor on basically strict liability, and that industry – or those industries, rather, have been successful. You can be successful, too, and if you don’t have a corporate compliance policy and you come in to see me on behalf of your client’s problems, I’m going to tell you, “I told you so.”

## QUESTIONS & ANSWERS

COMMISSIONER BUDD: Ladies and gentlemen, we've heard from four excellent speakers. I'd like to pose one of your questions to each of the speakers. I'm going to pose this first question to Bob Litt.

Bob, does cooperation under Section 8C2.5(g) require any of the following: one, mandatory waiver or tolling of the statute of limitations for the conduct under investigation; two, mandatory waiver of the attorney-client and work product privileges for information or documents otherwise protected; three, mandatory curtailment of payments of the attorney's fees for directors, officers, or employees who invoke their Fifth Amendment rights; four, mandatory forbearance from the entry of information-sharing confidentiality agreements, also known as joint defense agreements, with current and former employees and third parties; and, finally, requiring employees to submit to "Queen For A Day" interviews, "use immunity" interviews and the like?

Bob, would you care to respond to those?

MR. LITT: Let me just begin quickly by saying that, as to the last point, "requiring employees to submit" is probably an overstatement of what a prosecutor will ask. I think a prosecutor will ask you to request your employees to submit, but I don't think anybody expects you to strap them to a chair and hold klieg lights over them.

Also, I don't feel that at this stage I can be addressing this question in terms of what the sentencing guidelines require. I think that is something that is going to be worked out through the courts. I don't think there's a sufficient basis yet for assessing that.

I can tell you that from the Criminal Division's point of view in terms of how we assess a company's cooperation, the answer to all of those can be yes. And I go back to what I mentioned before. We're looking for a company that comes in and is committed to cooperating with the government.

From the prosecutor's point of view, if there are people out there who have committed crimes, a corporation that has one foot with the criminals and one foot with the government is not cooperating with the government.

COMMISSIONER BUDD: Bob, thank you very much. To Ron Sarachan, under the Justice policy, is a company barred from consideration for leniency or non-prosecution if it self-discloses a violation that it was legally required to report?

MR. SARACHAN: The short answer to that is no. Let me say two things in explanation. One thing, when you look at our policy, it makes clear that each of the components is a factor, and they can carry different weight in different cases. So if you have a company that does everything right – it discloses, it cooperates fully, it has a compliance program, it corrects – the fact that the disclosure happened to be mandatory won't mean that it doesn't get consideration.



The other thing is if you look at the disclosure provision of the policy, it talks about the quantity and the quality of the disclosure. There can be a big difference in a mandatory disclosure in which you tell the regulatory agency about your Clean Water Act discharges in a monthly discharge report versus coming forward to the government and saying this was not just a fluke, we have a problem here, this is what we're doing about it. So even in the context of a mandatory disclosure, there is often a lot more that can go into a voluntary disclosure.

COMMISSIONER BUDD: Thank you, Ron. To Gary Spratling, if an individual goes for amnesty before the company, is it possible for the company to come in and get amnesty as well?

MR. SPRATLING: It's possible. Obviously automatic amnesty would no longer be available because automatic amnesty is available only when we don't know about the violation. We know about the violation from the employee.

You still might qualify under alternative amnesty, but remember the two threshold requirements I mentioned there. Number one, you have to be the first one in. Assuming the first one in, you now face the major hurdle, which is whether or not as a result of your employee coming in we already have sufficient evidence to result in a sustainable conviction against your firm. If your employee has given us that, then you can't get amnesty. If he hasn't given us all of that, then you would still be eligible for amnesty. But even if you're not eligible for amnesty, of course, coming in that early and offering to cooperate, there are significant other benefits you might obtain.

COMMISSIONER BUDD: Thank you, Gary. A final question for Gene Thirolf. On page five of your printed material, you say that the proactive operation of drug firms can serve as a model. Could you elaborate on what you mean as a model for compliance programs?

MR. THIROLF: I mentioned it in my discussion. The food and drug firms have been under the responsibility of the highest standards of foresight and vigilance for 50 years. They have had to come up with what amounts to corporate compliance policies.

The Health Industry Manufacturers Association here in Washington spent two years – and I talked at two of their conferences – in trying to develop a set of recommendations to comply with the obligations of the Medical Device Act and the FDA regulations. It is very specific, it is very detailed, and it took a long time and a lot of effort to do it.

I see no reason why other trade associations could not assist in drawing from the large operations to give to the smaller operations insight into how to have a very particularly designed compliance program.

#### **QUESTIONS & ANSWERS – WRITTEN**

*Bob Litt*

- Q. You mentioned that U.S. Attorney decisions after voluntary disclosure are centrally reviewed, for consistency. What are the prospects for centralized review of other types of U.S. Attorney decisions regarding prosecuting corporations (*e.g.*, compliance program worthiness), especially with respect to large publicly-held companies?
- A. As a model, the Food, Drug and Cosmetics industries have a 50 year history of compliance with the provisions of the Food, Drug, and Cosmetic laws mandating “the highest standards of foresight and vigilance” in meeting statutory requirements. Consider the Health Industry Manufacturer Association, a trade group for medical device manufacturers. HIMA developed and formulated a corporate compliance policy for all of its members. As a service, HIMA makes the policy available and helps firms customize the plan to their needs.
- Proposed prosecutions of corporations (but not individuals) who have made voluntary disclosures under the Department of Defense Voluntary Disclosure Program are centrally reviewed by the Criminal Division of the Department of Justice. Requests for review of other decisions to prosecute corporations for policy reasons may be made to the Criminal Division in matters within the Division’s jurisdiction. However, the primary prosecutive authority rests with the United States Attorney in the district where the charges are being brought.
- Q. Do you see any value in a self-audit privilege?
- A. Although the Criminal Division fully supports the use of self-auditing as a means to obtain compliance with the law, we oppose the creation of evidentiary, discovery or testimonial privileges for self-audits. Such privileges would shield criminal misconduct, authorities, and be contrary to the goals of corporate “good citizenship,” *i.e.*, disclosure and cooperation. It would make enforcement of the law more difficult by interfering with the ability of law enforcement to obtain evidence relevant to their investigations and to their ability to quickly ascertain the facts. In addition, a self-audit privilege undoubtedly would lead to protracted litigation involving privilege issues, and would be susceptible to abuse. For example, corporations may claim that normal day-to-day business practices constitute “audits” in order to avoid disclosure of wrongdoing. Also, the privilege may be invoked to bar the use of evidence even against rogue employees who engaged in criminal conduct against company policy.
- Q. In light of your remarks about companies needing to turn over reports, investigation results, etc. – how does a company reconcile this governmental position with the “promise of confidentiality” “good citizen” companies make to their employees to encourage internal self-reporting?
- A. Most companies today, particularly those that participate in the Department of Defense’s Voluntary Disclosure Program, feel that they are ethically if not

legally obligated to advise their employees that their interviews are being conducted under the corporation's attorney-client privilege and that the company, at a later date, may choose to waive that privilege and provide the employee statements to the government. As a consequence, most employees are expressly told that this means that the company and the company alone decides whether to disclose what the employees say.

From the government's standpoint, once a company has provided thorough and full advice to their employees about their privileges and the possibility of future disclosures to the government, it ordinarily is in the company's best interest to waive its privilege and disclose the statements of some or all of the interviewed employees. As I stated earlier, to gain credit for "god citizenship," corporations must demonstrate their commitment to compliance when it's painful as well as when it is easy.

- Q. What is DOJ's position with respect to a corporation paying (advancing/indemnifying) for counsel for an employee who is alleged to have engaged in wrongdoing?
- A. The Department of Justice recognizes that under the corporate laws of the state of incorporation or in accordance with the corporate by-laws, most corporations may indemnify or advance fees for corporate officers and employees accused of wrongdoing, and sometimes are required to do so. In cases where indemnification or fee advancement is discretionary, the Department would expect corporate boards of directors to carefully scrutinize such action and to deny such payments when appropriate. While these decisions should be made by the corporation's board, and the government does not require that any particular action be taken, a corporation that seeks the benefit of cooperation with the government has a burden of showing that it is not providing financial support to wrongdoers.
- Q. Yesterday, a lawyer familiar with the National Medical Enterprises case (in which your division was involved) criticized the compliance requirements the government exacted from the company to resolve the case. He said these requirements might actually undermine the company's development of a corporate culture supportive of law abidance. How do you know when you exact compliance requirements in cases like this that the requirements are sound?
- A. The compliance program adopted in the National Medical Enterprises (NME) case resulted from lengthy negotiations between the Department of Health and Human Services and NME, and was intended to address the specific problems uncovered during the investigation. We believe that NME would not have agreed to the terms of this compliance program if it did not believe the program was appropriate. As a general matter, DOJ is not interested in imposing unreasonable conditions upon any company. The government and companies share the common interest of adopting compliance programs that will most

reasonably ensure that the company’s future operations are conducted in a fair, ethical and legal manner. Each case will be examined individually, and compliance programs will be tailor-made to fit the facts and circumstances. Indeed, in the more recent settlement involving Caremark, the compliance plan was different from the NME compliance plan.

- Q. To what extent will the government work with the corporation to maintain confidentiality of sensitive documents while allowing the government to obtain the information it needs or wants? Has DOJ considered adopting policies that would enable a “good citizen” corporation to fully cooperate without the punishment of having sensitive documents become publicly available?
- A. It is legally difficult for the government to maintain the confidentiality of documents provided by a corporation against third parties seeking access to such information. The current case law clearly suggests that the company waives privileges such as the attorney-client privilege if disclosure is made as a part of a voluntary disclosure, although as noted above, grand jury proceedings themselves are secret. The Department has not considered adopting policies, nor has it sought legislation, that would provide for a limited waiver.
- Q. In law, defendants are presumed innocent until proven guilty. Yet corporations – to get the credit under the guidelines – must consider their “guilty” employees as guilty and fire them, rather than defend them. Can you reconcile this apparent contradiction?
- A. We do not view this as a contradiction. As a sound business practice, corporations should question whether to continue employment relationships with employees who have knowingly violated company policies, state or federal civil laws, or who have engaged in criminal conduct. The decision whether to fire or otherwise discipline errant employees rests within the sole discretion of corporate management and is based on numerous factors, such as the employee’s position within the company, the duration and impact of improper conduct, whether company policies are violated and whether the employee has engaged in other wrongdoing. Under many circumstances, conduct need not even be deemed criminal to warrant dismissal. While the government generally will view in a more favorable light those corporations that discipline or terminate employees who have engaged in criminal activity, the government does not and will not require that any particular course of action be taken.
- Q. Does “full cooperation” mean complete adoption of the Justice Department position (*i.e.*, full *mea culpa*) or can a corporation cooperate fully and still preserve its defenses and those of its employees?
- A. There are no Departmental standards governing “full cooperation” by corporations, and prosecutors will consider each situation on a case-by-case basis, including the assertion of privileges such as attorney-client and work product. However, where prosecutors suspect or have evidence that

corporations or their employees are withholding critical evidence, seriously misrepresenting facts or obstructing the government's inquiry, they will demand more cooperation from the company. Moreover, "full cooperation" by the corporation does not mean protecting wrongdoers. If a corporation expects to receive the benefits of full cooperation, it will be expected to provide full information about its culpable officers and employees, and take whatever disciplinary action it deems appropriate.

- Q. It is my understanding that at the time of drafting the organizational guidelines, the Department of Justice was not very supportive of compliance programs – *i.e.*, DOJ did not think they should get much credit. What factors have influenced the shift in perception of these programs so that now DOJ believes there should be a baseline requirement?
- A. The Department of Justice has not had a shift in philosophy about compliance programs. The Department proposed its own organizational sentencing guidelines to the Sentencing Commission during the development of Chapter Eight. Our proposal would have provided a significant reduction in the fine for an offense that "represented an isolated incident of criminal activity that was committed notwithstanding *bona fide* policies and programs of the organization reflecting a substantial effort to prevent conduct of the type that constituted the offense." Thus, the Department recognized compliance programs as a basis to reduce fines. However, under the Department's proposal, the reduction could have been given only if the offense was an "isolated incident of criminal activity" committed despite the compliance program. We did not want to give credit to a program that repeatedly failed to do its job. There has not been a shift in this philosophy. If a program repeatedly fails to do its job, we would have to question whether it constitutes an "effective program to prevent and detect violations of law" within the meaning of Section 8A1.2.
- Q. Please comment on Bill Lytton's comment regarding the inherent conflict between *qui tam* actions and internal compliance programs. Specifically, individual greed versus sponsoring a corporate culture of good citizenship. Why not require notice to a company with a legitimate compliance program before an employee is permitted to file a *qui tam* action?
- A. Notwithstanding the existence of a compliance program, for various reasons employees may have little confidence that their allegations of wrongdoing will be taken seriously and may believe that they will be disclosed in due course to the government. There may be legitimate fears that going to the company before reporting the fraud to the government may lead to destruction of documents and suppression of relevant evidence. Thus, a requirement that employees report to the company in all cases could well discourage employees from coming forward at all.

Moreover, Congress amended and liberalized the *qui tam* provisions to provide monetary incentives and other protections from retaliation or other employment discrimination to those who have information about fraud against the government. Requiring a plaintiff to first report allegations to the corporation before he or she is permitted to file a *qui tam* action creates the very disincentives that the Act was intended to eliminate; that requirement exposes the employee to possible retaliation from the employer for reporting the fraud, and thus discourages employees from coming forward with the information. By allowing the employee to file suit under seal and allow the government to undertake an investigation, the employee’s allegations can be made without the fear of recrimination. However well-intentioned a corporate compliance program, certainly the perception of some employees in the corporate world is that allegations may not be taken seriously or pursued in an appropriate fashion if they must be given first to the corporation.

*All Panel Members*

- Q. There have been a number of high profile cases in which DOJ has announced a decision not to prosecute a corporation because of its compliance efforts (*e.g.*, Salomon Brothers, Sega Corporation in New York). Have there been cases in which DOJ has announced a decision to prosecute a high profile corporation because of non-compliance with the guidelines? Would this encourage compliance in the corporate community generally?
- A. (Robert Litt) Prosecutive decisions are based on a variety of factors. We do not base decisions not to prosecute solely on a company’s compliance program; rather, the existence of a compliance program is one factor to take into account in a prosecutive decision. Similarly, decisions to prosecute a corporation are not based solely on the failure of compliance programs, but that is a factor that can be considered.
- Q. What is the process for determining the culpability score in both consent decrees as well as in those matters that go to trial? For example, who determines whether or not the organization had an “effective program?” Is there a standard form that is used by the court or an agency that mechanically calculates the score?
- A. (Robert Litt) The sentencing court determines the culpability score, after consideration of evidence concerning the company’s compliance program presented by the government and the corporation. A company may want to enter into stipulations with the government concerning factual matters about its compliance programs and policies. Compliance programs will be the subject of intense scrutiny by the government during the criminal investigation. The

government will ask the necessary questions to satisfy itself that the program is not merely a “paper program.”

- Q. Would you subpoena (or seek voluntary disclosure of) any corporate compliance program from a target corporation before entering into plea negotiations?
- A. (Robert Litt) We would expect corporations to voluntarily provide us with their written compliance programs if we have reached the stage of plea negotiations, and it probably would be in the company’s interest to demonstrate the existence and effectiveness of their programs. In our experience, information concerning corporate compliance programs generally is made available to the government.

*Day Two*

## **Keynote Address**

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**Stephen L. Hammermann** , *Vice Chairman, Merrill Lynch & Co.*

*Introduction:* **Commissioner Michael Gelacak** , *Vice Chairman, U.S. Sentencing Commission*



**KEYNOTE ADDRESS**

COMMISSIONER MICHAEL S. GELACAK: It is my pleasure to introduce today's keynote speaker. He is a distinguished member of the bar and a force in the financial services marketplace. Our speaker today is a graduate of the University of Pennsylvania's Wharton School, as well as New York University's Law School. He is a former Assistant United States Attorney in the Criminal Division for the Southern District of New York. He has served as the New York regional administrator for the Securities and Exchange Commission. And he was appointed by President Reagan to the Board of Directors for the Securities Investors Protection Corporation. He is a past Chairman of the Board of Governors of the National Association of Securities Dealers and is now a member of the Board of Directors of the New York Stock Exchange.

He is presently the Vice Chairman of the Board of Merrill Lynch & Company, Incorporated, and Chairman of the Board of its broker-dealer subsidiary, Merrill Lynch, Pierce, Fenner and Smith.

Ladies and gentlemen, I am honored to introduce Mr. Stephen L. Hammerman.

MR. HAMMERMAN: Thank you very much, Mike. I am truly honored to have been asked to participate in this important program, and I got a piece of the program today. I was trying to get into the morning session, but it was standing room only and you couldn't get past the door, which is a compliment to Mike and Win who have put this program together.

When one reads the press, it appears that crime is rampant in the corporate world and that it is a new phenomenon. First, I do not believe that crime is rampant. I think that most people and most corporations are law-abiding and try to do the right thing. Second, what we read about is not a new phenomenon. The fact is that if crime were new, we would not have the Ten Commandments. We'd have the Ten Suggestions. But the fact that wrongdoing might have existed since Adam and Eve does not make it of less concern.

Regardless of what industry one is in, and no matter how good a reputation for integrity one might have, any attack on a corporation's integrity will result in the loss of confidence on the part of its important constituencies. For example, we have in the United States the strongest capital markets in the world. This is because our markets have integrity. Any hint that our markets lack integrity will result in a lack of confidence which will diminish our effectiveness as a nation. This is also true of any business. Before the sentencing guidelines were even thought about, we in the securities business had an expression that good compliance is good business.

We are, I dare say, in the securities business the most regulated industry in the world. We are regulated by the SEC, by the United States Attorney's Offices, by the states' attorney generals offices, securities commissioners, self-regulators like the New York Stock Exchange, and the NASD.

However, you could wipe away all this regulation and still be left with one principal regulator: the corporation itself. Any corporation that doesn't believe that it is its own chief regulator will not remain in business. There should be a race to the top and not to the bottom

when it comes to compliance standards. Perhaps this is what Judge Stanley Sporkin expressed as the “do the right thing” principle. A race to the basement when it comes to compliance might provide corporations with some short-term monetary savings and gains; however, history has taught that in the long run it is doomed for failure.

Just read Burning Down the House, which is the fall of E.F. Hutton in our business, or Serpent on the Rock, a book which just came out about how a limited partnership scandal cost a company almost \$2 billion.

Statements of principle like “good compliance is good business” have been proven to be true and are very important to help guide decisions made in the corporate world. I believe that it is very important for a good corporate culture to have established principles which are conveyed to employees, clients, and others by saying these are the principles we believe in and any deviation from these principles is not to be tolerated.

Now, having principles is important, but I think they have to be established in the context of a true story. This man was riding a Rolls Royce over a mountaintop, and all of a sudden the Rolls Royce hit a rock, and the Rolls Royce went over the mountain. And as the Rolls Royce was going down with the driver in it, the front door by the driver’s side opened up, and the man miraculously fell out of the Rolls Royce. And as the Rolls Royce crashed to the bottom, the man grabbed onto a branch, and holding onto that branch, he looked up to the sky, and he said, “Lord, save me.” And a voice boomed down and said, “Save you? Why should I save you? You’re a bum.” And he says, “Lord, save me. I won’t be a bum.” He says, “No, you don’t take care of your wife; you don’t take care of your children.” He says, “Lord, you save me, and I’ll be the best husband and father that they can ever find.” He says, “I have no reason to save you,” the Lord said, “because you give no charity. You’re a wealthy man.” He says, “Lord, I’ll give all my money away to charity. Just save me.”

The voice came down again, he said, “I can save you, but you have no faith. I have no reason to save you.” And he looked up and he said, “Lord, save me. I have faith.” And a voice came down and said, “You have faith?” The man said, “Yes.” He says, “If you have faith, let go of the branch.” And the man looked up and he said, “Are you crazy?”

Now, that is a true story – it was true because it was in the press.

That true story illustrates the difference between words and actions. Now, the philosophy of any corporation should be that no one’s personal bottom line is more important than the reputation of the corporation. All of us in management are responsible for making certain that at our institutions actions speak louder than words.

Any impairment of our reputation results in a direct negative impact to our bottom line and the price of our stock. There is no way we can reach the corporate goals that carry out the strategies if our reputation for integrity is tarnished.

It is to be expected that in any organization, whether it be the corporate world or in government agencies, there will be some individuals who will violate policies and rules.

However, how our clients, our fellow employees, shareholders, and regulators will view our behavior in the corporate world depends upon two things:

First, did we create a working environment that told people and taught people that at our company we do not tolerate violative behavior? Because if we create an environment where we say the rights words but we permit the wrong actions, we have a problem. If we create an environment where the penalty for a violation depends on whether or not the person is a big or small producer, we have a problem.

The second important criteria by which we are judged is how we handle a problem once it is discovered. If a problem comes to our attention, we must act on it, no matter who the individual is that is involved, whether it is the chairman of the board or whether it is a clerk in one of the functioning areas of the firm. A problem handled at an early stage may be a little difficult to swallow, but if you cover up the problem, well, when that problem surfaces – and it will surface – that problem becomes indigestible.

Management in business must set the tone every day for how our people should behave. Even allowing an employee to exaggerate or lie when it comes to travel and expense reports, or misuse cab services, only lets the individual mistakenly believe that rules exist only to be broken. You know, it would be like being at home and lecturing to your child about not stealing from the candy store while you're driving off with a towel that you just took from the Hilton Hotel. You've got to be consistent. You cannot be inconsistent.

I think the same is true of our responsibility regarding employees whose personal traits can affect our clients and our business. It is our business if someone dealing with our clients has a gambling addiction. It is our business if someone dealing with our clients has a drug addiction. These problems we must deal with. They cannot be buried.

You know, in business we have what's called ROE, return on equity, which determines our financial success as a corporation and in many ways the price of our stock. ROE, return on equity. But I believe there's also an ROI, a return on integrity. Perhaps we cannot calculate a return on integrity, but let integrity slip and take second place to revenue, then it will cost us more than the dollars. The cost would be fatal. In fact, increasing our return on integrity will almost guarantee without question increasing our return on equity.

Now, how does a corporation make certain that its ROI, that is, return on integrity, keeps improving? Is it sentencing guidelines? Is it more rules or standards? No. What is important is that an environment for doing the right thing exists, and it must start at the top. It sounds obvious. It sounds like a cliché. But it's true. If true, you ask, why isn't it working?

Well, it is working, but it needs help once in a while. This help comes in the form of a strong and effective legal and compliance department in a corporation. The foundation of an effective legal and compliance effort is formed by where or whom the counsel reports to. Where an individual reports reverberates throughout an organization.

For best results, it is my view that reporting to the CEO, the chief executive officer, lets everyone know the importance of the legal and compliance function within the organization.

But where an individual reports is only part of the solution. Whether the general counsel or compliance person is an activist or passivist is critical to the success of a corporation.

I think that the regulators of the '90s are looking at the '80s and are convinced that many of the ethical problems of the last decade have occurred in part because lawyers, both inside and out, and compliance people may not have done the right thing when the opportunity presented itself.

Now, having the job of general counsel or compliance officer is not an easy task. We know that. And we also know that the most difficult time to get people's attention to compliance is when business is very good or when business is very bad. When business is very good, people don't have patience for the impediments we want to impose. When business is very poor, the business people don't have the stomach for our impediments.

The signals of the struggle of the people in the compliance area appears in phrases such as, "You're killing my business. The other Brand X firms let the people do it"; or "If we don't do this type of business, we might as well be out of business"; or "Thanks for the advice, but it's a business decision to hire the bum or sell the product."

When these phrases start to appear, get ready because my 30 years of experience in this business tells me that the following happens: one, the other firm generally does not do it, including Brand X; two, you're better off being out of business than being indicted when in it; and, three, it's not a business unit's decision to destroy or even harm the reputation of our firms.

We as general counsel have a dilemma. Do we pigeon-hole ourselves and our responsibilities so that we limit ourselves to advice that, if not followed, we memorialize in a memorandum to show we oppose certain action? Or do we insist upon being more of an activist and participate in preventing harm to our firms?

Whatever role we choose to take will depend upon many things, depending upon the company we're in. But let me suggest to you, if something goes wrong, someone, despite your memo, will insist that you should have been more of an activist. We have to do our jobs right because we're going to be responsible anyway.

By the way, I said that the general counsel should participate in correcting the wrong. It is the highest executive for the business unit who bears the primary responsibility for taking compliance action and to react if one of their people does not adhere to good compliance standards. It is the job of the general counsel or compliance officer to convince him or her of what is the right action. Get the business executive to sign and send the memos on dealing with compliance matters.

For example, in our business, it should be the executive vice president in charge of investment banking that signs the memo cautioning against the misuse of inside information. It is the business executive who pays the salaries and the bonus, not the general counsel. General counsels do not have to live under the edict, "publish or perish." It's the executives at the top level who must believe law, and compliance must have immediate access to them. If it's a

public company, there is an audit committee of the board, and access to that committee is also vital.

The top executives must show every level of a firm that good compliance is good business. As lawyers, we should share with the business executives early and realistically problems as they arise. Do not be afraid of the CEO who doesn't like bad news. Teach him to swallow slowly. If you don't, you will, I am afraid, become the scapegoat.

The efforts of the general counsel to push for strong compliance efforts should never cease. Sometimes you have to push harder, although you have the feeling no one appreciates you. And if I may, just talking about appreciation and swallowing slowly, it reminds me of the story of the man who walks into a restaurant, and he sees another gentleman choking on a bone. And he walks over. This man is near death. And he walks over to him and says, "Take it easy, sir. I'm a doctor. Let me assist you." And he takes a fork and he bends the fork, puts it down the throat, and he pulls out the bone. He saves the man's life.

The man, after gasping a little while, says, "Sir, thank you very much. You saved my life. I must pay you for this service." He says, "Don't be silly. It was just fate that brought me into this restaurant. You don't have to pay me." The man insisted, "I'll pay you." He kept insisting, "I must pay you."

Finally, the doctor said to him, "I'll tell you what. If you have to pay me, why don't you pay me what you would have paid me when the bone was still in your throat."

So all of you folks who are working in corporations understand. Believe me, there will be plenty of bones to pull out.

As I said earlier, any corporation will have problems. A corporation should be judged by how it handles that problem. Some actions by individuals have clear-cut responses; others do not. To avoid being second-guessed by regulators and to guarantee a fair approach in handling problems, I recommend the formation of what we call a review committee.

In our company, our review committee is made up of the experienced folks in the legal and compliance areas who review the facts and circumstances of an apparent violation. After a full review, they sit with the business executives of the area involved and recommend action to be taken. If agreement on the action to be taken is not reached, the matter is elevated up the line. If the review committee and the highest level manager still cannot agree, the matter then comes to the executive vice president of that business unit and to me for decision.

We have had the review committee in place since 1985. The review committee, by the way, is not permitted, other than the person who has done the investigation, to know the production of the individual that they're reviewing. They must look at only the facts and not whether or not the person is a big or small producer. But since 1985, although we've had this review committee that has heard hundreds and hundreds of matters, only five matters have been sent up for review to an executive vice president or myself.

This is the result, I believe, of the culture being understood by the managers throughout the organization. And in our business we must report problems to the regulators. We don't have the luxury, as some, to sort of cover it up. So every time we've taken any discipline internally or there is a problem, we must on a form report it to the New York Stock Exchange or the NASD so it gets elevated. And I would say that in the ten years we've had this in place, not one instance has ever occurred where a regulator has in any way disagreed with the findings of the review committee and the business group. It works.

I'm a strong believer in an effective hotline. We have had a hotline in effect years before the sentencing guidelines. Yes, there are serious concerns and dangers that accompany a hotline. These should not be underestimated. However, a hotline controlled by professionals who are experienced in dealing with people and problems and are concerned with people's rights as well as protection for the corporation is a very effective compliance tool. It is effective not only because it gives employees a place to reveal possible wrongdoing, but it gives employees an opportunity to vent frustration about corporate policy. We take our general counsel's hotline very seriously. People know that, and that's why it works.

But to have an effective compliance program, there must be a consistent and sincere effort at education. Senior people in the organization should participate in these education programs, and executives should constantly refer to ethical standards while talking about the need for revenues. That's a very important point I personally believe; that as we talk to our various people in the business units about why we need greater production here or why we need to go ahead and increase productivity over here, we must always build into that – and the senior business people do – that that has to be done ethically and meeting the philosophies of the firm with its high standards. Just talking about revenues by itself gives a misleading impression that the corporation only wants to generate revenues any way that it can get it.

Memos are okay in education, but eyeball-to-eyeball contact is the best way to communicate compliance principles. Follow it up by real action when a problem arises.

One of the areas where questions have been raised is whether or not compensation practices create inherent conflicts of interest that result in violation of the law. In our industry, this topic was addressed in 1994 by a broad-based committee on compensation practices, which was formed at the request of the Chairman of the SEC, Arthur Levin. The committee found that although the existing commission-based compensation system works remarkably well for the vast majority of investors, the prevailing compensation system inevitably leads to conflicts of interest among parties involved. However, organization culture, the committee found, is probably the most effective tool for creating the best atmosphere that reduces the potential harm stemming from conflicts of interest. The kind of culture which is created when senior managers articulate high standards and communicate them through their own behavior and the administration of firm-wide policies is necessary to mitigate against conflicts of interest.

The committee also found that having a strong compliance department is essential for making certain that effective, preventive steps are taken to ensure that the client's interests come first. It is also clear that compensation plans that encourage appropriate supervision and behavior by managers are vital to controlling conflicts of interest. A significant portion of a

manager's compensation should depend upon his or her compliance record. Financial incentives can and should be used to encourage proper supervision by managers.

It is also important to test one's compliance program on a periodic basis. Stale compliance programs are not effective and can, in fact, be detrimental to a showing of trying to create a good compliance environment. If you're an industry like ours where new products can be developed in the amount of time it takes to take a shower, that new product or business should not commence until compliance has developed standards and procedures to detect possible problems.

Let me say that under the heading of there's always somebody out there who thinks that the glass is half full, I recently read that there is concern that industry officials comparing notes on how to fight corporate misconduct could amount to collusion among companies to lower standards. Nonsense. I have found that after being in the securities business since 1968 that one of the most effective ways to enhance and sharpen one's compliance programs is to share programs, information, and problems with other firms. I do not believe there is competition when it comes to compliance.

As I said earlier, there should be a race to the top and not to the bottom when it comes to compliance standards. I have never seen or observed a race to the bottom in the securities industry. The Securities Industry Association, which holds seminars and workshops which have become such a significant success, always worked toward the goal of high standards. Anyone with an attitude that lowers standards in compliance as the way to do business has a short career.

So, yes, let's get together and talk. Competitors and regulators should share their views and experiences to help make our compliance programs the best in the world, because that's where our competition is today – the world.

Before I close, let me say that government policies like the sentencing guidelines should favor corporate compliance efforts, not to wake up corporations but because it's fair. It's comforting to know that if a corporation does face sentencing, it has something to mitigate its hurt. However, what concerns me – and I was interested to hear Bob Litt's comments this morning – is that if a corporation's compliance effort is sufficient to mitigate sentencing, it should never have been indicted in the first place. The mere threat of an indictment or leak of an investigation will today cause a corporation to lose its clients, its creditors, and its employees. Sometimes there is not sufficient sensitivity or knowledge on the part of the government of the consequences of an indictment of a corporation. Sometimes it takes too long to end the government investigation and give the corporation a clean bill of health. Investigations that linger are like black clouds hovering overhead, ready to rain disaster.

In fact, the sentencing guidelines have given some U.S. Attorney's Offices the opportunity to say, okay, we will not criminally indict you, but we want X millions in a civil settlement for this privilege, as if reading a headline in a newspaper that X corporation paid a \$20 million fine is not damaging. It is extremely damaging.

I strongly urge government agencies, when considering vicarious liability, to understand the corporation and the efforts it has made to be a good corporation citizen and understand the corporation’s business in the context of a violation while reviewing the facts before indictment and at an early stage of investigation.

We all know what the law is, but if a corporation has created the right environment and has lived by its philosophy of doing business the right way, it should not be subject to attack because some individuals violated the law. I believe that the long-term senior management attitudes transcend economic conditions and dramatic events such as major litigation or regulatory actions in determining a firm’s commitment of resources towards good compliance and, accordingly, long-term success.

Senior management’s belief and emphasis on return on integrity will guarantee that good compliance filters throughout an organization. Today, good compliance is not just good business, it is vital to stay in business. Thank you all very much.



*Day Two*

# **Privilege Update: When Should Compliance Practices be Protected from Disclosure?**

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**Commissioner Michael Goldsmith** , *U.S. Sentencing Commission*

**Patricia Bangert** , *Deputy Attorney General for Natural Resources,  
Colorado Attorney General's Office*

*Moderator: Win Swenson* , *Deputy General Counsel/Legislative Counsel, U.S. Sentencing  
Commission*

## COMMENTARY ON EXISTING LAW

MR. SWENSON: With the new emphasis on corporate compliance efforts, some compliance practitioners are arguing that this is a classic case of no good deed goes unpunished. The better a company is at critiquing its own compliance practices, the argument goes, the more vividly the company draws a road map to its own liability.

The argument has certainly found receptive ears in state legislatures where a number of states have enacted statutory privilege laws, and I guess the question is: "Does the argument have merit? And if so, how should the problem be addressed?"

This afternoon we have two views that we are going to present. We will hear first from Commissioner Michael Goldsmith, whom you have already met, one of the organizers of this conference. Commissioner Goldsmith is certainly someone about whom you can say he has had varied experiences.

He served as counsel to the New York State Organized Crime Task Force, as Assistant U.S. Attorney in Philadelphia, and as senior staff counsel to the House Select Committee on Assassinations. He currently teaches law at Brigham Young University where he specializes in, among other subjects, privilege and evidentiary law. He will offer some commentary on existing law in this increasingly important area. Commissioner Goldsmith?

COMMISSIONER GOLDSMITH: Thank you, Win. My topic this afternoon is concerned with the question of disclosure and, more specifically, under what circumstances, if any, might compliance practices be subject to mandated disclosure in the courts. The reason that my colleagues assigned me this particular task, I think, is because they candidly acknowledge that there is no answer to that question.

You've heard a lot at this point, I suppose, about the carrot and stick philosophy underlying the sentencing guidelines. The stick, of course, is the very severe fines that apply in the context of the organizational guidelines. When an organization violates the law, the fine range is based upon the seriousness of the offense and the organization's culpability. Typically, what that means is that the greater culpability score, the more that you pay by way of a fine.

The carrot, by comparison, is achieved by creating an effective incentive for corporations to follow; more specifically, if corporations establish an effective program to prevent and detect violations of the law, then an organization may reduce its potential fine substantially if a criminal violation occurs.

However, the compliance practices contemplated by the guidelines pose disclosure and liability risks. The rest of my remarks are basically a long footnote to this statement. By way of example, two recent cases:

One is a case entitled *Slender v. Lucky Stores* back in 1992, which held that corporate compliance programs are subject to discovery. In the *Lucky Stores* case, the company had received numerous complaints of alleged gender discrimination. In response, they instituted an affirmative action program and held training sessions designed to instruct managers on how to

implement the affirmative action program. The managers also met on several occasions to review, comment upon, and modify the program. Well, in a subsequent sexual discrimination lawsuit, the court held that the plaintiff was entitled to obtain documents pertaining to this program.

Another case involved the Coors Brewing Company. Coors had conducted an extensive internal study, which revealed excessive emissions of volatile organic compounds. Notwithstanding the fact that such emissions were previously unknown both to major breweries and to regulators, the voluntary disclosure of its study by Coors ultimately resulted in a fine of \$1.05 million. (This was not a fine under the guidelines, but a fine imposed by the regulators.)

These two decisions occurred at a time when many corporations had, in fact, begun to institute compliance programs designed to identify and redress potential wrongdoing. Though such programs were obviously crucial to management, such audits oftentimes produced highly incriminating materials. Once these materials come to the attention of corporate officers and counsel, the guidelines in effect require the company to consider the agonizing question of whether to disclose this evidence to federal government prosecutors.

When you address that issue, there are a number of broad considerations that come to mind. Of course, there is the carrot, the incentive offered to you by the guidelines themselves. The fact of disclosure will allow you to obtain a better culpability score. Disclosure also avoids the potential risk that you will subsequently be accused of obstruction of justice and thereby incur an enhancement under the guidelines for obstructing justice.

Resolution of this issue, standing alone, is tough enough, but you have further complications because disclosure may cause other litigants to bring an action against you. Thus, even if the government chooses ultimately not to prosecute, or even if you get the benefit of a reduced culpability score, all of a sudden you may face a third-party lawsuit, either by a private litigant or by another governmental entity, a state regulatory agency, for example.

Moreover, if you choose not to disclose, there may not be any adequate legal basis to withhold such information from criminal investigators. Because this uncertainty hampers the effectiveness of any compliance program, it potentially undermines the incentive-based organizational sentencing guidelines.

(Incidentally, even though I'm going to be addressing the guidelines in this context and the issue of disclosure and disclosure risks, I want to emphasize that I'm speaking to you here today in my capacity, I suppose, as a law professor and, further, in my capacity as a Commissioner, but that my views in terms of the legal analysis here don't reflect the position of the Sentencing Commission *per se*. They reflect my own views, and I don't want to be binding the Commission by virtue of whatever this academic presents to you.)

Let's talk a little bit about creating a compliance program under the guidelines. Chapter Eight of the guidelines, of course, governs the sentencing of organizations for felony and class A misdemeanor offenses. The guidelines further set forth requirements for an effective program to prevent and detect violations of the law.

Generally, an effective compliance program must prevent and detect criminal conduct. However, the failure to detect criminal conduct does not automatically make the program ineffective. Rather, the hallmark of an effective program is that the organization exercise due diligence in seeking to prevent and detect criminal conduct by its employees and other agents.

Due diligence essentially requires the following: that the company establish compliance standards and procedures reasonably capable of reducing criminal conduct; that the company communicate the standards and procedures to all employees through training programs or publications that describe the practical application of the standards; that the company conduct audits designed to detect criminal conduct; that the company consistently enforce the standards through disciplinary mechanisms; and, finally, that the company take all reasonable steps to respond appropriately to the offense and to prevent further similar offenses, including making any necessary modifications to its compliance program.

The problem that you folks face is: how does one create and conduct an effective compliance program without producing a smoking gun for opponents to use in future litigation.

As Joe Murphy may discuss with you, at least in part, in his presentation later this afternoon, how do you avoid getting beaten with carrots or forced to eat the sticks that underlie the guidelines system?

Let’s talk a little bit about how materials might be protected under a variety of sources of law. First of all, the law of privileges. Privileges, as you folks will recall, at least those of you who took the basic course in evidence, are typically disfavored. They are disfavored because they serve to keep out highly relevant information. For the most part, the courts will construe the law of privileges narrowly and will recognize a privilege only when it is clearly warranted.

Now, there are a variety of reasons for this, but in part you can all thank Richard Nixon for that proposition, because the Supreme Court in U.S. v. Nixon established the principle or at least recognized once again the proposition that the government is entitled to every person’s evidence. In that light, a privilege will typically be construed quite narrowly.

Now, the privilege that most obviously comes to mind in this context is the attorney-client privilege, which protects confidential communications between an attorney and client. Ordinarily, the law requires four factors to be present before the privilege will be recognized:

- the privilege holder must, in fact, be the client or someone seeking to become a client;
- the communication must be with a licensed attorney who is acting as a legal counselor;
- the communication must be confidential;
- and it must relate to the rendition of professional legal services.

Now, these requirements trigger a variety of potential obstacles in our immediate setting. For example, as a practical matter, attorneys oftentimes lack the skills to conduct a proper investigation. This is especially the case where the corporation or collective entity is somehow involved in highly technical work. Lawyers don't always have the scientific background or the mathematical or technical background to understand the everyday functions of an organization's activities. Consequently, oftentimes you will need a trained person, someone trained in the particular workings of the corporation's affairs rather than legal matters, to conduct this investigation. Oftentimes, as a result, many compliance programs do not involve attorneys.

Furthermore, if the attorney is viewed as acting as a business advisor rather than as a legal counselor, the privilege will not apply.

In addition, because of conflicting case law, under the attorney-client privilege, management cannot be assured that its discussions of problems or remedies in the presence of other employees will be protected. As a result, management might not be able to advise employees about the results of internal audits, nor can these results be used in training materials for employees without the risk of waiver. Unfortunately, however, the guidelines at least implicitly seem to require such disclosure in order for employees to be effectively trained. Thus, the attorney-client privilege is an imperfect tool in this context.

What about the work product doctrine, which protects the opinions or mental impressions of attorneys in connection with litigation? That is a potential shield from disclosure, but the difficulty is that oftentimes compliance programs are not done in connection with immediate litigation. Indeed, the very purpose of the compliance program is to avoid litigation. Consequently, the work product doctrine may not be applicable.

Now, another speaker earlier in the program made reference to an ombudsman's privilege, which a few courts have recognized. However, that privilege is not widely recognized, at least not in the reported cases; and even where it has been accepted, it won't cover those situations where the compliance officer is not serving as an ombudsman.

I suppose the best potential gap-filler in this context is what has come to be known as the self-evaluative privilege. To promote corporate audits, some courts have begun to fill the gap in privilege doctrine by recognizing a self-evaluative privilege which protects audits and other materials from discovery when public policy outweighs the judicial system's need for access to that information. This evaluative privilege is designed to encourage self-analysis and self-criticism by a corporation.

Unlike the attorney-client privilege, the self-evaluative privilege does not require attorney involvement or any intention to engage in litigation. This privilege has evolved in the federal courts in part because Rule 501 of the Rules of Evidence allows the federal courts to create, in effect, a federal common law of privilege. The drafters of the federal rules anticipated a fluid set of privileges that would evolve over time in response to changing circumstances.

Even before the adoption of the federal rules, at least one federal court recognized at least a qualified self-evaluative privilege. The case, of course, is in the materials, and it's called

Bredice v. Doctors Hospital. Sometime in the late 1960s, Doctors Hospital experienced what has become known in the trade as a “therapeutic misadventure.” Of course, that means the patient died. And upon the death of the patient, the hospital established a committee to review hospital procedures and to improve patient care.

In a subsequent malpractice action, a plaintiff requested all minutes, reports, and data concerning the patient’s death. The court, in response, recognized a qualified privilege to protect that committee’s minutes and reports from discovery. The court found that three elements must exist to sustain this privilege: first, the information must result from a critical self-analysis; second, the free flow of this information must advance some public interest; and disclosure must curtail the free flow of this type of information.

Based upon the Bredice doctrine, subsequent federal courts in a variety of contexts have recognized a limited self-evaluative privilege. Now, I say it’s limited because it may be overcome on occasion by a showing of need. This type of privilege has been recognized, for example, in the context of medical peer review committees, railroad safety investigations, tenure decisions, and related situations.

The difficulty, however, is that the application in the courts has been uneven. Some courts have held that these materials must be prepared for a mandatory purpose, meaning, in other words, that the government has mandated the compliance program or preparation of the materials at issue. But there is a conflict of authority as to whether the compliance program must, in fact, be mandated.

Other courts have said that this type of privilege exists only if the program is a voluntary one. And, of course, what about the sentencing guidelines, which do not mandate these compliance programs, but give due credit for their existence?

Further, some courts have said that this material is limited to subjective, evaluative information generated internally. This creates problems defining what constitutes subjective data and purely evaluative data. And how do you deal with a situation in which you have a report that contains both subjective and objective material?

Some courts have further limited this privilege by holding that it is limited to situations involving public health or safety. Finally, others have said that under no circumstances will they recognize this type of a privilege when it is being asserted in response to a subpoena issued by a federal agency; and in my mind, by implication, in response to a subpoena issued by a grand jury.

As a result, we have a situation in which some courts have recognized the privilege, others have not, and inevitably we have a situation in which the outcome is going to be uncertain.

What is the best response to this situation? Well, in part, I can tell you that there are bills pending before Congress, at least in the environmental context, to enact legislation that will establish a limited self-evaluative privilege. On the state level, a number of states have likewise begun to consider this issue. But, again, keep in mind that even if the states are successful, a

state privilege, while valid under state law, would not ordinarily be valid in response to a subpoena issued by a federal agency. Consequently, state legislative relief will not be fully comprehensive for your purposes.

What do you as counsel do under these circumstances? Well, I think that what you've got to do, I suppose, is engage in the intolerable labor of thought. You need to figure out a solution. In part, I think what you've got to do is make the argument that the attorney-client privilege applies as broadly as is possible. In a situation, for example, when you have not engaged in the communication with the employee, but someone has acted for you, make sure that you have taken the proper steps to designate that interviewer as your agent so that that individual would fit within the umbrella of the attorney-client privilege.

Second, make sure that you are stressing the confidentiality of the communications at all times.

And, third, go back to the law books and re-read the Supreme Court's decision in Upjohn v. U.S. (1981). It will provide you with a lot of very useful text for two reasons: first, it will help you argue that the attorney-client privilege deserves to be broadly applied; and, second, the Upjohn decision, at least from a policy standpoint, provides good arguments in support of the adoption of the self-evaluative privilege.

The Upjohn case involved an internal investigation by Upjohn concerned with whether any of its employees had violated the Foreign Corrupt Practices Act by making improper payments to foreign officials. Its attorneys prepared a questionnaire for area managers, asking them to provide full information concerning questionable payments. The managers complied, and as a result of the investigation, the company filed a report with the SEC and the IRS.

Consequently, as soon as the IRS got this report, it issued a summons to the company seeking access to all the underlying questionnaires as well as all interview notes with company employees.

The company asserted the attorney-client privilege. The Court of Appeals eventually rejected the privilege, reasoning that the privilege did not apply to the extent that the communications were made by employees who were not responsible for directing Upjohn's actions in response to legal advice. Establishing, in other words, a control group test as a means of limiting the attorney-client privilege.

The Supreme Court rejected this control group test and, in doing so, broadly endorsed the principles underlying the attorney-client privilege. The court said that this privilege is the oldest privilege in our law. In a corporate context, furthermore, frequently the employees with the critical information will be beyond the so-called control group. We don't want to force a Hobson's choice upon counsel. Specifically, if counsel interviews employees outside the control group, the privilege will not be recognized. On the other hand, if counsel chooses not to interview those individuals, counsel will not get full information necessary to render complete advice to the company.

As a result, the court said that the narrow scope afforded the privilege by the control group test "threatens to limit the valuable efforts of corporate counsel to ensure their client's

compliance with the law.” The court also observed that corporations, unlike most individuals, constantly go to lawyers to find out how to obey the law, particularly since compliance with the law in this area is hardly an instinctive matter. That’s still true under the sentencing guidelines. No one has told me that the guidelines have made law any easier to apply. Not yet, anyway.

Finally, the court said that an uncertain privilege or one which purports to be certain but results in widely varying applications is little better than no privilege at all. On that basis, the court rejected the control group test, applied a broader analysis for trying to define the circumstances under which the privilege ought to be recognized, and protected the communications. The point here is that the Upjohn case, carefully analyzed by you, will provide you with a basis both for arguing that the attorney-client privilege ought to be broadly recognized in this context, and it gives you guidance also as to how to set up your own internal compliance program in a manner that conforms to Upjohn. Beyond that, Upjohn identifies the types of policy considerations that you can use in trying to assert the self-evaluative privilege by way of defense in this context.

Ultimately, however, I think the solution here is a legislative one. We need for Congress to adopt the right type of a privilege that will provide you with certainty in this context. Absent such a solution, the compliance initiative undertaken by the sentencing guidelines may never achieve its full potential. Thank you very much.



**THE SELF-EVALUATIVE PRIVILEGE: A COMMENTARY ON EXISTING LAW**

**Commissioner Michael Goldsmith** \*\*\*\*\*  
**Chad W. King** \*\*\*\*\*

- I. Introduction.
  - A. Do compliance practices, as contemplated by the guidelines, pose disclosure and liability risks?
    1. *\$1.05 Million Fine Against Coors May Deter Corporate Environmental Audits, Firm Says*, 24 Env't Rep. (BNA) 570 (July 30, 1993).
    2. *Stender v. Lucky Stores*, 803 F. Supp. 259 (N.D. Cal. 1992) (holding that corporate compliance program re:sexual discrimination is subject to discovery).
- II. Creating a Compliance Program Under the United States Sentencing Guidelines.
  - A. Chapter Eight of the Sentencing Guidelines governs the sentencing of organizations for felony and Class A misdemeanor offenses. UNITED STATES SENTENCING COMMISSION, SENTENCING GUIDELINES MANUAL §8A1.1 (1994) [hereinafter U.S.S.G.].
  - B. A “carrot and stick” philosophy underlies the guidelines. *See Oversight on the U.S. Sentencing Commission and Guidelines for Organizational Sanctions: Hearings Before the Subcommittee on Criminal Justice of the House Committee on the Judiciary*, 101st Cong., 2d Sess. 189 (1990).
    1. The Stick.
      - a. When an organization violates the law, the fine range is based on the seriousness of the offense and the organization’s culpability. “The seriousness of the offense generally will be reflected by the highest of the pecuniary gain, the pecuniary loss, or the amount in the guideline offense level fine table.” U.S.S.G., Ch. 8, intro. comment.

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2. The Carrot.
  - a. By creating and implementing an “effective program to prevent and detect violations of law,” an organization may reduce its fine if a criminal violation occurs. U.S.S.G. §8C2.5(f); Winthrop M. Swenson & Nolan E. Clark, *The New Federal Sentencing Guidelines: Three Keys to Understanding the Credit for Compliance Programs*, 1 CORP. CONDUCT Q. 1 (1991).
- C. Requirements for an “effective program to prevent and detect violations of law” as defined by the guidelines:
  1. Generally, an effective compliance program must prevent and detect criminal conduct. U.S.S.G. §8A1.2, comment. (n.3(k)).
  2. However, failure to prevent or detect criminal conduct does not automatically make the program ineffective. “The hallmark of an effective program to prevent and detect violations of the law is that the organization exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents.” *Id.*
  3. Due diligence generally requires that the organization:
    - a. Establish compliance standards and procedures that are reasonably capable of reducing criminal conduct, *id.* §8A1.2, comment. (n.3(k)(1));
    - b. Communicate the standards and procedures to all employees through training programs or publications that describe the practical application of the standards, *id.* §8A1.2, comment. (n.3(k)(4));
    - c. Conduct audits designed to detect criminal conduct, monitor employees, and utilize a reporting system through which employees can report criminal conduct within the organization without fear of retribution, *id.* §8A1.2, comment. (n.3(k)(5));
    - d. Consistently enforce the standards through disciplinary mechanisms, *id.* §8A1.2, comment. (n.3(k)(6)); and
    - e. Take “all reasonable steps to respond appropriately to the offense and to prevent further similar offenses—including any necessary modifications to its program,” *id.* §8A1.2, comment. (n.3(k)(7)).

- D. Problem: How to create and conduct an effective compliance program without producing a “smoking gun” for opponents in future litigation? See Ronald J. Allen & Cynthia M. Hazelwood, *Preserving the Confidentiality of Internal Corporate Investigations*, 12 J. CORP. L. 355, 357 (1987).
- III. Protecting Materials Generated Through Compliance Programs.
- A. Privileges generally.
    - 1. Privileges are typically disfavored. *Herbert v. Lando*, 441 U.S. 153 (1979).
    - 2. Privileges are often narrowly construed and may be invoked only when clearly warranted. See *United States v. Nixon*, 418 U.S. 683, 710 (1974); 8 JOHN H. WIGMORE, WIGMORE ON EVIDENCE § 2291 (McNaughton rev. ed. 1964).
  - B. Traditional common-law privileges.
    - 1. Privilege against self-incrimination.
      - a. Prohibits a person from “being compelled in any criminal case to be a witness against himself.” U.S. CONST. amend. V.
      - b. Problem: The United States Supreme Court ruled that this privilege is inapplicable to organizations. E.g., *United States v. White*, 322 U.S. 694 (1944); *Hale v. Henkel*, 201 U.S. 43 (1906).
    - 2. Attorney-client privilege.
      - a. Protects confidential communication between an attorney and a client. See *Upjohn Co. v. United States*, 449 U.S. 383 (1981).
      - b. Typically requires four factors:
        - (1) The privilege holder must be a client or someone seeking to become a client;
        - (2) The communication must be with a licensed attorney who is acting as a legal counselor;
        - (3) The communication must be confidential;
        - (4) The communication must relate to the rendition of professional legal services to the client.

- c. Problem: Many compliance programs do not involve attorneys or confidential requests for legal advice. In addition, under the attorney client privilege management cannot candidly address problems or remedies in the presence of other employees.
  3. Work product doctrine.
    - a. Protects an attorney’s work product prepared for litigation. *Hickman v. Taylor*, 329 U.S. 495 (1947); FED. R. CIV. P. 26(b)(3).
    - b. Problem: Many compliance programs are not conducted in connection with litigation.
- C. The self-evaluative privilege.
  1. The self-evaluative privilege protects audit and other evaluative materials from discovery when public policy outweighs the judicial system’s need for access to the information. The doctrine is designed to encourage corporations to engage in confidential self-analysis and self-criticism. *See Granger v. National R.R. Passenger Corp.*, 116 F.R.D. 507, 508 (E.D. Pa. 1987).
  2. Unlike the attorney-client privilege or the work product doctrine, the self-evaluative privilege does not require attorney involvement or an intention to engage in litigation.
  3. The self-evaluative privilege, however, may be overcome by a showing of need. *See, e.g., Robinson v. Magovern*, 83 F.R.D. 79 (W.D. Pa. 1979); Nancy C. Crisman & Arthur F. Mathews, *Limited Waiver of Attorney-Client Privilege & Work Product Doctrine in Internal Corporate Investigations: An Emerging Corporate ‘Self-Evaluative Privilege’*, 21 AM. CRIM. L. REV. 123, 172 (1983).
- IV. Creation and Evolution of the Self-Evaluative Privilege.
  - A. The privilege originated in *Bredice v. Doctors Hosp., Inc.*, 50 F.R.D. 249 (D.D.C. 1970), *aff’d*, 479 F.2d 920 (D.C. Cir. 1973).
    1. Upon the death of a patient, Doctors Hospital established a committee to review hospital procedure and improve patient care. In a subsequent malpractice action, plaintiff requested all minutes, reports, and memoranda concerning the patient’s death.

2. The court recognized a qualified privilege that protected the committee's minutes and reports from discovery. Three elements must exist to sustain this privilege:
  - a. The privileged information must result from a critical self-analysis;
  - b. The free flow of this type of information must advance some public interest; and
  - c. Absence of confidentiality must curtail the free flow of this type of information.
- B. Eight years later, in *Webb v. Westinghouse Elec. Corp.*, 81 F.R.D. 431 (E.D. Pa. 1978), the federal district court for the Eastern District of Pennsylvania delineated three different elements for the privilege:
  1. The materials must be prepared for a mandatory government report;
  2. The materials must be subjective and evaluative; and
  3. Proponent must show that the public policy favoring the privilege "clearly outweighs" the need for disclosure.
- C. Courts continue to limit the privilege. For example:
  1. The privilege will not apply if the organization voluntarily discloses the material to a regulatory agency, *see, e.g., In re Subpoena Duces Tecum*, 738 F.2d 1367, 1375 (D.C. Cir. 1984);
  2. Some courts decline to recognize the privilege if the material is requested by a regulatory agency under a subpoena, *see Federal Trade Comm'n v. TRW, Inc.*, 628 F.2d 207, 210 (D.C. Cir. 1980) (holding the self-evaluative privilege inapplicable to subpoenaed information); and
  3. Some courts hold that evaluative material will only be protected when it involves public health or safety. *See, e.g., Mergentime Corp. v. Washington Metro. Area Transp. Auth.*, No. 89-1055, 1991 U.S. Dist. LEXIS 11080 (D.D.C. Aug. 6, 1991) (declining to recognize privilege for this reason).
- V. Judicial Application of the Self-Evaluative Privilege.
  - A. Nevertheless, courts have applied the privilege in a variety of cases, *see Tharp v. Sivyver Steel Corp.*, 149 F.R.D. 177, 180 (S.D. Iowa 1993), including:

1. Medical peer review, *see, e.g., Bredice v. Doctors Hosp., Inc.*, 50 F.R.D. 249, 251 (D.D.C. 1970), *aff’d*, 479 F.2d 920 (D.C. Cir. 1973);
  2. Personal injury, *see, e.g., Dowling v. American Haw. Cruises, Inc.* 971 F.2d 423, 425 (9th Cir. 1992);
  3. Railroad safety, *see, e.g., Granger v. National R.R. Passenger Corp.*, 116 F.R.D. 507 (E.D. Pa. 1987);
  4. Products liability, *see, e.g., Roberts v. Carrier Corp.*, 107 F.R.D. 678 (N.D. Ind. 1985);
  5. Securities litigation, *see, e.g., In re Crazy Eddie Sec. Litig.*, 792 F. Supp. 197 (E.D.N.Y. 1992). *But see In re Salomon Bros. Sec. Litig.*, Fed. Sec. L. Rep. (CCH) ¶ 97,254 (S.D.N.Y. 1992);
  6. Denial of tenure or promotion in an academic setting, *see, e.g., EEOC v. University of Notre Dame Du Lac*, 715 F.2d 331 (7th Cir. 1983). *But see University of Pennsylvania v. EEOC*, 493 U.S. 182 (1990);
  7. Employment discrimination, *see, e.g., Banks v. Lockheed-Georgia Co.*, 53 F.R.D. 283 (N.D. Ga. 1971);
  8. Environmental litigation, *see, e.g., Reichhold Chems., Inc. v. Textron, Inc.*, 157 F.R.D. 522 (N.D. Fla. 1994). *But see United States v. Dexter Corp.*, 132 F.R.D. 8, 10 (D. Conn. 1990) (“The application of the ‘self-critical’ privilege in this action would effectively impede the Administrator’s ability to enforce the Clean Water Act, and would be contrary to stated public policy.”).
- B. Inconsistent applications. *Compare Bredice v. Doctors Hosp., Inc.*, 50 F.R.D. 249 (D.D.C. 1970) (medical peer review materials privileged) *with Davidson v. Light*, 79 F.R.D. 137 (D. Colo. 1978) (medical peer review materials not protected); *compare Reichhold Chems., Inc. v. Textron, Inc.*, 157 F.R.D. 522 (N.D. Fla. 1994) (environmental evaluation materials privileged) *with United States v. Dexter Corp.*, 132 F.R.D. 8, 10 (D. Conn. 1990) (environmental evaluation materials not protected).
- C. Reasons for rejecting the privilege:
1. Several courts believe that the self-evaluative privilege thwarts government efforts to enforce regulatory laws, resulting in reduced industry compliance. Robert W. Darnell, Note, *Environmental Criminal Enforcement and Corporate Environmental Auditing: Time for a Compromise?*, 31 AM. CRIM. L. REV. 123, 141 (1993).

2. Granting the privilege increases the cost and burden of discovery. Robert J. Bush, Comment, *Stimulating Corporate Self-Regulation—The Corporate Self-Evaluative Privilege: Paradigmatic Preferentialism or Pragmatic Panacea*, 87 NW. U. L. REV. 597, 634-37 (1993).
3. The self-evaluative privilege’s protection is unnecessarily duplicative of other incentives that promote corporate self-regulatory conduct, such as federal regulatory requirements or industry standards.
4. By restricting access to information, the privilege creates obstacles to litigation aimed at promoting good corporate conduct. See JAY A. SIGLER & JOSEPH E. MURPHY, INTERACTIVE CORPORATE COMPLIANCE: AN ALTERNATIVE TO REGULATORY COMPULSION 122 (1988).

VI. Federal Treatment of the Self-Evaluative Privilege.

A. Federal agencies do not recognize the self-evaluative privilege.

1. The Environmental Protection Agency recently announced that it will not treat corporate environmental audits as privileged business information.
2. The Securities and Exchange Commission does not recognize a privilege for audit or other evaluative documents, although it will enter into limited waiver agreements to protect such documents from civil discovery.

B. Federal courts.

1. Courts evaluate privileges “in the light of reason and experience.” FED. R. EVID. 501.
2. Federal courts generally construe the self-evaluative privilege narrowly. *Mason v. Stock*, 869 F. Supp. 828, 834 (D. Kan. 1994); *Everitt v. Brezzel*, 750 F. Supp. 1063, 1066 (D. Colo. 1990).

VII. Self-Evaluative Privilege Legislation.

A. Proponents of self-evaluative privilege legislation point to the following policies:

1. Corporations are more likely to conduct voluntary self-evaluative investigations if the materials will be protected from private-party discovery;

2. Although all privileges increase the cost and burden to the opposing party, granting a self-evaluative privilege will not increase the cost of discovery enough to overcome the need for the privilege, *see* 8 JOHN H. WIGMORE, WIGMORE ON EVIDENCE § 2291 (McNaughton rev. ed. 1964) (privileges are “an obstacle to the investigation of truth”); Robert J. Bush, Comment, *Stimulating Corporate Self-Regulation—The Corporate Self-Evaluative Privilege: Paradigmatic Preferentialism or Pragmatic Panacea*, 87 NW. U. L. REV. 597, 635-37 (1993);
  3. The privilege merely preserves the status quo. It essentially leaves litigants where they would have been if the corporation had conducted no evaluation, *see* Joseph E. Murphy, *The Self-Evaluative Privilege*, 7 J. CORP. L. 489, 496 (1982);
  4. The disclosure of audits adversely affects constructive corporate behavior, *see* James T. O’Reilly, *Environmental Audit Privileges: The Need for Legislative Recognition*, 19 SETON HALL LEGIS. J. 119 (1994); JAY A. SIGLER & JOSEPH E. MURPHY, INTERACTIVE CORPORATE COMPLIANCE: AN ALTERNATIVE TO REGULATORY COMPULSION (1988). For example:
    - a. Fewer internal activities are examined;
    - b. Fewer investigations are undertaken;
    - c. Fewer of the findings are translated into corrective plans;
    - d. Management hears fewer criticisms of past practices; and
    - e. Criticism is less widely distributed.
  5. Empirical evidence indicates that attorneys and corporations are more willing to perform investigations if they believe that their work will be protected from discovery, *see* Vincent C. Alexander, *The Corporate Attorney-Client Privilege: A Study of the Participants*, 63 ST. JOHN’S L. REV. 191, 260-61 (1989).
- B. Federal Self-Evaluative Privilege Statutes.
1. Bills are currently pending before both houses in Congress that will codify a self-evaluative privilege for environmental audits. Voluntary Environmental Self Evaluation Act, S. 582, 104th Cong., 1st Sess. (introduced March 21, 1995); Voluntary Environmental Self Evaluation Act, H.R. 1047, 104th Cong., 1st Sess. (introduced February 24, 1995).
- C. State Self-Evaluative Privilege Statutes.



1. Recognizing the need for a dependable privilege, several state legislatures codified the self-evaluative privilege in various areas of the law.
  - a. Medical peer-review committees.
    - (1) Nearly every state has some form of protection for medical peer-review committees.
    - (2) Medical self-evaluative privilege statutes are generally based on the *Bredice* case and protect all information and reports generated by a medical “peer-review” or evaluative committee from any discovery.
    - (3) *See, e.g.*, ARK. STAT. ANN. § 20-9-503 (Michie 1994); IDAHO R. EVID. 519; N.C. GEN. STAT. § 122C-30 (1994); R.I. GEN. LAWS §§ 5-37.3-7, 23-17-25 (1994); VA. CODE ANN. § 8.01-581.17 (Michie 1995); WASH. REV. CODE § 70.41.200 (1994); WYO. STAT. § 35-17-105 (1995).
  - b. Environmental audits.
    - (1) Approximately one-third of the states have enacted an environmental audit statute, and many legislatures have environmental audit legislation pending. *See* Barry Goode et al., *The Environmental Self-Audit Privilege*, Preventive Law Reporter 36 (Summer 1995).
    - (2) Under most of these statutes, when an organization conducts an audit to determine whether it complies with environmental laws, all information and reports produced in that audit are protected from discovery in any civil, criminal, or administrative proceeding.
    - (3) These statutes also require corporations to remedy violations discovered during environmental audits.
    - (4) *See, e.g.*, COLO. REV. STAT. § 13-25-126.5 (1994); IND. CODE ANN. § 13-10-3-1 to -12 (Burns 1994); KY. REV. STAT. ANN. § 224.01-040 (Baldwin 1994); OR. REV. STAT. § 468.963 (1994).
    - (5) In its recently enacted statute, Kansas is the first state to require that the company maintain an effective program to prevent and detect violations of law

before environmental audit information may be protected. *See* 1995 Kan. Sess. Laws 204 (S.B. 76).

2. Comparison of the common-law self-evaluative privilege and state statutes.
  - a. While many courts only protect subjective evaluations from discovery, state self-evaluative privilege statutes generally protect all information from all parties, including the government.
  - b. Under most state statutes, the privilege can only be waived intentionally.
  - c. State statutes often assess heavy penalties to persons who distribute privileged materials to third parties.
3. Direction of the self-evaluative privilege statutes.
  - a. Most statutes protect self-evaluations in only one area, such as medical review or environmental audits. However, Florida is considering a “blanket statute” which will protect all self-evaluative material from discovery. Self-Evaluative Privilege Act, S. 1440, 14th Fla. Leg., Reg. Sess. (1995); Self-Evaluative Privilege Act, H.R. 1545, 14th Fla. Leg., Reg. Sess. (1995).
  - b. Kansas recently enacted a self-evaluative privilege statute that requires a compliance program to be in place before information will be protected. 1995 Kan. Sess. Laws 204 (S.B. 76).

VIII. Conclusion.

## **THE COLORADO EXPERIENCE**

MR. SWENSON: Our second presenter is Patricia Bangert. Ms. Bangert is Deputy Attorney General for Natural Resources for the State of Colorado. In this role, she oversees legal issues arising from the administration of Colorado's environmental laws, and her topic today is a Colorado statute that one might call ground-breaking. It was the first state statute that, under some circumstances, permits companies the privilege and immunity from liability for auditing and voluntary disclosure.

MS. BANGERT: Actually, I'm here with a partial answer to the disclosure problem, and specifically, in Colorado, it's Senate Bill 139. What Senate Bill 139 does in Colorado in the environmental area – and everything that I'm going to say is limited to the environmental area – is to do two general things: first is to give a privilege to audits, to self-evaluative reviews that companies voluntarily do in administrative, civil, and criminal contexts; and, secondly, to go a step further than many of the other laws, other state laws, and give a disclosure immunity, and the disclosure immunity is given to a company that does a voluntary audit and finds a violation, discloses that violation, and corrects the violation.

That's in general what the law does. Let me go into some specifics. One thing I need to tell you first. This is an experiment. This is in the best methods of states acting as laboratories for democracy, and that is, this law begins in June of 1994 and ends in July of 1999. It is a five-year experiment in audit privilege and disclosure immunity.

Specifically, as I said, it provides a privilege for environmental audits in administrative and judicial actions, and those are actions brought by the government or actions brought by third parties. There are a number of exceptions to that privilege, though, that I have to point out.

One is it's not applicable if it's waived. Two, it's not applicable if a court finds that the audit revealed violations which were not corrected. And we think that this is really a major part of the law and a major selling point of the law, and that is, that in order to get the privilege, companies must correct any violations that they find in the course of the audit.

Third, if a court finds that an audit is done or was done for a fraudulent purpose or to avoid discovery of a violation in an ongoing or imminent investigation, the privilege will not apply. The privilege will also be inapplicable if a court finds that there are compelling circumstances that would require disclosure. I know that is an exception that might swallow the rule, depending on how the courts define "compelling circumstances." Unfortunately, we don't have a track record on that yet.

Also, the privilege will not apply if a court finds that there is some danger to health or environment outside of the facility that would require the findings in the audit to be made public.

Also, I have to point out that the privilege doesn't apply to documents that are required to be reported to a government agency or documents that existed before or after the audit. That's the privilege with all of its many exceptions.

Turning to the disclosure immunity, what the law does, what S.B. 139 does, is to say that companies that do an audit, discover a violation, promptly report that violation, and correct the violation have immunity from administrative, civil, and criminal negligence penalties and fines. An important thing to point out is this does not preclude an agency from bringing injunctive or seeking injunctive relief, and that is, an agency could still issue a corrective action order under RCRA.

The disclosure immunity also does not apply to bad actors, and that’s a provision that’s worded in a fairly clumsy manner, but for the most part applies to people who have had multiple environmental violations over the past three years.

That’s the Colorado statute in a nutshell. What I want to turn to next is how it has worked over the past year, since June of 1994. I would have to preface this by saying everyone has pretty much walked on eggshells. Everyone wants this to work. We’ve had about six instances in which companies have come into the Department of Health, the regulatory agency in this case, and have asked for disclosure immunity. We don’t have any instances yet involving the privilege aspect. I guess the issues there would arise if we, the government, would go in and want information that was otherwise privileged under the statute. We haven’t had any experience with that yet.

In the disclosure immunity area, the process generally works as follows. A company will send a letter to the Department of Health outlining in very general terms a violation and asking for immunity. The company will then meet with the Department of Health, who will ask for additional information about the violation and about the correction of the violation. At that point there will be some settled-upon method of correction, some path established toward compliance. It may be that the violation is fairly minor and it’s already been corrected. Maybe it’s a permit problem, operating without a permit. It may be a more complicated violation.

At that point, the Department of Health would likely put the company on some sort of a compliance schedule, either through a compliance order or some sort of a settlement agreement.

Expanding beyond Colorado, as I think the Commissioner said, 14 other states have audit privilege bills. They may or may not also have disclosure immunity. Many other legislatures – I think I heard 23 not too long ago – are considering such legislation. We think that this is a very good sign that other states are considering or have enacted such legislation. The problem for you is you have a lot of different types of legislation out there, and that obviously creates problems for companies that are operating in different jurisdictions.

For example, you may be operating in one jurisdiction that has disclosure immunity and another that just has a privilege, or that has nothing whatsoever. Consistency between state laws is something yet to be achieved.

The other thing I’d want to mention in stark contrast to the states is the federal government position, and I assume you’ve heard a little bit about this. The federal government does not recognize the privilege officially and does not grant disclosure immunity. In the

environmental area, this was vividly emphasized in EPA's interim draft policy on self-evaluations.

In that draft policy, which was released just a couple months ago, EPA said it does not recognize the privilege for audits; however, it will not routinely go after audits to trigger an investigation.

Secondly, it is not going to grant disclosure immunity, but as a policy it will reduce certain parts of the penalty in cases where a company has done an audit, disclosed violations, and corrected those violations. Again, this is a matter of policy. There was a long disclaimer at the end of their policy saying maybe we will, maybe we won't. This is just a policy.

Today, I heard an EPA speaker in another conference say they're thinking about trying to make this a little more firm, a little more certain. However, he is not making any promises. The thing that struck us in the EPA policy was that it came out very strongly against state laws that had privileges and immunities. They said they didn't like us very much. What was even worse, because we don't really care whether EPA likes us very much, is the fact that EPA said they're going to scrutinize enforcement more closely in those states with audit privilege laws.

What that has the potential to do is to pretty much scuttle state laws. Here's the scenario. You come to us. You say, I violated the Clean Air Act; my emissions are higher than my permit allows. We say, "Fine, correct the violation, and go on your merry way."

Unfortunately, staff so far – and this hasn't gotten up to the highest levels of the state, staff so far has interpreted the law as saying the following: "When you come in to give us the information and you get the disclosure immunity, the information you provide us is a public record." That causes a major problem, because if EPA wants that information, it can get the information. If EPA will not give a similar type of immunity, then the company is on the hook, at least for EPA. At the same time, it is off the hook for the state.

There are federal legislative efforts to try to correct that problem, and the Commissioner alluded to them. There is a bill in the House, 1047, and a bill in the Senate, 582, both sponsored by Colorado folks, that would create a privilege for environmental audits in any federal proceeding, and both bills would afford broad immunity from administrative, civil, and they may be read to say all criminal enforcement actions of any sort when a company finds a violation, discloses it, and corrects it.

The states are a little concerned about the bill or some states are a little concerned about the federal legislation because they see it as trampling on states rights. Like pretty much every issue within the environmental audit area, disclosure immunity area, this is one of great controversy and great uncertainty for the future.

## QUESTIONS & ANSWERS

MR. SWENSON: Do you think that attempts to apply the attorney-client privilege to compliance and audit information will impede the effectiveness of a compliance program because of an attorney’s inclination to control information and perhaps to impede corrective measures needed for unfavorable audit results? Do attorneys get in the way of the process, I guess?

COMMISSIONER GOLDSMITH: I think that risk always exists, but in the end it’s not ordinarily counsel’s job to make these decisions. Counsel’s job is to give the client advice, and then the client, the corporation itself and its officers, will be making this decision.

Beyond that, I think that oftentimes within this context the advice, frankly, will be to make a disclosure or to cooperate, precisely because of the carrot and stick approach adopted by the guidelines. The penalties are so severe, the downside risks are so heavy, that by a comparison the benefits of disclosure are many. And, indeed, it seems to me that in the situation in which you have made a full disclosure and attempted to rectify the problem and you’ve cooperated with the government, you have at least a decent argument to present to the Justice Department that the case ought not be prosecuted. The fines have been paid or full restitution has been made. Consequently, a criminal prosecution is not necessarily in order. So obviously the more you have done, the better off you are in terms of being able to make that argument.

MR. SWENSON: What do you think the public policy limits are on a self-evaluative privilege? That’s an open-ended question but a pretty good one.

MS. BANGERT: In Colorado, we tried to strike a delicate balance between going after the bad actor and giving companies incentives to do self-reviews, find problems, and correct them. That’s why we have so many exceptions to the rules.

The statute was a compromise after all parties had sat down to talk, and those included environmental interests, district attorneys, companies, and others, and state regulatory officials. I guess that we think that we have pretty much taken care of the public policy issues through the way the bill has been crafted. But, granted, there is always an issue of whether you’re letting too many bad actors off the hook while still trying to create the incentive.

## QUESTIONS & ANSWERS – WRITTEN

*Michael Goldsmith*

- Q. What is the practical value (in the criminal context) of a privilege which must be waived if the prosecutor is demanding cooperation?
- A. Even if a corporation eventually *chooses* to disclose its audit materials to the prosecutor, it still enjoys advantages unavailable to a non-auditing corporation. For example, an audit helps a corporation to better assess its potential criminal

or civil liability, determine available legal defenses, and make knowledgeable legal and business decisions. As a result, an auditing corporation will usually better know the strength of the government's case, and can fight or settle accordingly.

An audit may also assist the corporation to avoid indictment. A comprehensive audit can help the corporation avoid a government investigation, and will often give the corporation more control over such an investigation if it occurs. Furthermore, if the corporation cannot successfully settle the dispute, the audit materials may enable the corporation to respond appropriately to the allegations of wrongdoing. Information gained from the audit can also help the corporation prepare its public relations campaign.

Finally, many cases do not involve government demands for disclosure. Absent such demands, the privilege serves to protect against disclosure to third parties in civil litigation (*e.g.*, private plaintiffs, state regulators, etc.)

Q. The Department of Justice (DOJ) presentations this morning, and to some extent the sentencing guidelines, focus on cooperation and disclosure. How do the various privileges fit into this setting? (DOJ staff seemed to be saying they want all information, including privileged information, or else you get no credit for the compliance program.)

A. See answer to above question.

Q. Do you think that attempts to apply the attorney/client privilege to compliance and audit information will impede the effectiveness of a program – because attorneys' inclination to control information will impede corrective measures needed after unfavorable audit results?

A. Not necessarily. Depending upon the scope of the self-evaluative privilege, the attorney may not have any incentive to "control" information. Indeed, the privilege might be formulated to discourage such tight control by counsel.

Q. Could a strong self-evaluative privilege frustrate prosecutors sufficiently well to make compliance efforts unnecessary?

A. Any privilege can be made sufficiently strong to frustrate prosecutors, regulators, and the courts. It is unlikely, however, that Congress will enact self-evaluative privilege legislation that frustrates prosecutors to the detriment of compliance efforts. Federal legislation will probably resemble recent state environmental self-evaluative privileges, which provide protection only if the corporation meets a number of conditions. These conditions require corporations to conduct ongoing compliance audits that detect potential problems promptly. In some states, corporations must also repair the damage caused by the illegal activity before asserting the privilege; if the government demands production of audit materials before the corporation remedies the

damage and becomes eligible for the privilege, the corporation may not rely upon the privilege. Additionally, environmental audit privileges limit their protection to the corporation’s audit materials; any information obtained by the government independently of the corporate audit are still admissible. Accordingly, the audit privilege operates akin to the federal use immunity statute, which permits prosecutions based on evidence independent of a witness’s immunized testimony (under the Fifth Amendment privilege against self-incrimination).

- Q. If a quality assurance review of an organization’s ethical and legal compliance processes is performed by an outside consultant or auditor, would reported findings and recommendations be “privileged communications” between client and service provider? (*e.g.*, like the auditor/client privilege)
- A. The answer to this question would depend upon the scope of the self-evaluative privilege that is ultimately enacted. In most cases, however, an auditor’s report and recommendations should be researched and prepared at the direction of corporate counsel, thus invoking the attorney/client privilege.



*Day Two*

**In Search of Government’s Ideal Role  
in Fostering “Good Corporate  
Citizenship”**

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**Steven A. Herman** , *Assistant Administrator for Enforcement and Compliance Assurance,  
Environmental Protection Agency*

**Joseph E. Murphy** , *Senior Attorney, Bell Atlantic Corporation*

*Moderator: Win Swenson* , *Deputy General Counsel/Legislative Counsel, U.S. Sentencing  
Commission*

## **EPA'S COMPREHENSIVE APPROACH TO STRENGTHENING THE "GOOD CITIZEN" CORPORATION**

MR. SWENSON: The presentations up to now, especially the ones that we have heard today, have raised an important question. If strengthening the good citizen corporation is a desirable goal of law enforcement efforts, how should government best go about trying to achieve this goal?

Our next two speakers are especially well qualified to discuss this topic. The Environmental Protection Agency has recently developed a range of new policies aimed at strengthening good corporate citizenship in the environmental arena. These policies include a new environmental leadership program and, although it attracted some criticism just a few moments ago, a March 31, 1995, interim policy on self-policing and voluntary disclosure.

Steven A. Herman is the Assistant Administrator for Enforcement and Compliance Assurance, which really makes him the top enforcement official, at the Environmental Protection Agency, and he has been responsible for overseeing the development of these new policies. I think whatever you think about the March 31 disclosure policy and whether it has gone far enough or needs to go further, I think there really can be little doubt that EPA has been doing some very interesting, innovative thinking in the area of what government's role should be in strengthening the good citizen corporation.

MR. HERMAN: Good afternoon. It is a pleasure for me to be here at this session on "In Search of the Government's Ideal Role in Fostering 'Good Corporate Citizenship'." I want to first thank Win and the Sentencing Commission for the work they have done on both the review we've done on our auditing policy and on numerous other issues. The work has been extremely constructive, and you've been a wonderful colleague to have, and we appreciate it very much.

I want to use this opportunity to discuss the many changes that are occurring throughout the Agency, and most importantly, focus on the Office of Enforcement and Compliance Assurance (OECA). I believe that many of the actions and new policies we have undertaken provide incentives for encouraging the good corporate citizen and protect the public from those who are not so good, or are in fact bad.

I also cannot appear here without acknowledging that our progress and accomplishments are jeopardized by the budget cuts proposed for EPA in the House Bill. The reductions are 35 percent for the agency and 50 percent for enforcement. A cut of 50 percent is designed to wreck the environmental enforcement program. It presents a danger not only to the public but also to law-abiding companies. Polluters, those who cut corners and break the law, will gain at the expense of good corporate citizens if there is no enforcement program.

Enforcement of environmental laws is not an end in itself; achieving compliance which protects human health and the environment is the end. Enforcement serves this goal in several ways: 1) it deters bad behavior; 2) it levels the playing field; 3) it ensures polluters do not profit; and 4) it punishes wrongdoers.

This Administration, this agency and its enforcement and compliance assurance program, recognized early on that we must move forward – strengthen our current programs and

make changes where they are necessary. The initiatives and policies that I will discuss this afternoon present the regulated community, and small business in particular, with tremendous opportunities to improve the way in which they operate and relate to the agency.

Many of these initiatives, policies, and projects that the agency and my office are adopting involve risks to all interested parties. Change always involves risk. This risk should not be borne solely by the public. It must be shared by the government and the regulated community. The potential environmental and health benefits are great, and everyone stands to gain from these changes – but the public cannot bear the full brunt of these risks and different parties must be held accountable for their actions. These two factors – shared risk and accountability – represent the principles of fairness and responsibility underlying what we're doing.

The regulated community, and the EPA, must make these changes together if we are all to reap the many benefits of new approaches to environmental protection. This requires a fundamental level of trust and cooperation not heretofore achieved. This will not be easy but we must make the effort.

#### Reorganization

As I noted earlier, this Administration has been committed from the outset to change the manner in which the agency carries out its business. The first concrete manifestation of this commitment is embodied in the reorganization that created the Office of Enforcement and Compliance Assurance just over a year ago.

This reorganization is the realization of Administrator Browner's vision of enforcement as encompassing a spectrum of tools to assure compliance – from offering compliance assistance on the one hand, to seeking a criminal indictment on the other. It is our task to use the appropriate response and tool at the appropriate time. We recognize that our actions must be selective and discriminating.

It is important to recognize that OECA is not built upon an either/or principle when it comes to enforcement and compliance assurance. The solution to the problems of non-compliance – which we all face – can only be found when enforcement and compliance efforts work in tandem. It is this symbiotic relationship which allows us to be flexible and discriminating in our response when appropriate, yet firm when it comes to those companies that show a disregard for our laws, and the safety and health of our people and our environment. With this reorganization under our belt, we have moved quickly to embrace opportunities to improve compliance with our environmental laws. Several new policies serve to highlight some of these new directions.

#### Audit policy

On March 30th, I was very pleased to sign the interim agency policy on incentives for voluntary self-evaluation, disclosure, and correction. With an appropriate and voluntary self-audit, and disclosure, and prompt correction of any violations discovered, a company can expect the elimination of the entire punitive portion of any penalty. The goal of the policy is simple:

we want to promote self-monitoring, self-disclosure, and self-correction by everyone in the regulated community. It is good corporate citizenship, and its focus is on results – more compliance and a cleaner environment.

We recognize that we cannot achieve full compliance without the cooperation of a regulated community willing to act responsibly by self-detecting, correcting, and preventing violations. The basic conditions set forth in the policy reward responsible corporate behavior; such companies should expect better treatment from the government than those who take no responsibility for their actions or violations. If you audit, disclose, correct, we will completely waive the gravity component of the penalty. We will reserve the right to collect any substantial economic benefit of a violation, as recommended by the Compliance Management Policy Group, which represents the oil, chemical and paper industries (the most heavily regulated). We also will not guarantee a penalty waiver if there is serious actual harm, a pattern of violations, imminent and substantial endangerment, or criminal conduct by the corporation or its employees.

I want to underscore that this new policy provides significant incentives for self-evaluation, disclosure, and correction, without the inherent secrecy and potential for litigation which is a part of any statutory or policy privilege.

The new policy is fair and provides opportunities for the agency and the regulated community to work together to ensure compliance. This is a partnership that can only thrive when communication is open and frank. The idea of a privilege, which we rejected in the course of our extensive reassessment, yields suspicion and mistrust among all the players, including the public, without any added benefits. We continue to work on the policy: the public comment period ended June 30, the agency expects the final policy to be issued in October.

We also recognize that this will not be enough. Thus we will also maintain strong traditional enforcement. Federal laws and regulations set minimum standards for protecting human health and achieving environmental protection goals such as clean air and clean water. We will continue to uphold these laws through tough civil and criminal enforcement actions that appropriately penalize violators and require the adoption of better environmental practices.

#### Interim Policy On Compliance Incentives For Small Business

Another policy that embodies the same basic principles behind our self-disclosure and correction policy is an outgrowth of the Clean Air Act Section 507 enforcement policy which was implemented a year ago. Section 507 of the Clean Air Act requires each state to establish a small business assistance program, designed to help small businesses meet their obligations under the law. In response to concerns expressed by many states that small businesses would not seek assistance if violations discovered during their participation resulted in enforcement actions, EPA issued its section 507 enforcement response policy.

Building upon the success of this policy, in June, we issued the Interim Policy on Compliance Incentives For Small Businesses which expands the principles in the section 507 policy to small businesses that operate in other media besides air. The concept is simple: small businesses that act in good faith to comply, ask the right questions regarding their own facilities

and operations, and make the necessary changes and fixes if violations are discovered, will not be penalized.

The substantial benefits from this policy depend upon the regulated community's behavior. Everyone has a responsibility to comply with the law. Either through seeking and obtaining compliance assistance from a government-supported program, or through conducting a thorough evaluation of their own environmental practices, it is their responsibility to ensure they are operating in compliance. This policy provides substantial incentives to do just that, by eliminating any penalty under certain conditions, and focusing instead on the prompt correction of a violation. The Administration is committed to working with small businesses to improve the environment and the health of our people, and this policy demonstrates that.

#### Environmental Leadership Program

Related to these policies, is our Environmental Leadership Program (ELP), which was announced on April 7th. This program is piloting new ways to ensure multi-media compliance, third-party audits, and getting communities working with local industry to achieve environmental goals. As the Administrator said when she announced this program, these pilots will “demonstrate that environmental violations need not be simply an accepted cost of doing business. Pollution is not the price of progress. We can protect public health, protect our environment, and do it using common-sense and cost-effectiveness.”

Finding better ways to ensure compliance, and prevent pollution in the first place, benefits everyone – businesses, municipalities, and of course, the public. Many of the pilots involve the sharing of information between the ELP participants and other businesses. One pilot in particular (Ocean State Power, in Rhode Island) is developing a mentor program, which identifies large companies that can assist smaller businesses with environmental, health, and safety issues.

#### Compliance Assistance Service Centers

Another example of how our Office intends to use compliance assistance techniques to ensure compliance is through the development of Compliance Assistance Service Centers – serving four specific industry sectors heavily populated with small businesses. The agency has already entered into a cooperative agreement with the National Institute of Standards and Technology (NIST) to develop a National Metal Finishing Resource Center. We plan to launch at least one more center this year, most likely for the printing sector.

These multi-media, sector-oriented Assistance Centers would provide a base for “one stop shopping” for its targeted sector – one place to get comprehensive, easy to understand information on all regulatory requirements affecting the industry. In addition, technical assistance and training would be available on applicable treatment technologies to help minimize waste production, maximize pollution prevention technologies, and increase overall market competition.

This is one way in which we are fulfilling our responsibility to you. We will help you understand the rules, and provide assistance where we can, but the responsibility to comply is

yours. This feeds into an overarching theme of enforcement and compliance at the agency – we will make sure that information about compliance requirements is made available, but the regulated community, must take full advantage of these opportunities to expand their knowledge, and ensure their own compliance.

### Conclusion

These policies illustrate how the agency has taken the initiative to have a solid and strong enforcement program that serves the public, including the good corporate citizen.

EPA’s enforcement and compliance assurance program will continue to move forward, and ensure that regulations are understood, complied with, and that no one gains a competitive advantage by violating them. The new policies and programs at the agency are tremendous opportunities for the agency to improve its own operations, for the regulated community to improve its relationships with the public, the government, and the environment, and for the public to be assured that we are doing the maximum to protect its health and environment.

You can be certain that the agency as a whole is committed to implementing these new initiatives and policies because they make good sense for everyone. They fit hand-in-glove with our mission to protect the nation’s environment and the health of our people. For this reason, the future of environmental protection and regulation depends, in large part, upon our successes with these new approaches today and in the months and years ahead. Thank you.

**“BEATING THEM WITH CARROTS AND FEEDING THEM STICKS”**

MR. SWENSON: Our next speaker is Joseph E. Murphy, who is Senior Attorney at Bell Atlantic where he specializes in compliance issues. Joe’s voluminous writings on compliance issues have particularly focused on the theme of this segment, finding government’s ideal role in fostering good corporate citizenship. He’s the author and editor of several books – and those books’ names are in the program – that explore this theme, and he’s also the editor of Corporate Conduct Quarterly, which is an excellent journal dealing with compliance issues particularly. Because I really want to find out what he means by “beating them with carrots and feeding them with sticks,” I’ll be quiet and introduce Joe Murphy.

MR. MURPHY: I’d like to start by thanking the Commission for asking me to join in this excellent program, and I also want to thank and acknowledge the many familiar faces I see in the audience, people who have been my partners in the field of compliance; and, of course, especially my co-authors, Win Swenson and Jeff Kaplan, and one who is not here today, Jay Sigler of Rutgers University.

I also want to express my admiration for all of you who believe enough in this effort to be here today. And, of course, I should note that the views I express are my own, not necessarily those of any organization that I’m associated with.

There was a point that Senator Kennedy made yesterday that I thought was a good one and that I hope we can follow up on, and that was the need for people in government to learn more about compliance and ethics programs. I think the more knowledge there is in that sector, the more acceptance and support there will be for these efforts in organizations.

I think my title today may need some explanation – “Beating Them With Carrots and Feeding Them Sticks.” We’ve all heard the sentencing guidelines described as using the carrot and stick. The idea is to reward good acts and to punish the bad. But, in fact, we may be somewhat off the mark. Companies today that take aggressive ethics and compliance steps run high risks of being beaten with their own acts, beaten with the carrots that were supposed to lure them to do good things. Moreover, what is offered as a reward may not really be a carrot. Instead of offering real incentives, for the most part we are only shortening the stick that will be used against companies.

When I look at the legal landscape, I see a system that seems designed to make the Sentencing Commission’s bold experiment in promoting self-policing fail unless we take some determined steps to change it. To explain this, I’m going to show you what the future will look like through three reports from tomorrow’s newspapers. I will talk about the need to move to a true carrot and stick and what that means, and I will touch on what happens inside the corporation when it comes to compliance efforts and why we need to change the approach.

In your materials are the three newspaper articles from the future. These are all make-believe facts. The stories are not true – yet.

The first story is the businessperson’s nightmare to illustrate why we have trouble making more progress than we have already. I’m going to go through these a little quickly. The

material is in the book. In this case, Synergy Company, known for its strong compliance program, gets nailed even though it entered into a voluntary self-disclosure.

The details of its own program are used against it, and the prosecutor just shrugs off the importance of the compliance program. And, of course, one of all of our great fears, he nails the company on a technical defect. If there's a manager with 220 employees reporting to him who's involved, you don't get the credit.

Of course, immediately, the piling on begins with the state attorney general, and competitors learn the obvious lesson. They discontinue this type of "foolish" activity. Who loses in this scenario? Those who want their companies to do the right thing, all those who are affected when a company does wrong, and in the long term, even those in enforcement who take short-term advantage of compliance efforts. Fear can paralyze the development of effective and aggressive compliance efforts. If this story does, in fact, appear in tomorrow's newspapers, people like me who believe in this work will be kicked out the door and replaced with people who know how to litigate and stonewall.

But we in business fool ourselves if we think this is the full story. There is also the prosecutor's nightmare. We need to understand this to see why government hesitates to do more to encourage and recognize compliance efforts. In this story, a congressional committee is investigating prosecutors who were hoodwinked by a sham program.

The protagonist here, Fasttech, has its lawyers fool the prosecutors with the clever use of privilege and immunity protections and the guidelines standards. I know this is Steve Herman's nightmare. In fact, the compliance program was a meaningless charade. And, of course, others in industry were quick to learn from this maneuver.

I think both sides are capable of gaming the system. Either way, the same people lose: those in government who believe in the value of self-policing and those in industry who want to see this work.

The third story is about an interactive compliance system that I think follows the real logic of the sentencing guidelines. Skysoft Services has just received national recognition for its compliance program.

The compliance officer, the CFO, explains that the company started with the guidelines, but then used management techniques to go from there. Compliance was part of appraisals and objectives. Managers and work units competed for recognition. Managers at every level of the company see this as everyday business. This program had, in fact, started as a legal insurance policy.

But it took off when government offered real incentives and started a competition for best in class. And one particular point here, because of compliance audit protections, audit reports that had previously been kept secret were now posted at the working facilities.

This is a story of how both sides can win and how we can get there, through a form of social compact between business and government. It calls for a positive role for government.



Government must recognize the value of compliance efforts. It needs to make a commitment and reward those who take the risk of implementing effective ethics and compliance programs. To give this effort life, we need to use incentives that introduce competition. The desire to win and to achieve is a far stronger motivator than the criminal justice system's only weapon – fear.

What's wrong with what we do now? Our current model may seem designed to get companies to undertake self-policing. EPA talks about the value of environmental audits. The guidelines talk about effective programs to prevent violations. They say they are offering carrots. But are the carrots really bait for a trap? Are they just going to use those carrots to beat us over the head?

Let's look at what happens to a company that thinks these are real carrots and bites in. On the left are some things associated with compliance; on the right are some things that the legal system may do to these. For example, in one case, a company imposed a code of conduct. The National Labor Relations Board felt that this was an unfair labor practice. In the Lucky Stores case that Commissioner Goldsmith mentioned, people took notes in a discrimination seminar. In fact, the notes were their observations of examples of improper conduct in the workplace. One of the employees took notes and kept them. The court viewed those notes as appropriate smoking guns for the plaintiffs, not only allowed them into evidence but noted those very notes as a basis for punitive damages against the company. Is there a lesson there?

Similarly, one of the earlier speakers referenced the newspaper article about industry practice forums. This is something I participate in, I believe in, but it has been described as potentially involving collusion. And on self-disclosure, there is the example of the Coors case, a company that found its own problems and voluntarily reported them, only to be met by state enforcement action and the imposition of civil penalties. And the other items have similar histories.

I always think of the old saying, "Fool me once, shame on you; fool me twice, shame on me." Once government and the legal system beat a few companies like this, everybody gets the message. But there's a simple lesson here. The government should not exploit companies' compliance efforts against them, and they should not hold companies' compliance and ethics efforts to standards that no one could meet.

The first change needed is to complete what the Sentencing Commission started and shorten the stick for those who undertake rigorous compliance programs. Here are some of the primary examples. Sentence mitigation, of course, is a useful step. It has gotten people's attention. But things like the Colorado statute providing for immunity, privilege protection for compliance-oriented activities, including audits, ombudspersons, training, other areas, and removing the penalty provision from companies that have serious efforts in this area. These are critically important steps, but we need to recognize what they are not. They are not carrots.

Now, although I work in a city, I grew up in farm country. And we learned the difference between carrots and sticks. A stick is a hard thing that you beat people with. A carrot is a tasty thing that you want to eat. But on the list you see here, there are no pleasant things. There's nothing I would run to get to put on my plate. All that's on that list are things that government would otherwise use to punish me.

What's the difference between this and a carrot? A positive incentive does not use fear. It uses drive and competition. In fact, it uses the same motivators that lead most of us to do what we do each day. Competition is a driving force in society. What we need are incentives, positive incentives, real rewards. We need something people can strive for, that they can take back to their office and show off.

What kinds of things could this be? These are things that a compliance manager can point to as benefits here and now, for example, public recognition, tax benefits, bidding preferences, financing arrangements, agency liaisons. This is not insurance against a future hypothetical threat. It is a tangible incentive.

Now, the newspaper stories that I showed you also shed light on what happens within companies and what it takes to achieve ethical and compliant companies. When I first started in the corporate world, one of the biggest surprises to me was to find people within the company who were dedicated to doing the right thing. They may be internal auditors, industrial hygienists, environmental engineers, ombudsmen, compliance lawyers. These groups, these in-house compliance constituencies, can play a major role as a check against corporate misconduct. But they can only do this if they are empowered to have an effective voice. These compliance people, like others in companies, compete for attention and resources.

But under the current regime, with few real incentives offered, I want to show you what that competition looks like. This will also help you understand why there is so much burn-out and frustration among those who do in-house compliance work. Here's what the compliance function looks like. We bring bad news. We deal with bad news. To some of our managers, we are bad news. Is this a description of a job you would offer to your most talented and aggressive managers? Is this a post with great career prospects? What is it that this person celebrates? That another day passed without anyone being indicted?

Now, this is what a normal manager's job might look like. You notice I do have a bias. You see the same gap I described when I talked about carrots and sticks. There is no positive element. That weakens the ethics and compliance function. As a compliance person, I offer no fun, no rewards, no glory.

If we change our approach to compliance and offer real carrots, rewards, to companies that commit to implement effective compliance programs, this can dramatically change the organizational dynamics. That in turn can energize and empower those within companies who believe in effective compliance and ethics management.

Where does this take us? I want to warn against one detour first. We need to keep the focus on carrots and sticks and avoid red herrings. One of the most wasteful red herrings, I believe, is the misdirected debate between ethics and compliance, lawyers versus ethicists. Basically, this whole debate is off the trail. Both the compliance approach and the ethics approach have their own vocabularies and their own ways of talking past each other. I have never heard one side give an accurate description of the other, and for those in each camp who do bother to look at what really works in organizations, they're typically saying the same things, just using different terms.

Fundamentally, the issue is not law or ethics, compliance or integrity. It is: what affects organizational conduct? Do audits work? What training works, and what does not? What motivates actors in a group setting to engage in anti-social conduct, and what makes another group stop its members from harming customers?

Most of those engaged in debate about ethics and compliance need to start asking the much harder question: What really works in organizations to affect conduct?

I believe if an organization understands how to keep itself on the straight and narrow, it will follow both an ethical and legal path, regardless of whether you use ethics or compliance labels.

So what is the future for ethics and compliance programs? If we're going to harness the ability of organizations to self-police and we're serious, there are a few simple questions we have to ask ourselves honestly. First, is the company that does compliance work at greater or less risk than one that doesn't? Two, is the company that tries to improve its programs, test out new techniques, and lead the way better off or worse off than one who does not? Three, is the manager or lawyer who devotes attention to this area better off or worse off than one who does not? And as a test of whether your answers ring true, where would you put \$1 million of capital or \$10,000 of bonus money?

Until we can answer those questions in a way that makes sense, we're going to be like Sisyphus pushing the rock up the hill, only to have it slide down on us again.

Where does government fit in this? This is an area where government's role is crucial. The Sentencing Commission in its remarkable experiment has led the way, but it's up to the rest of government – agencies, legislatures, courts – to decide whether to stymie this or to offer support and encouragement. Will EPA relent in its opposition to the environmental audit privilege? Will the National Labor Relations Board look at codes of conduct with a clearer vision? Will the courts learn to stop seeing every bit of information as mere toys for the litigation game?

Government can strengthen those within corporations who share the commitment to doing the right thing. It can do this by using the strongest forces we know to get results, incentives and competition.

And what is your future? Will you be beaten up by carrots? Will you be made a victim in a front-page story if you support voluntary compliance and ethics programs?

This is a news story that we in this room will write. The Sentencing Commission has offered us the first carrot, or maybe just shortened the stick, but you and I are going to determine whether voluntary self-policing will be allowed to work. Thank you.

## QUESTIONS & ANSWERS

MR. SWENSON: Thank you, Joe. The question is: what is your response to Ms. Bangert's assertion – Patricia Bangert from the State of Colorado, whom you know, who spoke just before you – that EPA is stifling experimentation by the states? I guess with respect to its position on privilege.

MR. HERMAN: Our general approach has been to try and work very closely with the states, both on this issue and on numerous others. And, in fact, in the enforcement arena, I would venture to say that, in general, our relations with the states are as good – are better than they have ever been before, and I say that on the basis of conversations that I've had with state commissioners who serve on the state commissioner's enforcement committee.

Our position with regard to states that have passed various privileges and immunities statutes is that we will see how those statutes work. However, it is our responsibility to look at particular situations as they arise to make sure that the various programs are carried out in a way that is consistent with federal requirements. We have timely and appropriate standards, and is the state response appropriate for a particular situation? And that's what we're going to look at. We have not taken a blanket approach one way or the other, but we also – you know, I certainly don't – to the extent I can prevent it, I certainly would not like to see somebody who has committed criminal conduct go free because they come in and say here's an audit.

I certainly am not going – you know, to the extent that I have the ability to do it – would not stand aside and watch some company benefit significantly, you know, to the detriment of its competitors, because it goes, it pollutes, it profits, and then they come in and say, "We've polluted and we've profited and here's our audit." I don't think that's good policy.

That hasn't happened yet, and I think we'll just have to see how it works out. We are talking to the folks in Colorado and in other states to try and work this out amicably, as we have worked out many other problems over the past two years.

MR. SWENSON: Do you want to respond, Joe?

MR. MURPHY: Yes, if I could just make a comment about that. I'm afraid my colleague has basically set up a straw man and then shot it down. I listened to his description of what he's afraid of. I read most of the statutes. There's not a single one of those statutes that I know of where the scenario he just described could ever happen. They talk about good faith, requiring that you fix the problem. They have numerous exceptions. I'm sure that the representative from Colorado could verify what I'm saying.

If you're talking about an experiment, I would say let the states experiment. After all, we have 51 jurisdictions. They each have attorney-client privilege. There are significant variances among the states. They each have work product protection. There are significant variations among the states. I've never heard EPA say it's going to examine the state attorney-client privileges in those states. Let's give these experiments a chance to work. Read the statutes in good faith. They have built in a number of very, very serious protections.

MR. HERMAN: If I could just respond?

MR. SWENSON: Absolutely. Absolutely.

MR. HERMAN: I think this is important. I think if you do read the statutes carefully, there are statutes which potentially provide immunity for criminal behavior. That's the first thing.

Secondly, I think there are not a lot of privileges out there. There is attorney-client privilege. There is the husband-wife privilege, the doctor-patient privilege, and maybe, you know, priest-penitent. And that's it. And basically our society has taken a very restrictive and unfavorable view towards privileges, because as has been said, privileges are by their nature in derogation of the truth. And I think we should be very careful how we work with these.

Now, I also think that it is a mistake, a serious mistake – and I think this is really unfortunate that the debate has gotten off on the issue of privilege. The issue should be how – and the way I think we have tried to approach it, the way I frame the question is – how do we encourage self-monitoring, self-disclosure, and self-correction?

I guess the question is, “Can't it be done without secrecy? Can't it be done in the way you have described, I think, with incentives and with true carrots?” Which is, I think, what we are trying to provide.

I don't think holding out an exception for substantial economic benefit or for criminal behavior or where there has been serious environmental harm is an abuse or turns that carrot into a stick. I think what it does provide is some accountability, which is something I did not see on the slides. In other words, if somebody does – let's say you are doing – you have your policy and you're trying your best, yet you do have a major spill or you have a major discharge. You should be responsible for cleaning it up and for ensuring that it doesn't happen again, and there should not be some kind of blanket protection.

MR. SWENSON: Maybe that is a good segue into this question, Joe. Isn't your best in the class suggestion closely related to EPA's environmental leadership program? And isn't the environmental leadership program one of the best existing models for the kind of thing that you're talking about?

MR. MURPHY: I don't want to come across as too harsh on Steve. I think the EPA deserves a lot of credit for being willing to innovate. I would like to see them more willing to innovate. But I think it's important that they're starting down the road.

Actually, the model that I used was based on the same things the EPA model is based on. There's an OSHA program called the STAR program, which has been very successful, very innovative in this area, although the rewards are rather sparse. And another example that I use, although it's got some limitations, is the Baldrige Award. If you think of what the Baldrige Award did – when I started in business, the notion that government would award somebody for quality would have been ludicrous. The notion that government would be able to assess quality would have been ludicrous.

You look at the notion of the Baldrige Award, and for quite some time that had people running around like crazy trying to develop quality programs. And that's just a small example to me of what you can get by giving a positive reward to people.

I see this, by the way, the need – I also agree, I'm not particularly in favor of secrecy. What I'm in favor of is not having people beaten over the head with trying to do the right thing. I think there's a need for protection. Secrecy is not the issue. It's the use against companies of this type of material.

MR. SWENSON: Steve, I don't want to get too bogged down in this issue because we've already had a lot on it today. But is that where EPA seems to be heading, to some extent? Given your concerns, I mean, it seems to me you're saying that secrecy is not something that's particularly desirable, but that you think it may be relevant to the question of what the use or impact is of information when companies have tried to do the right thing.

MR. HERMAN: I think the real issue – secrecy is one issue, and I think that the public's right to know is very, very critical. In terms of use, I guess I don't – if the company is doing, you know, the work and has it, I don't think it should be a shield. We have said, though, that we will not initiate an investigation based – you know, we won't go out on a fishing expedition looking for an audit.

I would also say that the companies – and I'm sure many of you would acknowledge this – benefit tremendously from doing the audits, that there are many, many benefits in terms of making operations more efficient, preventing violations. There is a reason why some tremendous percentage, especially of large companies, do audits. We think there are also reasons why smaller companies haven't, and we're trying to address those concerns.

But one thing that I would mention is – some of you may know this – we have had for almost a year a very, very extensive process which Win has participated in and I know several other people in this room have participated in, in the re-evaluation of our self-audit policy. And I've attended several of the sessions. I went to one in San Francisco, which lasted two days, and there were representatives of industry and environmental groups and various state and local groups. And we broke up at one point into various smaller groups, and each addressed the same questions. And what was remarkable to me was that basically there was agreement on maybe 95 percent or 98 percent of the principles, and I agreed with much of what Joe was saying. And it was a similar kind of exercise where everybody, from environmentalists to corporate attorneys, was agreeing.

There were a couple of fundamental differences, one being the privilege issue, but in terms of some of the exclusions, like for criminal behavior or significant economic benefit, and encouraging companies to do audits, there was – you know, I think there's a tremendous amount of common ground, and we are in our effort, you know, trying to exploit that as much as possible.

I actually took away from that a fairly – you know, I was fairly optimistic and am fairly optimistic in terms of that, that ultimately there is going to be some very positive results from our effort and from discussions like this.

**QUESTIONS & ANSWERS – WRITTEN**

*Steven Herman*

- Q. EPA's program directed at fostering environmental management systems in small companies sounds impressive. Why not take a similar approach with larger companies?
- A. In the course of revising the interim "Self-Policing and Self-Disclosure" (Audit) Policy, EPA is seriously considering whether to provide substantial penalty mitigation for companies that discover violations through compliance management systems. The interim Audit Policy is applicable to all regulated entities, large and small. In addition, the Environmental Leadership Program is exploring compliance incentives for facilities that adopt environmental management systems and for facilities that adopt compliance management systems. I would also note that EPA's Office of Water and my office have agreed to provide funding for a grant to the NSF to develop guidance for small and medium-sized businesses implementing ISO 14000 environmental management system standards.
- Q. Why does the EPA allow special interest groups to direct its (EPA's) attention to a particular industry rather than relying on data and scientific studies?
- A. For those not familiar with the EPA process for selecting national priority sectors, I want to strongly emphasize the heavy reliance placed upon data and scientific evidence. In fact, over the last several years, EPA has streamlined its data systems to improve the environmental impact analysis that can be conducted for industrial sectors. Based upon this effort, EPA now has the data on the source, location, type and amount of release for every major toxic chemical. Pollutant release data is further informed by detailed analysis of industry-specific non-compliance patterns. These two factors are the two main components of EPA's national priority sector selection process. Special interest groups (*e.g.*, environmentalists, industry groups) played no role whatsoever in this selection process. In the future, EPA will continue to improve data analysis capacity by adding risk-based targeting criteria – toxicological weighing of chemicals released, and estimates of human exposure to toxic chemicals.
- Q. What is your response to Ms. Bangert's assertion that the EPA is stifling experiments by the states?
- A. EPA has worked very closely with the states in developing and revising the interim Audit Policy. States have generally praised the process by which EPA has considered the views of all stakeholders. For example, states have commented: "As a preliminary matter, let me state that the process undertaken by EPA to formulate the Policy has been a model of thoroughness and thoughtfulness." Letter from Scott A. Harshbarger, Attorney General for the

Commonwealth of Massachusetts to Carol Browner, Administrator, U.S. Environmental Protection Agency, June 27, 1995 (document #II-C-48). “Generally, we support EPA’s new policy and applaud the open and deliberative process used to develop it.” Letter from David A. Shorr, Director of the Missouri Department of Natural Resources to U.S. EPA, May 29, 1995 (document #II-C-53). In contrast, the federal audit privilege and penalty amnesty legislation which is modeled after the Colorado law appears designed to impose the Colorado model on other states.

*Joseph Murphy*

- Q. How can you justify your “carrot patch of incentives” when all citizens have the obligation to comply with the law? That is, do you really think it’s good public policy to offer “prizes” for compliance with the law?
- A. There are a number of answers to this question; I will cover a few here. However, I would be happy to discuss this at length with anyone who is interested.

The first point is that the question misses what the incentives are intended to do. They are not to reward mere obedience with the law. Rather, they are to motivate organizations to develop and implement management systems to promote compliance and ethics. A company would not receive recognition merely because no one had caught it breaking any laws. Rather, the incentives would be given to those companies that had implemented the most effective ethics and compliance programs. Also, the rewards would not be limited to “prizes.” While prizes have appeal, they do not have the same impact on all companies (*e.g.*, consumer goods companies care more about public recognition than do manufacturers of industrial commodities). Other incentives with bottom-line impact also need to be added to the mix.

The second response is to recognize the inherent limits on law compliance. While the law tries to deal with some objectives, it can only set minimal objectives. For example, the law tries to protect equal employment opportunity, workplace safety, an honest marketplace and a clean environment. But the law sets minimums, and punishes those the government can prove crossed the line. The use of incentives allows society to use a more open-ended standard, *i.e.*, the “best” in improving workplace safety or in cleaning up the environment. This can inspire creativity and a greater positive effort than can ever be achieved by the use of threats of punishment.

A third answer to this question is the recognition that companies are not individual citizens and do not act like individuals. While one might pause before offering rewards to individuals for doing their civic duties (although, even with individuals, governments do use various forms of incentives), it is an entirely different matter to deal with groups and organizations. Organizations are composed of a broad range of people – good, bad, honest, dishonest,



indifferent, etc. The idea of incentives is to motivate the organization to empower those who will help assure the organization does the right thing, and to deter those who would otherwise do wrong. Organizations generally are formed for a purpose, so offering a reward that helps the organization advance toward its goals can change the way the organization acts.

The Baldrige Award is an example of how this works. One could say that any company should want to produce a quality product – it is the right thing to do, and the product will sell better. But many companies resisted emphasizing quality, and focused on where they saw the immediate payoff – short-term earnings. The Baldrige Award offered immediate recognition for having a quality orientation, and this helped change the way companies approached the subject of quality. Of course, the quality story is a more complicated one than just this award, but the Baldrige Award is a striking example of how a very modest reward can affect organizational behavior.

The last response is perhaps a bit more philosophical. I sense in the question a resentment toward the idea of rewarding people for doing what they are supposed to do. If something is right, people should just do it. Yet, unless I misread most religious doctrine, it seems that rewarding those who do right is a fundamental tenet of theology. All the religious parables I can think of involve bad actors being punished and good ones being rewarded. I see nothing morally questionable about using incentives and competition to motivate people to do things that benefit and protect society. If it works, everyone benefits. And it seems to have worked for millennia.

- Q. It seems that you are critical of EPA's efforts to strengthen the good citizen organization, but, through the varied approaches Steve Herman has outlined, hasn't EPA been out front of most agencies in the enforcement community in this regard?
- A. When we are looking for change, we should always recognize those who have shown the courage to step forward. EPA's efforts merit strong encouragement, and Steve Herman deserves our support and recognition. Because EPA is, in many respects, a pioneer, we should also point out where we think they are off the trail, and what routes others have taken that will get to the result more directly. That was what I intended to do.

I think EPA is starting to realize the value of voluntary compliance efforts and the potential for using incentives to improve industry practice. But there are some fundamental shortcomings in EPA's approach that threaten the success of these efforts. The first of these is the agency's reluctance to make a commitment. EPA is looking for companies to put their heads on the block by doing compliance audits and then voluntarily reporting violations that such audits uncovered. In exchange, EPA states its policy to take such good conduct into account, but offers no promises. But if EPA wants companies to trust the agency and to voluntarily search for, and disclose, problems, the agency must

make a firm commitment that the company will not be penalized for taking these steps. Unfortunately, thus far, the disclaimers have tended to be the firmest parts of EPA’s policy statements.

The EPA deserves praise for being outspoken in its support of voluntary compliance efforts. In the important area of voluntary disclosure, however, it has not kept pace with several other enforcement agencies. EPA does not have a binding commitment to give immunity to those who voluntarily disclose violations. Compare this to the Department of Justice’s Antitrust Division’s policy in this same area. If a company discloses to the Department of Justice that it has been involved in price fixing with other companies, and it meets the Department’s stated conditions, there is a real commitment not to prosecute. This is not a “maybe” or a “we will consider in the exercise of our discretion.” Companies who commit to self-disclose do so knowing they will not be ambushed in the process.

The EPA also needs to develop a deeper understanding of what happens to compliance efforts within organizations to realize why its hard line against a self-evaluative privilege is off the mark. Without such a privilege, we are left with a legal system bent on exploiting voluntary compliance audits against those who conduct them. Even if the agencies made a binding commitment not to do this (and EPA has never gone that far), private plaintiffs still can use these materials. Within any company that has to decide how much to commit to conducting internal audits, and how aggressive to make those audits, the lessen will not be lost. This opposition to a self-evaluative privilege will backfire on environmental enforcers and weaken those in companies who want to do audits. If EPA means what it says about the value of these audits, and it wants companies to self-inspect and self-remedy problems, why should companies be required to have that work handed over to the government to use against the companies? Does this result seem calculated to inspire anyone to conduct aggressive audits? Or will this just push those who do audits to use lawyers to fit under the mantle of the Upjohn decision, and to wrap their limited compliance activities in a cloak of secrecy and innocuous language?

In these two areas, self-disclosure and immunity for audits, the states have been showing leadership. There are now several interesting experiments with disclosure immunity and immunity for compliance audits. But EPA, instead of using these as test laboratories to see if such initiatives can increase voluntary compliance efforts, has fallen back on the litigator’s aghast reaction to anything that infringes on their ability to rummage through everyone’s files to find embarrassing documents.

EPA’s interest in a “Leadership Program” holds great hope for recognition of good corporate citizenship. This is a model that OSHA has been pursuing with success for some years. Another example can be found in Camden County, New Jersey, with its Silver Platter program for restaurant sanitation. EPA should look at taking a more aggressive approach in offering incentives. If this

requires legislative authorization, the agency should not be reluctant to make suggestions to Congress. Reward programs can do wonders as motivators, if they have real substance and they are carefully designed and implemented.

EPA deserves credit for starting down this path. But if it wants to blaze a trail to real results, it needs to leave its litigation lawyers back at the base camp and rely on different guides who are not reluctant to explore this new terrain.

*Day Two*

# **Symposium Wrap-Up: Commentary on Ideas and Issues Raised During the Conference**

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**Neal S. Cartusciello** , *Shanley & Fisher*

**Janet C. Cook** , *Assistant General Counsel, U.S. Air Force*

**Richard S. Gruner** , *Professor of Law, Whittier Law School*

**Lynn Sharp Paine** , *Associate Professor, Harvard Business School*

*Moderator: Win Swenson* , *Deputy General Counsel/Legislative Counsel, U.S. Sentencing Commission*

## **SYMPOSIUM WRAP-UP PANEL**

WIN SWENSON: I present to you for this closing segment four brave people. They have been cribbing notes and thinking about what they've been hearing over two days, and we've asked them to talk to you a little bit about some of the things they thought were significant which I think is really overall an impossible task any way you look at it.

We've kind of typecasted this panel – and all of these folks are people who decided to come to this conference as attendees, but each really has a rather unique and, I think, in many ways very extraordinary background.

The typecasting works like this: Neal Cartusciello is going to go first, and Neal is our private defense attorney, if you will, but the reason the typecasting is particularly poor is that Neal is the former Chief of the Environmental Crimes Section at the Justice Department and spent many years as a prosecutor. And I suppose that's the other thing I should add about each of these folks, is that I think each one of them adds something, a real dimension beyond the typecasting.

Next is Janet Cook. Janet is our government representative, and she's the assistant general counsel of the Air Force for contractor responsibility and I think is widely recognized, certainly in the defense industry, but now much more broadly, as one of the real experts in government about what makes compliance work.

Richard Gruner, a Professor of Law at Whittier Law School, is our legal academic. However, Richard also spent a number of years in-house doing compliance work for a major corporation – IBM. You may have heard of them.

Batting clean-up is Lynn Paine, who is Associate Professor at the Harvard Business School where she's a member of the general management faculty. She's written some very thought-provoking articles extolling the virtues of integrity-based, law-centered compliance programs, notwithstanding the fact that she also has a law degree.

What we're going to ask each panel member to do, as I said, is offer some thoughts on what they thought was significant, and they are going to direct those thoughts to constituencies they particularly identify with or think of themselves as comfortably relating to. I don't know if that makes much sense, but it will probably become clearer as we go on.

We may have a little time at the end for the panel to respond to some of your thoughts about what you think was important. Hopefully we're going to capture that in those feedback forms that you get, and we're going to learn from that. And I tell you absolutely we are extremely interested in reviewing those forms from all of you. But during the course of this, if you would like this panel to respond to some things that you thought were significant, go ahead and jot it down on a card. If we can, we'll try and work some of that in.

We'll start with Neal Cartusciello.

**WRAP-UP: REMARKS BY NEAL S. CARTUSCIELLO**

NEAL S. CARTUSCIELLO: Thank you very much. At the risk of burning some of my five minutes, I want to say thank you to the Commission, not just for the opportunity to be here, for which I'm really thrilled, but because what I've seen has lived up to its billing. This has been an extraordinary symposium. It has been truly historic. I think the Commission is to be commended for having the wisdom and the courage to do this.

In that regard, to the extent that this symposium is so extraordinary, in some ways maybe it's simply a reflection of the extraordinary nature of the work that the Commission has done over the last six years and the work that it has spurred on.

I've talked to a number of attendees here who have said to me that this is the best program of its kind that they have ever attended, and many of these I know personally, and they are not given to that sort of hyperbole. I share that view. I was absolutely stunned at the depth and the quality of the substance that I heard. It's very difficult for me to do a five-minute wrap-up because I feel like I am not in a position where I've digested very much of what I've heard. I feel like I'm on information overload right now. I heard a lot of statistics yesterday. I'm usually not afraid of numbers, but for the life of me, I'm not really sure I can tell you what they mean.

What the four of us decided that we ought to do is attempt to focus on some of the nuggets that we each found in these two days, and maybe pick two or three each, zero in on them, and state why we think they're important to the particular audience segments that we feel we can identify with. Myself, I feel a kinship with the prosecutors, although in the tradition of the best defense lawyers, what I'm about to do is do what good defense lawyers do, which is spend most of my time whining about what the prosecutors are doing and telling you why I think it's wrong. And the others are going to attempt to represent their constituencies as well.

Now, since we have only five minutes, a lot of what I'm going to present to you is fairly elementary, and I apologize for it. You can think of it as sort of a Cliff Notes of the symposium from Swenson to Murphy.

The first point is corporate crime is different. I don't think there should be much debate about this anymore, but not only is it different in the sense of what causes corporate crime, I think we have developed a fairly broad consensus that the approaches to corporate crime and preventing corporate crime are fundamentally different from those that might or might not be effective in preventing or deterring individual crime.

For corporations, I don't think there should be any question anymore, and this gathering ought to be the best evidence of the fact, that specific deterrence works and general deterrence works. Specific deterrence in the sense that when we punish a particular corporation, that corporation changes its behavior in a fashion designed to diminish the likelihood that it will commit the same or similar crimes again. I really don't think that can be open to question anymore.

This gathering proves the effect of general deterrence. Punish one corporation as an example, others stand up and take note and make every effort to modify their behavior.

But one thing that struck me – I would like to put forth the hypothesis that punishment in the area of corporate crime, to quote Win Swenson, you can't put Allegheny Bottling in jail. Punishment is dollars. It's money. Money doesn't mean simply fines, but it means the monetary effects of prosecution, which can include loss of productivity, loss of business, loss of business relationships, loss of credit relationships, inability for a corporation or any other business entity to do what it's there to do, which is, by and large, earn a profit, or if it's a non-profit entity, at least do its job economically.

Given that, since general deterrence and specific deterrence work, I believe that government attempts to achieve specific deterrence and general deterrence are what lead and have led to compliance management systems. But here I believe a significant distinction has to be made, and this was brought home for me with the presentation of John Meyers about what he viewed as wrong with the court-imposed compliance system in the NME case. I can't remember what the name of NME is anymore. Tenet or – it's now Tenet. That's one way to rehabilitate a corporation, it seems to me. Change the name.

Compliance management is a response to deterrence and is aimed at preventing future violations, but should not be considered as a form of punishment. I think what Mr. Meyers brought home for us is that, to the extent that compliance management starts looking like punishment, it doesn't work. It's counterproductive. It's not good punishment, frankly, and it's not good compliance management.

Now, what lessons do I believe need to be drawn from that? I believe the prosecutive community, the law enforcement community, needs to draw the lesson that they should not seek and judges should not order compliance programs with elements that are inefficient, that don't work, or that may impede compliance by breeding cynicism. I think those things are really possible, and how do they prevent it? They prevent it, I believe, by devoting greater resources to doing what everybody here at this symposium is doing, which is educating themselves on the best current thinking and knowledge of what does and doesn't work and the reasons why.

I for one would like to see the Justice Department have its own centralized body, maybe a small group of people, devoted to the mission of gathering information about compliance management. And, by the way, I prefer the term "compliance management" because it connotes permanence over the term "compliance program" which to me connotes something more temporary. And that leads me into my next point, which is the next nugget that I believe I have taken out of this. That is, there is an extraordinarily broad consensus, I've heard, that the most effective corporate compliance systems view compliance as a management function, not as a policing or legal function.

I was going to go through everybody who said this, but I heard it over and over and over again for two days, and even Joe Murphy, who was our last speaker, emphasized that. What concerns me terribly about this point, as to which I believe there is broad consensus, is I didn't hear enough of it from the law enforcement community. And I find that terribly troubling. What I heard from the law enforcement community were terms like "failed compliance program," which to me is antithetical to the concept of a management system or good management practices.

I believe that management is not a guarantee of success. Management, I believe, is a performing art. Some might say an improvisational art. It is not, as one of our speakers said, Euclidian geometry. The mere fact that a corporation experiences an incident where an employee commits a crime is not a basis for concluding that the compliance management system has failed. I believe that that thinking can be dangerous, and is probably contrary to what will work the best in compliance management, which are good management practices.

Finally, what I would like to see is good management practices, not an adherence to a checklist du jour, not an insistence on 100 percent compliance as exerting the greatest influence on the thinking of the law enforcement community.

I have well overstayed my five minutes. There’s plenty more that I could say, but the others have a lot to share with you as well. Thanks.



### WRAP-UP: REMARKS BY JANET C. COOK

JANET C. COOK: Well, like Neal, I feel that this is really a daunting assignment to wrap up all of two days' seminar in five minutes. But let me give you a couple of thoughts. One is very general, and one is more specifically related to who I am and what I do.

I know many of you in the room. Most of you know what I do. In a sense my job is as an enforcer, but it's a little different from what the prosecutors do or what civil enforcers do. I am the debarring and suspending official for the Air Force, which means that I look at contractors who have been indicted and convicted, have had other kinds of problems, and assess whether they should remain eligible for government contracts. Some of them are debarred. Some of them are suspended. Some remain as government contractors.

I have a general comment on ethics and compliance programs and then something more specific. The general comment is that I heard throughout the seminar the terms "compliance program" and "ethics program." I want to be sure we recognize there's a difference. The ideas come from different mind-sets. A compliance program sets basic rules and procedures and can be summed up in a checklist. An ethics program addresses values and decisions in the grey areas. The sentencing guidelines in a sense lend themselves to a checklist type of approach. And a corporation can get good protection against the maximum penalties of criminal prosecution by meeting the different elements of that checklist.

I don't think, however, that a guidelines-based compliance program without more is likely to be an excellent internal management tool. As an aside, I agree that I don't like the term "program." An ethics officer at one of the leading defense companies refers to an ethics "process" rather than an ethics "program." In any case, a successful process must be a management process. It's not so important whether you say program or process, compliance or ethics. What is important is that your program or process be values-based and have some soul.

Somebody said yesterday that employees don't like you playing with their soul. I'm not so sure. I think they want you responding to their soul in the sense that people want to do the *right* thing, not just the compliant or lawful thing. In most cases, all you have to do is free employees to do the right thing, and compliance will follow. We heard at lunch a CEO who understands the difference between ethics and compliance. He not only knows the words of a compliance program but hears the soul in the music that goes behind it, and has moved beyond compliance to a value-based ethics program, to a good program that can really do the company some good.

It's going to be fairly expensive to put in a compliance program that will meet the guidelines. But that's not going to give the corporation a great deal of cost/benefit in the long run. How many corporations are ever sentenced under the guidelines? Not very many. You could almost self-insure by not having a compliance program and putting the money aside every year into a penalty fund. But let's assume you're going to have a compliance program and hope for some benefit over and above guidelines protection. Why not put a little more effort and maybe a little more money, and certainly a lot more thought into it, and have a real ethics program that is going to benefit the corporation internally. Create a values-based ethics program and you're going to get employees committed to an ethical way of business life,

employees who care about their business integrity. The principal benefits are going to be internal. Benefits show up in workplace relationships, confidence in management, and dedication to quality. Ethical conduct feeds itself.

Someone mentioned the Baldrige Award. A lot of companies started out with so-called TQM programs because it was the flavor of the month and maybe they were competing for the Baldrige Award. But now, practically every corporation that's paying attention, even some very small businesses, have programs that have a lot of the elements that count as qualifications for the Baldrige Award. They are empowering their employees.

My observation is that if you are going to empower your employees, they had jolly well better be ethical. And you've got to set values for them. Not every tough issue that every employee faces, is going to be within a compliance kind of orientation. It's in the gray areas where companies and employees get into trouble, where they have the questions. Ethics education and discussions and a high ethical tone from management go a long way toward assuring empowered employees reach the right decisions.

A specific thought from an agency perspective: where are you when you come to the debarring official after indictment or conviction? The agency will look for compliance and ethics programs, but do not expect to use a compliance program as a sword against the debarring official. Don't argue that the agency can't debar your company because the Department of Justice gave full credit under the guidelines.

The guidelines are framed in a punishment context. Unlike the Department of Justice, the agency debarring official will assess your programs from the customer's point of view. When you're convicted of cheating your non-government customers, you don't expect those customers, because you have a compliance program, to continue doing business with you. But some companies seem to believe that the government should continue to do business with them because the prosecutor thought they had a good compliance program. The distinction between punishment and business responsibility fundamentally changes the analysis.

As many have noted today, most prosecutors are not experienced in recognizing a good compliance program. I think Neal's suggestion of an office at DOJ to serve as a center of compliance expertise is an excellent one. Private industry has established such centers to good effect. None of us is as expert in this line as we ought to be. I would also encourage openness between industry and government to share best practices and different viewpoints.

I am troubled by the emphasis some place on litigation privileges in regard to compliance programs. As a debarring official I'm not interested in hearing about litigation privileges. I understand privileges may be important in litigation contexts, but it's going to be very difficult to reestablish business integrity with a suspension or debarment official, if a contractor is not willing to provide full information about underlying facts and any related preventive or responsive steps. Suspension or debarment proceedings are just an example. If you're dealing with the FDA or OSHA or EPA, there will be similar issues of free and open access to compliance-related materials. Potential privileges involve hard choices. In many cases you're going to have to make the hard choice to waive a privilege and let the agency look

into your programs in significant detail. The more forthcoming you are and the less you try to hold back, the quicker things are going to go and the easier it's going to be.

As a last thought I'd urge private industry to establish high-quality compliance and ethics programs that have some music to them as well as just the words on paper. Do try to reach the goal of a values-based ethics process, stretch your process or your compliance management system to get to a higher plateau that will better serve everybody: employees, management, and government in its many roles. If you do, we will all have better government contractors, and have better citizen corporations. Besides, it's worth doing for its own sake. Thanks.

**WRAP-UP: REMARKS BY RICHARD S. GRUNER**

RICHARD S. GRUNER: I want to start by echoing Neal’s comments about the quality of this symposium. I have been to a number of programs on related topics and this one is extraordinary. It’s not just extraordinary because of the quality of the symposium administration, which has been excellent, or the quality of the presenters, which has been top-notch. The defining feature of this symposium has been the quality of the idea around which this whole conference revolves – the need to develop distinctive, favorable legal treatment for the “good citizen corporation.”

I submit to you that the concept of the good citizen corporation as a feature of our legal landscape is not only new, but fundamentally important. By a good citizen corporation I mean the type of corporation that has been the subject of our discussions here – a corporation that has undertaken due diligence to prevent offenses in its business operations. We are moving from a legal regime in which the concept of the good citizen corporation was irrelevant to a legal system in which this concept may be a central consideration in evaluating corporate liability. Currently, corporate criminal liability usually depends on *respondeat superior* principles. These principles effectively equate an employee offender with the offender’s corporation. If an employee commits an offense within his or her scope of employment and for corporate benefit, then the corporation is liable for the offense as well as the employee. We are moving from these principles for measuring corporate liability towards a view that a corporation’s responsibility for an offense should be evaluated separately. Under this new approach, the good citizen corporation that can show due diligence concerning law compliance may avoid liability for an occasional, aberrational employee offense. In short, the law is shifting towards a system in which the culpability of the organization matters.

This is a significant change that has broad implications. I want to sketch a few of the legal developments that may implement this new approach in the next few years. You have seen hints of some of these developments here at this symposium. My comments are aimed at suggesting how the good citizen corporation may figure in additional legal standards.

One type of change that seems likely is an expansion of the range of legal contexts in which good citizen corporations are exempted from liability. We have heard suggestions at this symposium of corporate criminal liability standards that would turn on whether a company undertook due diligence to prevent offenses before a particular employee committed an offense. Such standards would shift the assessment of the quality of a corporation’s law compliance efforts from the sentencing stage – where they reside under the Sentencing Commission’s Organizational Sentencing Guidelines – to the liability determination phase of the criminal case.

There are several ways that this sort of change may be implemented. Standards may be changed so that the absence of corporate due diligence needs to be shown to establish corporate criminal liability. More plausibly, corporate due diligence of this sort may be recognized as a basis for an affirmative defense to corporate criminal liability. These sorts of changes need not be limited to criminal offenses. I think that we will see equivalent developments in regulatory settings in which definitions of regulatory violations are revised to turn on whether or not a corporation has undertaken diligent efforts to prevent violations.

This is still not a broad enough perspective, however. I think that we are going to see greater reliance on the good citizen corporation concept in law enforcement activities. In particular, the targeting of government investigations and regulatory oversight will increasingly depend on prior assessments of how extensively particular corporations are policing themselves. Experimental programs now being tried by the EPA illustrate how the good citizen corporation might be treated in this context. Under these programs, companies that submit to an intensive review of their compliance systems can qualify for later relaxation of governmental oversight. Once the internal policing within these companies is shown to be sound, the need for external reviews is correspondingly diminished. This sort of targeting of regulatory oversight makes sense not only as a means for allocating scarce regulatory resources, but also as a means to recognize and reward corporations that have pursued socially beneficial efforts to prevent offenses.

The status of a firm as a good citizen corporation may also have growing significance in other legal contexts. For example, it was suggested in Joe Murphy's presentation that punitive damages should not be assessed against a corporate defendant in a tort action if the corporation is found to have taken diligent steps to prevent the misconduct at stake. Withholding punitive damages on this basis would be a logical means to reserve such damages for the worst cases of irresponsible corporate conduct. In addition, standards diminishing punitive damages for good citizen corporations would strongly encourage diligent law compliance and harm prevention efforts in areas where tort actions and damages are real threats, but criminal sanctions are not.

Finally, a firm's status as a good citizen corporation may figure in day-to-day contracting and commerce. Perhaps the most significant activity discussed at this conference was the development of ISO 14000, a standard for measuring the sufficiency of environmental law compliance systems. Once issued, this standard is intended to figure in a system of privately enforced compliance system obligations in which one contracting party will insist that its contracting partners certify their compliance with ISO 14000. Maintaining an adequate compliance program – and being a good citizen corporation, at least in the respects addressed in ISO 14000 – will be a matter of contract obligations and incentives. Hence, a system of private contracting and rewards may ultimately drive the development of better compliance practices.

What other trends are going to affect this area? I believe that if we were to attend a conference like this one ten years from now, two new topics would be on the agenda as major considerations. First, corporate management techniques for addressing law compliance and liability risks will be improved, establishing a related domain of technical expertise among organizational management experts. Managerial specialists are just now beginning to give detailed attention to the features of good compliance programs and to assessments of what compliance program techniques work and don't work. We have seen some of the very first products of these efforts in the empirical research presented at this symposium. In the compliance system standards embedded in ISO 14000, we have also seen some organized efforts to describe how corporate managers should approach the construction and operation of compliance systems. However, there should be many improvements ahead in our understanding of how to manage law compliance so as to have a real impact on corporate workforces.

As our understanding of available techniques improves, corporate managers' appreciation of the need for those techniques should also increase. Sophisticated managers already appreciate the importance of careful management of corporate law compliance. You heard precisely that message at lunch today when Stephen Hammerman emphasized in his remarks that, for each business unit, the chief executive officer of that unit has to be responsible for law compliance. This to me is a signal that compliance programs must be initiated by line management and that they must operate through line management. Corporate managers will increasingly accept this in the future and turn away from non-line management compliance programs that are no more than half-hearted efforts to gain possible legal advantages.

Let me amplify this a bit. Managers who don't get this message, that don't pursue law compliance as an aspect of line management through the same types of management techniques that they utilize in other business areas, are hurting their firms in several respects.

First, they are spending money on compliance efforts that are unlikely to prevent offenses or reduce liability. Throwing money into ineffective compliance efforts is simply a waste of corporate resources.

Second, undertaking law compliance efforts poorly may be worse than doing nothing at all. We saw this demonstrated in some of the research that was presented at this symposium. Compliance programs that are treated by management as a sham tend to encourage cynicism by employees. Such cynicism, in turn, tends to cause employees to pay less attention to legal requirements and to be more willing to commit offenses. Hence, a poor law compliance program may actually increase levels of offenses, making it worse than doing nothing.

Third, operating a compliance program that is a sham will forfeit an opportunity for favorable treatment in regulatory and criminal proceedings. From the presentations of government officials at this symposium, it is obvious that prosecutors and regulators are becoming more adept at evaluating compliance programs. They are becoming more sophisticated in the proof they demand and in what they view as the necessary features of an effective compliance program. The likelihood that a sham program will pass muster is diminishing accordingly.

How does all this bear on the role of inside counsel? As was mentioned in the introduction to this panel, I am here in part as one who has acted as an inside counsel and who thinks a lot about the role of inside counsel as an academic. I believe that the challenge to inside counsel in the next few years is to help corporate managers pursue law compliance programs as aspects of day-to-day management processes. This is critical because there is no other effective law compliance program strategy. Management must pursue law compliance as a line management objective if corporations are to adopt compliance programs that both prevent offenses and meet government standards for favorable treatment.

What is counsel's role in helping corporate line managers pursue compliance systems? First of all, it's a new role. It's a role that many corporate counsel (both inside and outside counsel) aren't very familiar with. It's a role as part of a team constructing management processes, rather than just providing legal advice about relevant legal requirements and possible types of violations. Granted, construction of the necessary management processes will start

with some traditional legal advice describing the sorts of legal risks confronting a firm. These are the legal risks that the resulting processes will need to address and minimize. However, beyond just providing this type of advice, counsel should also pose questions to line managers that help the managers think about the techniques they might use in the course of managing and diminishing legal risks. Counsel can also challenge the sufficiency of what management comes up with, by comparing a company's proposed law compliance practices with practices undertaken by other firms or required under management standards like ISO 14000. These types of comparisons are critical in evaluating the sufficiency of proposed compliance systems because similar comparisons will be undertaken when compliance systems are reviewed by regulatory agencies or sentencing courts.

I would like to offer one last thought on how corporate counsel might conceive of their role and the overall process of developing and pursuing corporate law compliance programs. Steps undertaken now regarding these programs should be seen as setting the stage for later reviews of those programs in contexts where corporate liability is at stake. To help define what to do now, a corporate counsel should imagine hypothetically that he or she is at the end of the process in the midst of a critical review of a compliance program by a regulatory official, a prosecutor, or a sentencing court. The question under discussion in this review is, "What kind of compliance program did your company have?" What would you like to be able to respond?

Well, what you'd like to be able to say is something like the following: "We felt law compliance was a critical aspect of corporate performance. We addressed compliance with the same types of techniques that we would use to address other critical management concerns. For example, our management techniques were similar to those we would use in a quality control or production system. Let me show you how we applied similar techniques to our law compliance efforts."

That's the sort of presentation which will convince regulators, prosecutors, and courts your company was serious about law compliance. The corporate operations necessary to make this sort of presentation a reality should be counsel's present objective. By helping line managers develop these operations, corporate counsel can ready his or her firm for the rigorous, but potentially rewarding compliance system reviews of the future. Thank you.

**WRAP-UP: REMARKS BY LYNN SHARP PAINE**

LYNN SHARP PAINE: This conference is special for many, many reasons. The things we’re talking about represent some very important changes in how we encourage and support lawful conduct in our organizations, and particularly in our companies. Two changes stand out. The first is that managers are being asked to assume greater responsibility than in the past for insuring lawful behavior in their organizations. A second related aspect of this change is that government is being asked to demonstrate a greater willingness to recognize managers’ efforts to encourage lawful behavior in their organizations. And this observation applies to government officials in a number of contexts.

If we look at this development from a broad historical perspective, we see that it’s part of a sea of change in thinking about business-government relationships in this country. This, in general, is a very positive development, and it’s one I have urged in my role as a management educator and a management researcher. In particular, I have urged that law compliance be treated as a management function, not a legal function. Law compliance is something managers should be concerned with on a routine basis. After all, the executive’s job of is to define the goals and responsibilities of an organization and then to mobilize people and resources to achieve those goals and responsibilities.

I doubt that anyone here would quarrel with the idea that abiding by the law is an important organizational responsibility, though in practice it’s not a responsibility that anybody embraces with great enthusiasm. To paraphrase both Joe Murphy and former SEC Chairman Richard Breeden, aspiring to get through the day without being indicted is not a very inspirational ethical standard.

So while I really do think we’re moving in the right direction, I want to use my few minutes just to underline a few concerns I have. There are three in particular.

The first concern has to do with the search for guidance. In listening to discussions at the conference, I have felt that a lot of people, particularly representatives from companies, would like the Sentencing Commission to stop being vague and just tell companies what to do. Many feel the guidelines don’t, in fact, give enough guidance. When I hear such comments, my reaction is – be careful what you wish for; you might get it. There is no single model for what managers should do on a day-to-day basis to ensure adherence to law in their companies. What motivates a Wall Street trader is different from what motivates a health care worker. And while it’s very laudable and appropriate for the Sentencing Commission to spell out the specific compliance-related functions managers should undertake – and by functions, I mean activities like the setting of standards, education, motivation, assurance, audit, and other assessment systems – it would be a mistake for everybody if the Commission were to get into the business of laying out very specific steps for what managers should do.

Rather than providing a compliance cookbook directing companies to do A, B, C, and D, the government could stimulate innovation and experimentation by requiring companies to evaluate their own effectiveness in carrying out the compliance functions. Companies seeking relief or approvals would have the onus of demonstrating how they have evaluated effectiveness and what kinds of self-improvement efforts they have undertaken over time.



In the course of our conversations, we have at times moved up two quite different issues, both of which are very, very important and which should be looked at, but which in the first instance should be looked at separately. The first issue is the lawyer's concern about how a company proves that it's a good corporate citizen, and second is what should be the manager's concern, which is how actually to be a good corporate citizen.

Now, I have a bit of a bias here. I am convinced that the best and easiest way to seem to be a law-abiding company is actually to be a law-abiding company. So I believe that the management question should take priority, but I also am enough of a lawyer to realize that the issue of evidence and proof in various contexts is also very important.

So that brings me to my second concern: what companies should do to become law-abiding organizations. Here, we need a better understanding of the management practices followed in companies that actually are good corporate citizens with a good track record and who have built respect for law into the corporate value system.

The environmental leadership program that Steve Herman talked about is a good example of what I have in mind. It's something we should be paying more attention to. In our discussions, a lot of attention has been focused on corporate misconduct, understanding its origins and so on. I have done research in this area, and I believe it's very, very important. A lot can be learned from research on the fundamental origins of misconduct. Sometimes the findings can be surprising.

For example, I did research in one company which, if described in detail, I'm sure 80 percent of you would say was a good corporate citizen. That company, by the way, didn't have a compliance program like the ones that we have been discussing. Nevertheless, the company did get involved in misconduct related to the falsification of environmental reports.

Once one diagnoses why this occurred, it turns out that some of the employees had been asked to do a job for which they had not been trained very well. Now, you say, what do these employees need? Do they need a talk about ethics? Or do they need some job training? Well, probably they need both, but clearly they need job training. In my experience it's very common to find that organizational misconduct often goes back to poor management and to management practices that need to be improved. So it's quite important to push back and understand the origins of misconduct.

Nevertheless, while we need to understand that, we also need better research not on compliance programs *per se*, but on the management practices that are used in companies that are good corporate citizens. What this type of research will show, I believe, is that concern for law is reflected in all the core management systems that drive the organization, from its leadership, its supervision, its hiring, its promotion, its evaluation and rewards, its planning system, its resource allocation, information, communication, training, education, oversight, control.

When a company has truly integrated respect for law into the corporate value system, it shows up in every aspect of the management process and of the leadership of the organization. So I find it a bit troubling that so much attention has been focused on the willingness of

employees to report misconduct as the leading hallmark of a good corporate citizen. There are lots of other things we should be looking at that are more positive and much more central to what makes a good corporate citizen.

An excessive focus on misconduct can also lead to recommendations that are in conflict with management’s efforts today to empower employees, to build trust, to enable people to do their jobs better, and to strengthen personal accountability. We must not lose sight of our core objective here: namely how to build and maintain law-abiding organizations and to uphold high levels of adherence to law in our society.

The final issue I want to mention is my concern for the individual employee. As companies rush to prove to the government that they are good corporate citizens by voluntary disclosure and by zealous housecleaning after misconduct occurs, I hope they do not lose sight of the importance of fairness to the individual employees who may or may not be involved directly in the misconduct.

I recently heard a story praising a company’s management for its exceptionally quick response to allegations of misconduct. Some individuals were accused of misconduct and dismissed within a matter of only 24 hours or something like that. They were gone, and the company was getting on with its business.

I don’t know the facts of that case, and maybe the evidence was clear. But it’s very, very important that managers take the time to think about the fact-finding process, about fairness and due process in their determinations before dismissing employees in their eagerness to be good corporate citizens. That’s important not only for fairness to the individual employee, but also for the impact on other employees, particularly their willingness and their commitment to do their job.

Recently, I was reading about some research done by Professor W. Chan Kim at INSEAD, a business school in France. One of Professor Kim’s findings was that employees in global organizations are most likely to implement corporate global strategy when they believe that due process has been followed in developing the strategy. There are other lines of research that suggest that if you want your employees to go the extra mile, to do the extra work, to take on the discretionary effort, you should be especially concerned about fairness. This research says that people are more likely to do their best to support the organization when they perceive their work environment to be a fair environment, where their efforts will be recognized and where due process is followed in making and implementing decisions of all sorts.

Clearly in today’s environment, if we are going to compete effectively as individual companies and as a nation, we have to have lots of employees who are willing to go the extra mile, to do the extra work, to go above and beyond the call of duty. To the extent that treating people fairly and exercising due process is part of creating an environment in which people are willing to do that, we have to think carefully about how we approach compliance and how we deal with misconduct. We don’t want to undercut those important motivations and commitments.

So, in conclusion, let me just say that, of course, adherence to law is a fundamental responsibility of companies, but it's not their only responsibility. And as we seek to build law-abiding companies, we need to select methods that recognize not only the obligation to obey the law, but also the responsibility to produce goods and services needed by society in an efficient manner. We must be careful to select methods that enable companies to compete effectively in a global marketplace. Thanks very much.

WIN SWENSON: Thank you. Those were really wonderful comments and they have given us a lot to think about. It's late, and so we'll stop. I'd like to just close with three very brief thoughts. One is in response to the question, "Does the Sentencing Commission have plans to do any further symposia in other parts of the country?" I think it will be some time before we do it. On the other hand, if you think it has been useful, you might want to note that on your feedback form. Maybe there's something that we should do from time to time.

Second, I wanted to say how grateful we are to International Meetings, Incorporated, IMI, which has done the production of this symposium and we think has done really a wonderful job.

Finally, I wanted to just say in parting to you all, I think Senator Kennedy had it right yesterday when he said that the issues and policies we've all been thinking about over the last couple of days are matters that each of us can positively influence in our own jobs. Whether we're in government or we work inside of companies, whether we're in law firms, in business schools, or in law schools, I think we can all make a contribution to thinking about these policies and making them work.

So keep in touch with each other and with us, and go well. Thank you.

### COMMISSION QUESTIONS & ANSWERS

Q. What is the current status of environmental guidelines for organizations — is there a time frame for implementation? Is anything in the works for food and drug crimes? What has slowed the Commission's actions?

A. Proposed environmental guidelines drafted by an outside panel of practitioners, known as the "Advisory Working Group on Environmental Sanctions," were submitted to the Sentencing Commission on November 16, 1993. Since that time, the President has appointed four new members to the Commission, including a new chairman. As newly constituted, the Commission has decided to complete a comprehensive review of the federal guideline system before undertaking any significant new amendments. For this reason, the Commission has not taken action on the Advisory Group's working proposal. After its comprehensive review of the guidelines, the Commission expects to evaluate this and other proposals on environmental guidelines that come to its attention. The earliest that work on environmental guidelines might recommence would be late 1996.

Regarding food and drug crimes, the Commission is now considering a staff proposal that would delete the existing separate guideline, §2N2.1, for these offenses and henceforth have them sentenced under §2F1.1, which generally governs fraud offenses. One effect of this change would be that the fines provision of the organizational guidelines would then apply to food and drug offenses. *See* USSG §8C2.1. This proposal recently was published for comment. *See* 61 Fed. Reg. 79 (1996).

Practitioners are reminded that it is only the *fines provisions* of the organizational guidelines (Part C) that do not now apply to environmental and food and drug offenses. For example, the restitution and probation provisions (Parts B and D, respectively) already apply to organizational offenses.

Q. It appears that guideline penalties treat organizational size in a backwards fashion — *i.e.*, a smaller organization is easier to police than a larger one, yet the larger employer gets a higher culpability score. Is this because of CEO involvement or because simply more is expected of larger organizations?

- A. Under the guidelines, larger organizations do not, *per se*, receive higher culpability scores and penalties than smaller organizations. Under USSG §8C2.5(b), however, culpability scores (and thus potential fines) will increase if organizational officials with responsibility for relatively higher numbers of employees are found to have been involved in the offense. For example, if an official with responsibility for 200 employees was involved in the offense, the culpability score will be *three* points greater than it would have been if only low-level employees had been involved. If an official with responsibility for 5,000 employees was involved, the culpability score will be *five* points higher than it would have been if only low level employees had been involved.

The background commentary to this culpability score provision explains:

The increased culpability scores under subsection (b) are based on three interrelated principles. First, an organization is more culpable when individuals who manage the organization or who have substantial discretion in acting for the organization participate in, condone, or are willfully ignorant of criminal conduct. Second, as organizations become larger and their managements become more professional, participation in, condonation of, or willful ignorance of criminal conduct by such management is increasingly a breach of trust or abuse of position. Third, as organizations increase in size, the risk of criminal conduct beyond that reflected in the instant offense also increases whenever management's tolerance of that offense is pervasive.

- Q. Mr. Swenson was quoted in a newspaper as observing that certain people have raised concerns that the practice in some industries of comparing notes on how to fight corporate misconduct could, in fact, lead to collusion among companies to *lower* compliance standards. What is the Commission's view on this? Is there an acceptable means by which a trade association can actually raise the standard, *e.g.*, use an outside entity such as someone in (or formerly in) government or a law professor versed in this area to help develop a framework for an effective program for a particular industry?

- A. The Commission applauds efforts by industry groups to share information on compliance program practices — as long as the objective is to achieve “best practices,” not the lowest common denominator. There is no single agreed upon approach as to how industries should proceed. The symposium segment entitled “Sharing ‘Best Practices’ Information” examined several possible models, and the Commission encourages further thinking and innovation in this important area.
- Q. Assume a statute allows for fines up to \$200,000 for a certain type of conduct, but the guidelines would require \$500,000 in fines. Which prevails — the statutory maximum (\$200,000) or the guidelines (\$500,000)? What legal basis permits additional burdens (e.g., a high-dollar restitution order) over and above the maximum statutory fine?
- A. Consistent with congressional intent, the Sentencing Commission takes the position that statutory sentencing parameters “trump” the guidelines where a conflict exists. *See* USSG §5G1.1. Consequently, all guideline fines are subject to limits established by statute. On the other hand, it is expected that fine ranges generated by the organizational guidelines will infrequently exceed statutory maxima. For example, the highest fine range called for by the guidelines has a floor of two times the “base fine,” which will often be the loss. *See* USSG §§8C2.4, 8C2.6. Section 3571(d) of title 18, United States Code, specifically authorizes fines up to twice the loss. Thus, in most cases this statutory provision will authorize a fine within the highest applicable guideline range, and other statutes may provide even higher maxima.
- By statute, restitution is a separate sanction from a fine. *See* 18 U.S.C. §§ 3551, 3556. Thus, restitution may be ordered in addition to a fine.
- Q. What if dollar amount of loss or pecuniary gain is low, but the product is defective and is a critical safety-of-flight aircraft part? Is risk of harm or bodily injury factored into an organization's sentence under the guidelines?
- A. In fraud cases, risk of serious bodily injury may be directly reflected in the base fine. *See* §§8C2.4(a)(1), 2F1.1(b)(4). In other cases, Chapter Eight authorizes an upward departure if the offense either resulted in, or involved a foreseeable risk of, death or bodily injury that is not adequately reflected in the fine. *See* USSG §8C4.2.

- Q. Is there a protection so that by self-reporting the company does not significantly increase its exposure far beyond the benefit gained from the five-point culpability score reduction under the guidelines?
- A. Disclosure of wrongdoing by companies is not only encouraged by the guidelines but now by a number of other governmental policies as well. At the symposium segment, “The Experience and Views of the Enforcement Community,” representatives of the Justice Department’s Criminal, Antitrust, and Environment Divisions all spoke about voluntary disclosure programs and policies administered by their respective Divisions. Eleanor Hill, the Inspector General at the Department of Defense (DOD), spoke about DOD’s voluntary disclosure program in the “Finding Government’s Message” segment of the symposium.

Recently, the Environmental Protection Agency finalized a new policy called “Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations” that provides for reduced *civil* penalties when companies disclose environmental violations and meet certain other criteria such as having a sound “compliance management program.” *See* 60 Fed. Reg. 66, 706 (1995).

While, overall, these government programs clearly provide substantial benefits for self-reporting, some experts have posited that further policy or legal changes may be warranted. *See, e.g.*, symposium remarks by William B. Lytton, Commissioner Michael Goldsmith, and Joseph E. Murphy.

- Q. Can the judge include, as part of a sentence of probation, a requirement that the corporation submit to unannounced examinations of corporate records by probation officers or even agents to assure the court that the corporation has not returned again to criminal conduct?
- A. The court may order as a condition of probation that the company submit to “a reasonable number” of such examinations for the purpose of ensuring that the company is either: (1) following the dictates of its compliance program, or (2) safeguarding its ability to pay a court-ordered monetary penalty. *See* USSG §8D1.4(b)(1) and (c)(4).
- Q. Under the guidelines, will the entire benefit of an effective compliance program be lost if the offense is not promptly reported to the government?

- A. Under USSG §8C2.5(f), the guideline benefit of having “an effective program to prevent and detect violations of law” — a three-point reduction in the culpability score — will be lost if the organization “unreasonably delayed” reporting the offense after becoming aware of it. In other words, this credit is not lost simply because the organization failed to report an offense if the organization was unaware of it — although on these facts a court might *infer* that the organization’s failure to detect the offense was unreasonable and therefore indicated that its compliance program was undeserving of culpability score credit. In terms of the *automatic* elimination of the credit, what counts is whether the organization *unreasonably delayed* reporting an offense after becoming aware of it.
- Q. If an organization truly has an effective compliance program and self reports, why does not the fine range begin at \$0.00 so that the incentive for self compliance is truly maximized?
- A. During the development of the organizational guidelines the Commission debated, but ultimately rejected, building “zero fine” outcomes into the guidelines. Enforcement community representatives persuaded the Commission at that time that a guideline fine of zero would be unnecessary to encourage compliance and self-reporting and, moreover, could send an undesirable signal regarding the seriousness of criminal conduct. However, the Commission did structure the organizational guidelines such that relatively nominal fines apply when culpability is low. *See* USSG §§8C2.5, 8C2.6. The Commission further adopted a policy statement authorizing courts to consider departing below the prescribed guideline fine range when culpability is especially low. *See* USSG §8C4.11, p.s. In theory, a departure pursuant to this policy statement can yield a zero fine.
- Q. How is the Sentencing Commission going to ensure that federal prosecutors, probation officers, and judges use Chapter Eight effectively? How does a prosecutor analyze the “effectiveness” of a compliance program?
- A. The Commission’s enabling statute authorizes the Commission to “devise and conduct periodic training programs” for persons whose professions are affected by federal sentencing matters. *See* 28 U.S.C. § 995(a)(17) and (18). Consistent with this authority, the Commission has sponsored or otherwise engaged in numerous nationwide training programs for probation officers, judges, prosecutors and private sector



practitioners of various kinds. Training has covered both the individual and organizational sentencing guidelines.

That said, the Commission recognizes that a number of issues raised by the organizational guidelines, such as the meaning of an “effective” compliance program, are complex and relatively new to the criminal justice field. For this reason, the Commission will monitor training needs in the field and lend support as appears practical and necessary.

It might be noted that apart from Commission-sponsored training, the organizational guidelines anticipate that courts may acquire expertise in especially complex cases by appointing knowledgeable experts. *See* USSG §8D1.4(b)(2) and (c)(4). How federal prosecutors will approach these issues is ultimately, of course, a matter of within the purview of the Department of Justice. Views on how prosecutors may approach these issues were presented by Justice Department officials at the symposium segment entitled “The Experience and Views of the Enforcement Community.”

- Q. Joint ventures among major corporations are becoming more and more commonplace in many industries — what thoughts should the participants/parents have regarding compliance programs of joint ventures?
- A. In general, the guidelines’ “carrot and stick” incentives — *e.g.*, to establish effective compliance measures — would seem equally applicable to joint ventures. If a violation occurs within a joint venture and the joint venture is charged with and convicted of the offense, the joint venture’s compliance track record and general response to the offense will be assessed under the guidelines in determining its penalty. For all practical purposes, the same would be true if a parent were instead charged with and convicted of the offense — the joint venture’s actions and conduct would be highly relevant in determining whether the parent had an “effective” compliance program with respect to its business endeavors.
- Q. Does the Sentencing Commission provide certification or feedback on proposed compliance plans?
- A. No. The Sentencing Commission is not involved in the adjudication of individual cases and has no authority to certify organizational compliance plans.

- Q. Does the Sentencing Commission have any plans to sponsor similar symposia in other parts of the United States or to participate in conferences sponsored by universities or other entities?
- A. Although a significant number of symposium attendees suggested that the Commission consider doing so, the Commission as yet has no plans to sponsor future symposia on strengthening good-citizen corporations. The Commission does, however, consider requests from outside entities for training assistance as resources allow. Over the past several years, Commission representatives have participated in a significant number of privately sponsored conferences around the country on these and related issues.
- Q. Do the guidelines require an organization to: (1) waive the attorney-client privilege, (2) forbear from joint-defense agreements with employees and third parties, and (3) waive or toll the statute of limitations at any stage of the proceedings?
- A. Although the submitted question does not specifically say, these issues are usually raised in connection with the question of whether an organization — despite pursuing one of the rights or remedies referred to — can nevertheless obtain culpability score credit for compliance efforts, cooperation, and acceptance of responsibility. *See* USSG §8C2.5(f),(g).

Each of the relevant culpability score factors — “an effective program to prevent and detect violations of law” *ŕ.e.*, a qualifying compliance program under the guidelines) evidence that the organization “fully cooperated in the investigation,” and the organization’s “acceptance of responsibility” — is defined by the guidelines. *See* USSG §8A1.2, comment. (n.3(k)), §8C2.5, comment. (n.12, 13). Because the relevant definitions do not *expressly* speak to the three legal avenues asked about, a definitive answer is not possible. Barring further clarifying commentary from the Commission, courts will have to resolve these questions in actual cases.

What can be said is that answers to these questions are likely to be resolved on a case-by-case basis. For example, an organization might have a surpassingly strong compliance program, fully and promptly disclose all relevant information regarding the offense, and enter a joint defense agreement with an employee solely for the purpose of litigating a nonfrivolous legal issue unrelated to factual guilt *ŕ.g.*, to address the applicability of a statute to the defendants involved in the

joint defense agreement). In such circumstances, a court might well examine the definitional commentary in the guidelines and conclude that the organization qualifies for compliance program, cooperation, and acceptance of responsibility credit.

On the other hand, if the organization were to enter a joint defense agreement with an employee whom its own investigation showed was involved in criminal conduct, and then put the government to its burden of proof at trial by denying the essential factual elements of guilt, a court might conclude that the organization qualified for none of these mitigating factors. The possible barriers to credit for cooperation and acceptance of responsibility are relatively straightforward in this hypothetical; a court might conclude that credit for the compliance program also should be denied for such reasons as: (1) the organization failed to disclose an offense of which it was aware, *see* USSG §8C2.5(f); (2) the organization failed to appropriately discipline employees responsible for the offense, *see* USSG §8A1.2, comment. (n.3 (k)(6)); and (3) the organization failed to respond appropriately to the offense. *See id.*, (n.3(k)(7)).

With respect to waiver of the attorney-client privilege, it might be noted that guideline credit for cooperation requires that “all pertinent information” be disclosed, not all potentially relevant documents. *See* USSG §8C2.5, comment (n.12)(emphasis added). Whether withholding a privileged attorney-client communication would still allow an organization to satisfy the guideline definition of “all pertinent information” — and the related question of whether disclosure of all pertinent information would effect a legal waiver of the privilege — are matters that must be resolved by the courts.

- Q. Have there been difficulties encountered by companies endeavoring to implement compliance programs, getting such programs past unions or even less formal employee groups?
- A. Commission staff have been advised informally of a few instances in which unions have sought to subject compliance plan formulation to collective bargaining. One NLRB case has held that codes of conduct are subject to collective bargaining in a unionized workplace. *See* American Elec. Power Co., 302 N.L.R.B. 1021 (1991), *aff'd*, 976 F.2d 725, 1992 WL 245880 (4th Cir. Oct. 1, 1992). Many companies reportedly find it desirable to involve employees in compliance plan formulation, and NLRB decisions suggest National Labor Relations Act standards can apply. *See, e.g.*, Electromation,

Inc., 309 N.L.R.B. 990 (1992), *aff’d*, 35 F.3d 1148 (7th Cir. 1994). For further discussion, *see* Albert F. Cacoza & David L. Gregory, *Labor and Employment Issues, in Compliance Programs and the Corporate Sentencing Guidelines* (Jeffrey M. Kaplan et al. eds., 1993).

- Q. Have any companies been found to violate probation? What happened? How are assistant United States attorneys verifying probation requirements — especially those dealing with compliance programs?
- A. While the Commission comprehensively collects information on the sentencing of federal defendants, it currently has no mechanism for collecting information on probation violations. Further study may be warranted.

In a case involving Consolidated Edison in New York, the judge followed an approach anticipated by the guidelines, *see* USSG §8D1.4(c)(4), of placing the organization on probation and requiring as a condition of probation that a court-appointed monitor oversee the organization’s development of the compliance program. This case was discussed by Kirk Jordan at the symposium. The court-imposed compliance plan in the Natural Medical Enterprises case discussed by several symposium participants demonstrates verification tools available in a non-probationary setting, *i.e.*, under a consent decree. There, among other things, the government required scheduled independent audits, third-party verification of various activities and transactions, and specified reports and notifications.

- Q. By giving five points for self-reporting/cooperation and only three points for an effective program, are we not undervaluing the need to have an effective compliance program?
- A. Under the organizational guidelines, there are two ways that an organization may achieve maximum mitigation of the culpability score (and therefore of the fine). *Method One*: have an effective compliance program, fully cooperate, and accept responsibility. *See* USSG §8C2.5(f),(g). *Method Two*: voluntarily disclose the offense, fully cooperate, and accept responsibility. *See* USSG §8C2.5(g). Both methods lead to a five-point reduction in the culpability score. The difference is that credit for cooperation and acceptance of responsibility are *required* before credit for a voluntary disclosure can be given. Credit for “an effective program to prevent and detect

violations of law” (three points by itself) does not*depend* on the organization’s qualifying for the two-point reduction for cooperation and acceptance of responsibility.