UNITED STATES SENTENCING COMMISSION

PRESENTATION OF THE
AD HOC ADVISORY GROUP ON THE
ORGANIZATIONAL SENTENCING GUIDELINES

Tuesday, October 7, 2003

Judicial Conference Center
Thurgood Marshall Building
One Columbus Circle, NE
Washington, DC 20002

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The Honorable Ricardo H. Hinojosa
The Honorable William K. Sessions, III, Vice Chair
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P R O C E E D I N G S

JUDGE MURPHY: [Opening Remarks in progress] members of the Organizational Advisory Group that we appointed almost two years ago, but by the time we got started and so forth, the 18 months arrived at today, with the work product that you all have turned out.

We had the chance to review it and I must say that it is a very impressive piece of work. We were very enthused about this group from the beginning, because we knew how much expertise and experience in the area of sentencing and corporate defendants and other organizational components were represented on the group, and we kept a very diligent schedule that we have been aware of from afar.

We did have the one interim report about your work and now we are here. This is going to be available for everyone that works in this area and to make it known to everyone, I'm going to call on you, Todd, and I think it might be worthwhile just taking a minute to introduce all the members who

are here, because I think -- I'm not sure if everybody is here, but I see an awful lot of the members.

I want to thank you right at the outset, Todd, for your willingness to take the leadership role and in this and to every member of this group for the dedication that you have given to the project.

MR. JONES: We appreciate that. I would like to take a minute to introduce everyone, not only those that are up here, but the other members of the advisory group, and start out by saying that this work product was the product of a lot of team effort.

We had a very good group, one of the better groups, one of the best groups that I have ever had an opportunity to work with, a very eclectic group with a variety of experiences, and I will go around and introduce them. They are referenced in the report.

Starting to my far left, Mary Beth Buchanan, who is the U.S. Attorney in the Western

District of Pennsylvania. Next to her, Professor Richard Gruner, from Whittier College in California.

To my right, immediate right, is Professor Julie O'Sullivan, at Georgetown.

And someone that some of the Commissioners and the staff know is Win Swanson, who is a former deputy general counsel here at the Sentencing Commission.

Their presence here is nothing more than a safety net for me, when you have some hard questions, because they had, like the whole group, a lot of input into this report and we do want to leave some time for questions from you.

If I could go back to the rest of the group and do some introductions.

Gary Spratling, who is a partner at Gibson, Dunn & Crutcher. Ron James, who is with the Center for Ethical Business Cultures. Greg Wallance from New York. Dick Bednar, Paul Fiorelli, Chuck Howard, Jane Nangle, Lisa Kuca in the back there, Ed Petry, and, of course, Eric Holder

from D.C.

And we had almost perfect attendance at every meeting.

What I'd like to do is go through the report. We have a PowerPoint. Sorry to torture you this morning, but we have a PowerPoint that does a couple of things. It highlights some of the suggestions that we have made in the report and it also outlines the report itself.

The report, as you could see, is about a 140 pages. It is substantive. It is detailed. A lot of effort went into it.

One of our goals from the outset was to not give you a 10 or 15-pager after some cursory review of Chapter 8, because we are well aware of our mandate and our mission to look at Chapter 8 with a particular focus and provide you with a work product that would be useful and useable to the members of the Commission.

This morning, what we would like to do is talk about the group mission, not so much for the members of the Commission, because you, of course,

gave us our mission and are well aware of it, but there are other individuals here in this venue that may need a refresher on exactly what our mandate was from the start.

Discuss briefly our process. This was a topic of our interim report and, again, just to refresh everyone's recollection.

Discuss our findings, and the findings, again, are well grounded both in the input that we received from the public, both in a public hearing and in written submissions, and, also, our collective knowledge and experiences from our own professional backgrounds.

I would like to discuss our recommendations, with the caveat, of course, that this is a report that the Commission is free to use as it so chooses. We also were well aware from the outset that the more detail that we gave you, the more useful the report, and several of the recommendations that we have made have actually been put forward as proposed guideline changes, because, again, it was our understanding that the

most useful product we could provide you would be something that would be user friendly and easily transferrable to your processes and actually promulgating a guideline, because we are well aware of the time frame that you all have to operate within and we wanted to give you a useful product.

With respect to that, we have made several proposals regarding guideline changes and we have also identified a number of issues for further consideration.

I will discuss further the linkage between a couple of different concepts, but given our mission, we found ourselves spending a considerable amount of time discussing issues that weren't exactly related to compliance as articulated in the guidelines.

There are issues that are directly linked to those compliance criteria that are amplified and expanded on in the report, and I will go through them.

Our mission at the outset from you was for

this group to review the general effectiveness of Chapter 8, which is 12 years old now, had not been reviewed during that period of time, and you, the Commission, desired that we place particular emphasis on the application and the criteria for an effective compliance program and report back to you with our recommendations as to improvements that may be warranted, and what we have as the heart of this report are our suggestions with respect to this mission for improvements.

Our process was one that was very deliberative and structured. In the fall of 2001, the Commission announced its intentions to form an advisory group to look at Chapter 8 at its tenth anniversary.

We were subsequently empaneled in February of 2002. We had our first meeting in March and very shortly thereafter put out a general request for public comment, utilizing your website and other means, and we received a substantial amount of written public commentary.

In August of 2002, based, in part, on that

initial public commentary, we refined and published a list of specific issues, because during that process, we were able to identify certain issues that were emerging and solicit additional public comments on the specific issues which were published in August of 2002, which culminated in a hearing, and I notice from looking around the room that there are a number of participants from that hearing in November of 2002 that was hosted here at the Federal Judicial Center, and we had a day of commentary.

It is all part of the public record, as are all the written comments that are on your website, where we generated a substantial amount of discussion.

That was very helpful in our follow-up work. We received testimony from a number of individuals and entities and it, again, helped us refine and understand better the issues that we were going to tackle.

In March of 2003, we provided the Commission with an interim report. It was an oral

report by myself and Professor O'Sullivan here at the center, and, of course, the culmination today, October 7, the final report to you all within our 18-month mandate.

What helped shape our recommendations? Well, there were a variety of factors. In addition to the very deep and sometimes long discussions that we had amongst ourselves about various issues, one thing that was unanticipated was the response to legislative and regulatory responses to a number of corporate scandals that occurred.

If you can recall the time line, when we were empaneled, the world was a lot different with respect to white collar crime and federal regulations with respect to publicly held companies than they are today.

During the summer of 2002, the Sarbanes-Oxley Act was passed by the United States Congress, with a very short time frame for implementation by the Securities and Exchange Commission.

In addition, the New York Stock Exchange looked at some of its listing requirements. The

Conference Board had a forum and published a report.

So there was a lot going on in the corporate world that was paralleling our process and we were very aware and attuned to that, and attempted, gave it our best to synchronize some of those developments, including a mandate from Congress to the Commission to look at Sarbanes-Oxley and get that in synchronization.

These were all things that we looked at during our process that helped shape the recommendations and are reflected in the report.

In addition, our very eclectic and experienced group brought a number of their own personal experiences and backgrounds in the area of compliance and business prosecution.

The composition of the group was very strong with respect to the different perspectives that we brought to the table.

We have had a decade of practice in the compliance area, engendered in large part by the 1991 promulgation of Chapter 8.

We looked at the Caremark case in particular and there have been other judicial decisions talking about corporate governance that, in a very real way, are impacting how corporations in America are operating, and these, again, helped shape our recommendation.

Again, ten years of experience with Chapter 8 has led to an expanded field of practitioners in the area of compliance and we were able to tap their knowledge, both directly and indirectly, through the participation of individuals in the public process and as a member of the advisory group.

I'd like to summarize some of our recommendations, in particular, focusing on that specific language that we are providing to the Commission for its consideration with respect to guideline changes.

Now, granted, the report is substantive and discusses a number of other issues. There is a substantial background section that we felt was very important not only for the Commission, but for

any member of the public who wanted some context for what Chapter 8 was all about.

It was very easy, given our experiences, to get lost in the details and one of the things that we wanted to make sure happened in the report, is that it was useful not only to the Commission, but to others in the public, keeping in mind the Commission's mandate and a charge to educate the public about these issues, to provide a digest, so to speak, of background, both corporate liability, corporate governance, and some of the other issues that are directly related to compliance.

First and foremost, you will note in the report that we are recommending a standalone guideline for compliance programs.

I will come back to these specific recommendations, but I would like to just flag those for the Commissioners at this time.

One of the issues within the stand-alone guideline for compliance programs discusses organizational culture and leadership.

Again, this is an issue that was the topic

of hot discussion during the process and the operative word, we believe, for the Commission to consider is the synchronization issue.

While in early 2002, this may have been less of an issue, the subsequent events and revelations both on the corporate front and the Sarbanes-Oxley requirements sort of pushed this one to the forefront and our suggestions are an attempt to synchronize the sentencing guidelines with what is going on both in the regulatory and corporate governance world.

We have some language and some recommendations with respect to risk assessment, and this is one of those macro issues that, once we got down into the nitty-gritty of compliance, it goes without saying that best practices that have emerged have talked about risk assessment done in conjunction with compliance and one of the other themes that I think you will pick up on, again, based on ten years of practical experience, but more recently, based on some of the corporate scandals, is no more paper programs.

We have done some definitional change, some focus, some refinements, and answered some questions that, quite frankly, have arisen throughout the course of ten years of practical experience with the seven steps, with the criteria that are articulated in Chapter 8 now, and tried to refine, focus, expand on occasion, and discuss, in a better and more useful way, what some of these terms mean, and we have some suggested language defining compliance standards and procedures.

We talk about monitoring, auditing, and evaluation. Again, this is linked with risk assessment. But when you talk about compliance and in an effort to ensure that there are no more paper programs, at least with respect to getting credit under the sentencing guidelines, that you've got to talk about all of these various things together.

We discussed training requirements and a reporting mechanism. Again, the reporting mechanism is an issue that has a broader context with respect to the litigation dilemma and confidentiality, but it is also something that is

recognized in Sarbanes-Oxley and is something that was discussed in the current Chapter 8 that we expand upon, to a certain extent.

And lastly, we have some refinements, some proposed language with respect to cooperation, substantial assistance, and privileges.

Let me take a minute to talk about the stand-alone guideline for compliance programs. Why did we do this? We felt that it was important to place what is currently in application notes and commentary in a position of more prominence, just as a recognition of what the reality is.

It, also, from a practical standpoint, allows us to use the application notes and commentary to define certain terms and gives you all the opportunity to define those terms and add them in the application notes.

What we are doing, in essence, is taking an application note and extracting it out, putting it in its own place of prominence as a guideline, and expanding on certain definitional terms in commentary for the application.

As a result, you will see in the report a proposed revised definition of an effective program to prevent and detect violations of law. We have some discussion in the report and had much discussion amongst ourselves about violation of all laws, not just criminal laws. That's a recognition, again, of the fact that not only are we discussing federal criminal law, we are also discussing regulatory schemes that are in place and state laws.

So it's a minor change, but it is a change that was discussed and is identified in the report, along with the rationale for doing so.

We amplify and refine the seven minimum requirements. Again, these are not new news to practitioners in the field, and by extracting out the seven minimum requirements for a compliance program, putting in its own place of prominence as a stand-alone guideline, and then, in effect, using the commentary to expand on that, it, we believe, will be more helpful both to those in a proactive way to have a better understanding as to what the

minimum requirements for compliance are, and, also, will articulate better guidance for probation officers, for judges, and for those responsible for making decisions and charges, potential charges, with articulating what a minimum baseline is for a compliance program, and, again, elevating it from an application note to the guideline gives it a place of prominence.

Let's discuss some of the criteria. Again, for those that are practitioners, these terms are not completely new. They have been enhanced, they have been burnished, they have been amplified.

One of them is organizational culture and leadership. A little context. This was, quite frankly, kind of scary. When we started off talking about how do you mandate ethics, how do you change a corporate culture. We had substantial discussion about that in our group.

The discussion translated into the document itself and, again, given our time constraints, I don't want to go too deep into it.

The report will be available, if I understood Judge Murphy correctly, and I think we have done a good job articulating some of our rationale in the written document.

Suffice to say that synchronization was our goal, and, again, things that have happened outside of the world of the sentencing guidelines in Chapter 8 had an impact on us making suggestions with respect to this particular provision.

We make it clear in our proposed guideline that it is important that organizations promote a culture that encourages commitment to compliance. We know that one of the strengths of the current seven steps is its flexibility, that we are not being prescriptive, that these are simply guidelines, and that we are well aware that should any organization choose not to do compliance, that is, in fact, their choice, that what these guidelines do is provide them with guidance as to how to do it right at some minimal level in order to have an effective compliance program.

And we, as a group, understand that in

today's environment, promoting an organizational culture that encourages a commitment to compliance is, in reality, what it takes to do compliance right, because our mandate was to make suggestions to you about effective compliance programs.

We know that the SEC has a code of ethics requirement post Sarbanes-Oxley that publicly held companies are required to do. Most privately held companies, and, again, the statistical analysis that we did showed that most of the organizations actually sentenced under the guidelines are privately held companies, but most of the -- most privately held companies do look to what the public governance standards, the public listing requirements, SEC requirements are as their baseline for how to organize.

So, in effect, our look at the SEC code of ethics requirement was helpful in coming up with this particular language and suggestion.

We also have the New York Stock Exchange corporate governance proposals. We define the role of the governing authority. Over the last 18

months, there has been much discussion about corporate governance, the role of a board, the role of the audit committee.

These are things that are happening on the regulatory front. These are things that are happening in the law. These are things that are happening with private litigation, and these are things that are happening in corporate board rooms around America.

And one of the things that we have done in our suggested language is break out a definition of the responsibilities with respect to compliance for the governing authority.

We also identify and define things with respect to corporate leadership, not the governing authority, and there is language in our proposed language defining these various roles and the linkage between these roles.

We discussed risk assessment. It is implicit in the current guidelines. Risk assessment is implicit in the current guidelines. This is not a new concept.

What we do is make it explicit. And why do we make it explicit? Because it is our understanding, after 18 months of grinding down on these issues, that this is an essential component for effective compliance. You cannot do effective compliance without having an understanding as to what your risk is. It's just common sense, and we have articulated that in our proposed language.

We have also looked at other public and private standards that are in place, and, again, the theme of synchronization is one that permeates this report, because we believe that would enhance its value to you as a Commission in terms of making the decisions that you need to make.

And risk assessment, of course, involves an ongoing review. Again, with our theme of no more paper programs, ongoing review, a risk assessment, ongoing review, and we also talk about some other concepts down the road with monitoring and auditing, in terms of an effective compliance program.

We have got a new definition. Do not be

scared by the word "new definition." This is, again, an enhancement, more focused, something that is based on ten years of experience, public input and our own discussions. It is pretty straightforward and simple.

Standards of conduct and internal control systems that are reasonably capable of reducing the likelihood of violations of law.

Monitoring auditing, and evaluation of program effectiveness. The current guidelines suggest monitoring and auditing as a possible way to implement reasonable steps to achieve compliance.

The proposed language requires monitoring and auditing to detect violations of law. Again, ten years of practical experience, synchronization with the current state of affairs in corporations around America, in particular, but organizations generally, require that in order to do compliance effectively, you've got to do the risk assessment, you've got to monitor, you've got to audit, you've got to take -- you have to be proactive, in a word, in order to do compliance effectively, and this is

simply a recognition of the reality, and we have a requirement for periodic evaluation of the program effectiveness.

Training, an important component. The current guidelines do not mandate training. There is language in the seven steps in the application notes that talk about training. We, again, solicited much public input on this area and we have burnished the training part, the training component of doing effective compliance and, in fact, require that training be done as appropriate at all levels.

This doesn't mean you bring in everyone that is impacted by a compliance program and give them the same training requirements, and this doesn't mean that despite the size of your organization, you have to follow the same model for training.

Flexibility is something that is of value in the current seven steps in the application note and it is something we have tried to capture in bringing it out into a stand-alone guideline.

The training needs to be appropriate to rules and responsibilities. You're not going to give the chair of your audit committee the same level of training as you are going to give the person who actually monitors the valves and gauges on a daily basis on the company floor, and there is a recognition in the proposal as to the appropriateness of training, dependent upon what your responsibilities and roles are in an organization.

We are also well aware that small organizations have limited resources. And so the one-size-fits-all with respect to training is made clear in the proposed language.

Smaller organizations don't need to have formal training. They can do it in the most effective way possible, and, again, this is one of those areas where you can, by extracting out the seven steps and giving it its own place and prominence as a guideline, it allowed us to use the commentary in this proposal to articulate some of these suggestions as application notes as to how

various entities could do things like training.

Reporting mechanism. This is something that is articulated in there. The proposal requires a system for a reporting mechanism, and to allow for anonymous reporting, to report or to seek guidance.

Confidentiality, and there is much discussion in the report. I won't go into it this morning. I am well aware of the clock and my apologies for going on, but I wanted to make sure that you all had some basic comprehension here as you went through the report.

But confidentiality is something that is discussed. There is substantial play in the report talking about this issue. There are legal requirements. There are issues related to the litigation dilemma.

This was something that we spent a substantial amount of time discussing and came to the language with respect to anonymity.

Again, this is also an issue that goes back to the synchronization with other things happening, because Sarbanes-Oxley does have language in there regarding whistleblowers and causes of action and all of these things that have emerged over the last 18 months that did come into our discussions with respect to a reporting mechanism.

Bottom line. Reporting mechanisms and compliance programs are important and you need to have some level of anonymity, irrespective of credibility, anonymity in order to motivate people who see things wrong, letting those who could take action take action.

I discussed the Sarbanes-Oxley Act and the whistleblower provisions. The issue of synchronization came into play in this part, and that is, in effect, the stand-alone guideline.

Cooperation, substantial assistance, and privileges. This is a topic of hot discussion currently. The input that we received both in our public hearing and from the participation of our

valued member from the Department of Justice, and the discussions that we had, led us to make the suggestions that we have made in the chapter or the part of the report.

Now, there is a whole separate section in the report discussing these issues. I think it is beginning on page 105, but essentially what our proposal for Chapter 8 recommends is adding some specific language and commentary regarding cooperation, privileges and protections, and making it clear that this is something that is not an automatic.

In the area of corporate criminal defense and prosecution, there probably is not a hotter topic right now. The report discusses the Holder memo, and we have the benefit of Eric Holder's personal insights, and the Thompson memo. We had input from both defense counsel and the Department of Justice during our public hearing with respect to the waiver of privilege and cooperation issue, and a lot of good discussion inside the group.

What we have provided to the Commission is

our suggestion in terms of clarification and commentary as to what is and is not required under the sentencing guidelines with respect to this issue, and we would expect, if the Commission does decide to promulgate a proposal based on our report, that this particular section will engender much discussion during your process.

What we have attempted to do in the report is to provide you with as much detailed, well reasoned, and diplomatically articulated language so that you have value as you engage in those discussions, and I will leave it at that.

Suffice to say this was a topic of hot discussion.

One of the things that we did not do that was considered, was suggested during the comment period, to talk about increasing culpability scores for the absence of a compliance program and it would be our recommendation, and we did this, to not make a recommendation on this.

The primary reason, again, was that there are, in Chapter 8, a number of machinations that

needed to be gone through anyway. An entity that is going to achieve credit or act in a proactive way with compliance should get the points, but we did not feel it necessary to increase the culpability score for the absence of a compliance program.

Again, this goes sort of with the theme of this is voluntary. If an entity does not want to do compliance, they don't have to do compliance.

If, in fact, they find themselves at the end of a litigation trail resulting in a sentence being imposed by a judge and they haven't done compliance, they will live with the repercussions.

If they have attempted to do compliance and if they have, looking at the proposal, the guidelines for guidance in doing compliance effectively, maybe they will not even be at the end of the trail with litigation.

And if that makes sense, that is one of the reasons why we decided that it would not make much sense to have an enhancement for the lack of a compliance program, because, quite frankly, an

organization is already in enough trouble, and it would have a disparate impact on small organizations.

Small organizations are the ones that are, more often than not, statistically, at the end of this litigation trail. They don't have the resources. Sometimes they don't have the internal knowledge.

What we have attempted to do is to provide through this enhancement some guidance for smaller organizations, maintain the flexibility, but they need that flexibility to operate their businesses and the absence of a compliance program, we believe, would have a disparate impact on smaller organizations and, hence, another reason for not having a culpability score enhancement.

Issues for further consideration. There were a lot. And I will wrap up with this to allow some time for questions of myself and hopefully the other members of the group.

There is a linkage between the issue that we had a particular mandate on, that being

effective compliance program, and other things that came up during our process.

We believe that the Commission, under its statutory powers, should consider, in an appropriate way, issues for further study. We couldn't cover it, wasn't part of our mission, but [some things] need to be looked at. The relationship of the statutory maximum fine to the fine table is an issue that we identified that needs further study. Organizational probation and the limitation at five years is an issue that we believe needs further study, as is evaluation of the loss definition.

The economic crime package that the Commission engaged in the last couple of years and some of the other things that have happened outside of the guidelines probably require the Commission to further study the loss definition, moving forward.

Training and outreach. We understand that part of the statutory responsibilities of the Commission is training and outreach to the public

about issues related to sentencing and the criminal justice system.

These are all identified in our report and we would hope that the Commission consider doing enhanced training and outreach on these issues.

And last, but not least, is the litigation dilemma. We have devoted a whole section to the litigation dilemma, and I think that this is probably an appropriate point to close out, with respect to its impact on compliance.

The reality is that compliance done well is something that takes effort. The reality is that we are a litigious society, whether it's criminal or civil.

The reality is that -- and we say this in the part of the report, the litigation dilemma is tough.

Generating internal documents, protecting your work product, exposing your organization to the collateral consequences of doing compliance right are all issues that are linked to the suggestions that we have made.

In the end, what we have suggested in the report is, in whatever way appropriate, the Sentencing Commission flag this litigation dilemma for some kind of remediation, working with other entities, such as Congress, the Executive Branch, to try and get some answers to how you get organizations to self-report, to do the right thing, to do compliance right, and not have the unintended consequences of them facing all kinds of other issues in the litigation front, and this is a tough nut to crack.

Now, we spend a lot of time in the report talking about this, not so much for purposes of making a specific recommendation to you, other than to say that we believe the Commission has the opportunity to take the lead in keeping this litigation dilemma at the forefront and working backwards through the compliance process, maybe provide some answers that will allow organizations to do compliance, to self-report, to self-police, to work with regulators and the government in remediating wrongdoing, and do so without

destroying their business.

Questions?

JUDGE MURPHY: Judge Castillo.

JUDGE CASTILLO: Yes. First of all, let me thank you and the other members of the advisory committee for your sacrifice of time, all these efforts.

I have worked in this area for a long time; in fact, in another life, was involved in the Caremark case, and I can tell you I have read cover to cover this report.

I think it is an outstanding work product that is going to assist the Commission and corporate America reach new levels of compliance.

As you know, I have gone around talking on these issues a long time, and I think that the organizational guidelines are a success, but these suggested improvements are only going to elevate, I think, the organizational guidelines to bring us more up to date with the world as we see it.

The only question I have is really with regard to this litigation dilemma. You suggest, I

think at page 130, that we use our various statutory powers to advance and further the dialogue among the branches of government, and I think I know what you're talking about, although I just want to give opportunities to any member of the group or yourself to tell me.

Are you suggesting that we publish some suggested alternatives to this litigation dilemma, the waiver issue, which is complicated and complex, and then possibly conduct a public hearing of some sort, or are you suggesting something else?

MR. JONES: Obviously, 28 U.S.C. Section 994, which you all are well aware of, has limits, and we had discussion of what can we do, what can we provide to the Sentencing Commission with respect to this litigation dilemma, and what you suggest, Judge, is exactly what our thought was, that there needs to be a forum to discuss this issue, because this is a reality with respect to compliance.

We know that there are limitations here, but, for example, and we identified this in the report, there is discussion within the Securities

and Exchange Commission about things that they can do to protect information that is provided to them in the context of their regulatory charge, and there is legislation pending on the Hill now.

I don't know if any of the other --

MS. O'SULLIVAN: The legislation is sponsored by the SEC and the SEC actually is really a mover in trying to take care of the litigation dilemma. So it may not be as difficult as it sounds, if the Federal Government is also, or at least the prosecutorial arm of the Federal Government, is interested in also resolving this in a way that would promote reporting.

JUDGE CASTILLO: Then we should keep track of these efforts and, as you suggest over and over again, synchronize with the other branches of government and make sure that our organizational guidelines do that and are, at the very least, consistent.

MS. O'SULLIVAN: I think actually -- hopefully, I'm speaking for the committee. I think this was left a little vague, but I think the

committee had the sense that it would perhaps be not so much monitoring it, but something more proactive.

In other words, that the Commission, as part of its ability to study and even propose legislation for consideration by Congress, could bring the parties together and work on the issue actively, because it really is the one unresolved issue that seriously impacts compliance.

That is something we couldn't make a recommendation on because it's not within --

JUDGE CASTILLO: You are suggesting we play more of an active leadership role.

MS. O'SULLIVAN: Yes.

MR. JONES: Yes.

JUDGE CASTILLO: Let me just end my questions by saying, again, how deeply grateful I am for your work, because you have allowed us to work in a very proactive way, which is unusual in this time and age for the Commission.

We had, under the leadership of our Chair, appointed you all to work on these issues well

before all of these corporate scandals came to pass and it is something that I am really deeply grateful for and it is something that let's us, I think, operate in the right way as opposed to always operating in reactive settings which are more difficult.

So thank you.

JUDGE MURPHY: Commissioner Horowitz.

COMMISSIONER HOROWITZ: Well, as a former member of your group, I knew it would be an outstanding work product, but this is truly an outstanding work product.

I certainly wish I had been there for the last six months of the process, when everybody got to sit around the table and agree on everything very collegially, I'm sure.

I actually wanted to ask about the privilege issue that you mentioned. I take it that the ultimate proposal is an agreed-upon proposal from all 15 members.

Secondly, in the course of looking at the privilege issue, did you undertake any effort to

gather data about when privilege is being requested to be waived by the government, what situations, waivers, are happening or are not happening?

Because I think that there has been a lot of dialogue about this issue and I have heard it both on the government side and now that I'm on the defense side, and one of the things that I sensed was always lacking was a real effort to gather data on when waivers were being asked for and when they weren't being asked for, and whether there were standards out there.

MS. BUCHANAN: This was one of the issues that was very difficult for us, because there was a large divergence between what the Department of Justice believed the practice was and what the defense bar believed the practice was.

The United States Attorneys conducted a survey. The results of the survey was that United States Attorneys said that waiver of attorney-client privilege or work product protection was requested in a very small number of cases.

On the other hand, the defense bar

contended that this is something that happens with great frequency.

The United States Attorneys have instituted various practices within our own offices. Speaking for my office, waiver of attorney-client privilege or work product protection cannot be requested without the approval of myself, the United States Attorney.

In the near future, the Department will be instituting some best practices to make sure that waiver is requested only in those situations in which it is absolutely necessary to tell the government what the criminal conduct is and who is responsible for that conduct.

We believe that the proposal set forth in this report is going to accomplish the concerns of the defense bar, as well as to make it clear that while waiver is not a prerequisite to getting cooperation or substantial assistance, then in some circumstances, it might be necessary.

JUDGE MURPHY: I've got a question that I think my colleagues have zeroed in on the area that

is a dilemma, the litigation dilemma.

But I wanted to ask about the part of the proposed amendment, the great bulk of it, which deals with compliance programs as such, and it strikes me, as somebody who has gone to a number of meetings on this, read a lot of the literature, talked with people about programs, looked at the cases and so on, that you pulled together here, you have moved it up into the guideline itself with your proposal.

You have pulled out what experience has indicated is needed to have a program that is not a paper program.

In other words, you have set something out, a roadmap, as a concept that has been used recently in many areas, a roadmap for companies and other organizations to follow.

But I'm wondering if there is -- it just looks like this is great and who could object, but with all of the expertise that you've got on your group and when you have been at this for an awful long time, for a young fellow, are there some

hidden controversies that some of the Commissioners who haven't been out in this field might be wanting to know about in that proposal?

MR. SWANSON: From my perspective, I think the perspective of the group is that the proposals that we made, just as Todd said, really do synchronize well with what best practices have come to be under the existing guidelines regime.

Really, what has happened over the last 12 years is that the guidelines framework has been out there and companies have been through organizations like the Defense Industry Initiative, of which Dick Bednar is the director, and the Ethics Officer Association, of which committee member Ed Petry is the director, developing best practices.

I think we haven't proposed anything that leading organizations aren't already doing or thinking is required.

What kind of feedback you'll get may not exactly, I think, mirror that observation, because the people who do this in-house have their own

views and sometimes they have to fight their own battles, frankly.

The budget for an ethics or compliance program compared to an advertising or marketing budget or that kind of thing is usually a small percentage. Getting heard, getting resources is difficult.

Companies may, in terms of an official position, tend to say, as they did about 12 years ago, leave well enough alone, this is fine.

But I am pretty confident that if you went and talked to the practitioners who have to fight these battles every day, they would say that what we have proposed is really on the right track.

I don't think we've done anything, suggested anything that is radical in that sense, that really, among practitioners, that they would say that's controversial.

MR. GRUNER: Let me amplify that. I think the best way to summarize what we have done is that these proposals are evolutionary, in the best sense.

We looked at the existing guidelines and saw a lot of great value there and tried to carry forward the valuable components.

We saw a few areas where there were ambiguities and we tried to clarify that language. And we saw, based on ten years of experience in the field and the other regulatory standards that have been developed in those ten years, as well as industry practice, a few areas where the guidelines omitted some key topics, and we tried to inject those topics.

But all of these changes are well grounded in experience of industry leaders, experience of regulators. So in that sense, I don't think we are extending the field dramatically in any respect. Rather, we are building on a very sound foundation.

In terms of why companies have not embraced these kinds of programs, I think there may be two answers to that. One is that there are some costs as it relates to the privilege area.

It's a little like asking a company or even an individual to be very strongly self-evaluative, to

document your worst inner features, and then potentially have those available to your enemies or those who would attack you.

It's hard for companies perhaps to do that and we do have to think about what are the implications of that outside of these programs, and I think some companies may overreact to that threat as they think about how aggressively they want to pursue these.

Ultimately, hopefully, there are enough rewards, such as the sentencing rewards that will come out of these very processes that will overcome the hesitancy of executives to embrace this very self-evaluative process.

MS. O'SULLIVAN: May I add one comment, which is we do think these are absolutely grounded. But one word that might provoke some commentary would be culture, the emphasis on encouraging a culture of compliance.

As we said, it absolutely is reflected in existing regulatory requirements that apply to at least publicly held companies and those

companies are the leadership for smaller privately held companies.

So we actually don't think it's controversial once you look at the law.

Also, people should know that this is not a word that requires judges or prosecutors to engage in a freeform analysis of whether somebody has good values or good ethics.

It is important to know that the proposal is that if you follow the seven steps that are articulated here, you will have done the minimum required both to satisfy the due diligence requirement and to satisfy this requirement that you must promote an organizational culture.

It is not a stand-alone vague requirement. It is tied specifically to the seven steps.

If people understand that, I don't think it will be at all controversial.

JUDGE MURPHY: Commissioner O'Neill.

COMMISSIONER O'NEILL: I would echo the other sentiments that have been expressed around the table about how good the work product seems and

what a solid sort of report that it was. It certainly will help us inform our decisions, because these are obviously extraordinarily complicated issues that we have to deal with that are not sort of easily resolvable, in part, because of the things like the litigation dilemma.

Any individual company that wants to engage in wrongdoing, if its corporate directors want to engage in wrongdoing, probably they are going to do it, as we have seen the past.

And similarly, because of the litigation dilemma, I would imagine, in terms of self-reporting, you've got to make a decision and you've got to decide how do you want to expose yourself to risk.

It seems to me or it strikes me, in looking at all these things, that this sort of breaks down along two specific lines, and then there are sort of the two classic lines of criminal law generally.

One is deterrence, saying are we going to have penalties that are high enough and are we

going to sufficiently inform corporate directors, accountants, people working for the organization, of what the penalties are and what their exposure to liability and risk are so that they know, and that's really sort of the classic sort of deterrence function.

Then there is this other sort of thing where once the deterrence function is sort of broken down and there has been wrongdoing, what mechanisms or incentives exist or are in place that will encourage people to then go forth and visit their local priest and confess, and it is the confession angle that is sort of troubling in terms of the litigation dilemma, because that is obviously, even as a good lawyer, a good defense lawyer, you've got to, obviously, advise your client on what kind of risk they are exposing themselves to.

What I wonder, and maybe there is no real evidence out there and maybe it hasn't been collected yet, and I understand that it is probably beyond your charter, what evidence, to the extent

that we've got evidence, even anecdotal, although I always hate to rely on anecdotal evidence, do we have either the deterrence function of the present organizational guidelines has been effective, or, secondarily, and maybe this is sort of an ongoing process, as well, because people weren't thinking about the fact that, you know, Elliott Spitzer was going to take me to task if they came and reported to the Federal Government.

They weren't thinking about state liability necessarily. But do we have any good evidence currently in terms of self-reporting and Mea culpas that have occurred under the present structure?

MR. JONES: I'll start off. I know that we had discussions during the course of our meetings about this, and that was a hard data field to capture, because what we don't have a handle on is how many organizations were not charged because they did compliance in accordance with the current application.

We do, anecdotally, and we had the benefit

of both current and former prosecutors around the table who relayed anecdotally their experiences with organizations who were not charged because they did compliance and their compliance program, in large effect, had, as its baseline, the seven steps that are in the current application, though.

But, again, what we weren't able to capture were hard numbers on who or which entities have not been charged because they had done compliance right.

MS. BUCHANAN: I think that what we found when we looked at the corporations that had been charged, the vast majority of corporations that do get charged are corporations that either don't have any compliance program or a completely ineffective paper program.

So certainly the benefit of having an effective compliance program is going to mean the difference between the corporation being charged or not, which is a significant benefit.

COMMISSIONER O'NEILL: Might it be useful for the Department of Justice, in terms -- because they

capture declination data already.

Might it be useful for the Department of Justice to also report that and keep that and report that to the EOUSA?

MS. O'SULLIVAN: That would be terrific.

COMMISSIONER O'NEILL: Because in that way -- because it seems to me, in part of this incentive struggle and getting people to self-report, to the extent that you can tell companies, look, we've got data that say that however many companies out there that self-reported, these folks, at least in terms of federal prosecution, there was a declination.

Obviously, they can be followed up to determine whether it was a state prosecution or whether it was a civil -- exposed themselves to civil or stockholder liability, as well.

MR. JONES: That is an excellent suggestion, because one of the things that we heard during the course of public commentary was how to sell this program internally with people that do compliance, sort of the standard question of why should we do this.

Well, because if something goes wrong then, fill in the blank here and you are not able to do anything other than provide them with possibilities, as compared to hard information and data.

Well, if we do this and we do it right and it is effective, it will preclude us from getting in trouble with the government, should something happen.

COMMISSIONER O'NEILL: Because it seems to me that is at least one step, maybe not a comprehensive or a complete step, in terms of encouraging the self-reporting, because right now I've got to say, I mean, it all looks pretty great, but if I'm sitting there as a corporate director and I'm thinking, gee, you know, how do I know this is even going to work, it's great to have a paper compliance program, but is it really going to be -- am I going to get any benefit out of it.

It seems like, to me, it's hard to tell somebody that.

MS. O'SULLIVAN: Also, part of our mandate

was to try and report on how these things were working, and we did run into some real data problems and there just isn't a lot of data out there.

First of all, we don't know how many companies didn't commit a crime because of it. We also didn't have -- even some people who actually do this work empirically have done studies and the data pool is so small right now. So it's hard to draw any conclusions.

But we did survey the practice literature pretty -- as thoroughly as we could, and you do get senses from that. The people really -- what was clear is that the guidelines, as they existed, have raised the visibility of the need for compliance very high.

Everybody knows about that. Whether they are effective programs or not is hard to tell, although this idea that only those with no program are really ineffective programs get charged, leads one to think there may be a fair number of effective ones out there.

So we do think they were a success in raising the visibility and we are hoping that this proposal would ensure or give companies a greater guideline in making it a truly effective program.

COMMISSIONER O'NEILL: If you have any suggestions n terms of either data that we could collect or different reporting that we ought to do or things that the Department of Justice could do that we could inform the Department of Justice, that would be great.

I can think of things, off the top of my head, but, obviously, you've looked more closely than I have.

JUDGE MURPHY: Commissioner Steer, did I see your hand before?

COMMISSIONER STEER: Yes. I think you did, although I was following the discussion as it evolved and I don't know if I can remember what I was going to ask.

Let me just -- I do remember I want to thank all of you and congratulate you on an excellent report.

Speaking of proactive, I hope that we can start that effort by making this report as widely publicly available as possible, including sending it to the committees of Congress that have been delving into these issues, both criminal and civil.

I think I wanted to ask you about the small business side of the ledger. As you know, I have had a concern about that. It has always seemed to me that we have focused a lot in the organizational guidelines, trying to push the bar forward, and we are here doing it again and I am sure I am going to be joined in favor of that.

The further we push it forward, the more difficult it is for small business to sort of catch up and for it to be a meaningful program.

I'm sure you have had discussions about that. Do you have any observations you would like to share?

MR. SWANSON: First, as you know, most of the cases involving small businesses also involve, typically involve somebody from management. It is sometimes the CEO, often the CEO who is also

involved.

So credit for compliance won't even come into play and it's not even really practically a concern.

But having said that, one of the things that we -- we did think about this quite a bit and in the commentary to the newly proposed guideline, there is a section on small businesses or small organizations which tries to make the point, which I think is absolutely fair and accurate, but small organizations can achieve compliance programs in a less formal way.

It, I think, is a correct observation, because part of what drives the need for formality is, in a large organization, you have people in command at a central location making decisions on policy and how things are going to run.

Then the organization is scattered around the country or the world. So that is sort of the separation for people making decisions from the policy and how the organization ought to run, and the people who are actually implementing the

business on a day-to-day basis is what drives the need for formality.

In a small company, the CEO, as we sort of suggest in this section of the commentary, where other members of management can walk the floor, they can talk to people, they can hold meetings with the direct reports, and pretty quickly cover the entire organization and accomplish the things that need to be accomplished in a more formal way that are captured in the seven steps.

MS. O'SULLIVAN: One additional comment. I think part of our -- this is another proactive recommendation is outreach, is just outreach to small businesses.

We tried to get a lot of comments from small businesses and contacted organizations that might have members who are interested and we couldn't get anybody to comment.

I'm just not sure that the community really knows about the guidelines.

MR. JONES: We did discuss an outreach to the Small Business Administration as one of the

possible avenues and with respect to training and education, that is something that is a suggestion that the Commission link up in a proactive way, because there is a lack of awareness with respect to Chapter 8, the sentencing guidelines, compliance programs generally, with the number of small businesses.

So when they get in trouble and they have to look at this or their attorneys do, it's like what is this chapter.

I know Richard Bednar had some comment, too, with respect to this issue.

MR. BEDNAR: Just to add a footnote in response to the question, Judge.

I'm Dick Bednar. I coordinate the Defense Industry Initiative on Business Ethics and Conduct. We've been at this since 1986.

One of the areas of our particular interest now is outreach toward our major subcontractors and suppliers, many of whom are small companies.

What we have done to encourage some

attention to the importance of compliance in those organizations is put together and published what we call a tool kit that is available online for their use. We have also published sort of an expectation.

It is not a requirement at all, but an expectation that our major subcontractors and suppliers will have programs that are commensurate, and that's the word we use, with the size of the organization and the nature of its business, very much in line with the observations that Win just expressed.

So there is some recognition of the need for doing more in this area.

JUDGE MURPHY: Judge Sessions.

JUDGE SESSIONS: I have to add my congratulations for a job incredibly well done. But more importantly, I find it absolutely stunning that you all arrived at consensus in regard to privilege and the waiver and to think that perhaps you should be going to the Middle East.

MR. JONES: It wasn't easy, Judge.

JUDGE SESSIONS: Based upon the differences of approaches. But I looked at it and it is somewhat vague, obviously, in many ways. This is driven by the local U.S. Attorney or the Justice Department.

I'm just wondering where this goes from here. I heard you say that there is going to be a memorandum coming from the Justice Department which deals with the best practices in regard to the waiver of privilege as a basis of cooperation.

Is that where this is headed? Because, if we are going to take up this issue, we need to know specifically what the Justice Department's position is.

Are we headed in that kind of direction, whether we're going to get a new memorandum?

MS. BUCHANAN: Well, Judge, I don't want to speak prematurely until the memorandum is issued. The former Deputy Attorney General Larry Thompson asked both the white collar subcommittee of the Attorney Generals Advisory Committee and the Corporate Fraud Task Force to look at this issue.

We joined forces and looked at the various practices that U.S. Attorneys had around the country to try to determine how could we have such a great divergence of opinion. How could so many Assistant U.S. Attorneys be seeking waiver if U.S. Attorneys don't know about it?

So we decided that we probably needed to educate our Assistant U.S. Attorneys about when waiver is really required and that we should institute policies within our own offices, so that we could make sure that we were seeking it in appropriate cases in accordance with the Thompson memo.

As you know, Deputy Attorney General Larry Thompson is no longer with the Justice Department and a new Deputy Attorney General, hopefully, will be appointed and confirmed soon, and, as you know, Jim Comey is going to be that person.

I think that very soon we will see the best practices come out from the Department that will cover a number of these issues, because we realized that it was a significant concern based

upon the testimony that was received at the public hearing that this committee held.

MR. JONES: There is also some linkage, Judge, to the litigation dilemma, because underlying the waiver of the protection issue from the defense standpoint is oftentimes the collateral consequences.

It is not so much that we don't -- that we, the defense bar, does not want to share the information in an effort to avoid charge or to explain the circumstances.

It is that, with the exception of the eighth circuit, there is no limited waiver. So waiver for one is waiver for all, which ties back into this bigger issue of, sure, we'd love to talk to you and let you know what our internal investigation says, but our attorneys did it an waiver -- that is not really the issue oftentimes.

It is you waive it for them, then you've got all kinds of other repercussions from civil litigants and anybody else with respect to privileges being gone.

JUDGE SESSIONS: It's an enormous complicating factor and if we are moving in a direction of having a directive come from Main Justice in particular with regard to the standards for waiver of attorney-client, waiver of work product privileges, then we sort of have to listen and wait, because obviously that is a significant contribution to the discussion, it would seem to me.

Do you agree with that?

MR. JONES: I do. I do, but I don't think that it can be looked at as the catch-all here. That would be helpful for purposes of dealing with the Department of Justice in circumstances where an organization is somehow in the spotlight for some potential misconduct.

It does not address the litigation dilemma aspect, which, again, was discussed earlier about the Commission being proactive and keeping that larger dilemma in the forefront for potential statutory -- there are all kinds of suggestions that are out there, self-evaluative privileges,

statutory privileges, waiting for the case law to emerge, whatever it is, and we articulate that.

That is why we devote a whole part of the report to the litigation dilemma. You may read that and say why is this in here, because it is an important part of doing compliance right, working backwards.

And if you work backwards from compliance to, okay, you need to self-report and you have to deal with the regulators, and so how do you make disclosures with protections, and then you take another step back and it's like you've made these disclosures and you've talked to regulators and you've done compliance.

What are the unintended consequences of that, and that is, in effect, this litigation dilemma. That oftentimes, at the back end, is what stops organizations from doing compliance right at the front end.

JUDGE MURPHY: Unfortunately, Congress has given us a very tight deadline to respond on some aspects of the sentencing guidelines and that is on

our agenda for the rest of the day.

I think it would be very interesting for us to be able to engage in more dialogue on this. It is such a professional job that you all have turned in and to have, as it has been pointed out, consensus on these issues and to give us something that we can look at and possibly on this year's agenda and, obviously, somewhere long-term issues has been extremely helpful.

I think that at the time that we had the idea about doing this, it was a variety of things that caused us to do it. There were people in the field that were making suggestions that we should look at this and that some time ago.

There was experience with Chapter 8. But who could have thought, at the time that we set up this group, that it would be the issue that so many people have been concerned about in the meantime.

I know Attorney General Ashcroft said some time ago we were ahead the curve. Congress and the Department, of course, have been working in this area as have many others.

We are going to post the group's report on our website and it will be available from the Public Information Office of the Commission.

It is hard to express our appreciation. All we can do is say thank you.

MR. JONES: One last note. We would like to thank the staff. They were invaluable throughout this process, both in hosting our meetings and providing us with logistical support, particularly toward the end and actually compiling the report and going through various edits.

The Office of General Counsel, Charles Tetzlaff, Paula Desio, Amy Schreiber, and Judy Sheon, were invaluable to our process and we wouldn't have this fine written document without their help. So we would like to thank them, as a group.

JUDGE MURPHY: We would, too. I will adjourn the formal meeting at this time.

[Whereupon, at 10:23 a.m., the meeting was concluded.]