TESTIMONY OF THE UNITED STATES DEPARTMENT OF JUSTICE

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BEFORE THE AD HOC ADVISORY GROUP
ON ORGANIZATIONAL SENTENCING GUIDELINES

UNITED STATES SENTENCING COMMISSION

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INTRODUCTION

Mr. Chairman, Members of the Advisory Group–

We thank you for the invitation and very much welcome the opportunity to appear before this Advisory Group to discuss the important issues surrounding organizational sanctions and specifically the federal organizational sentencing guidelines.

We want first to commend the Sentencing Commission for having had the foresight to convene an Advisory Group on this topic and for continuing to address the Commission's statutory responsibility to regularly review the efficacy of the sentencing guidelines. The Sentencing Reform Act recognizes that federal sentencing policy, for organizations and for individuals, must not be static; that it must develop over time and in the words of the Act, "reflect, to the extent practicable, advancement in knowledge of human behavior as it relates to the criminal justice process."

As we all are too aware from recent news, there could be no better time than now to be reviewing the organizational sentencing guidelines. Over the past year or so, we have witnessed how corporate fraud can cause wide-ranging damage to the national economy. We have seen that business crimes can involve not only corrupt individuals, but entire corporations lacking a culture of respect for the law and for the ethical rules of fair play. Most corporations foster and encourage compliance with the law, but for those rare cases where an enterprise allows corruption to exist and indeed to thrive, the organization itself must be held accountable under the law. This kind of corporate fraud -- even though committed by a relatively few bad actors -- has shaken the country's economic foundation. It has robbed employees, seniors, and families across the nation of their financial security by luring them into unsound investments. It has undermined public confidence in our financial markets by putting into question the reliability and veracity of publicly-filed corporate financial statements. And it has dramatically reduced consumer confidence.

But lest we forget, organizational crime is not a new phenomenon. Corporate crime is literally as diverse as our economy. Corporations and their employees have been prosecuted for more than a century for a diverse set of frauds, including, among others, mail fraud, wire fraud, and securities fraud. Medicare and other health care fraud amount to billions of dollars a year and have for many years. Environmental crimes have polluted our air and water from Prince William Sound to Prince George's County. At the Justice Department, we have investigated and prosecuted bid rigging and other contracting frauds that affect our national defense and impair the ability of the government to meet its responsibilities.

The dire and wide-ranging consequences of corporate and other organizational crime are why we believe the advent of the organizational sentencing guidelines some ten years ago was so significant. Obviously, corporations themselves do not commit criminal acts, their employees do. However, the organizational guidelines – and mandatory corporate criminal penalties as a whole – recognize that the policies, practices, and culture of a corporation or other organization may in a very real sense be responsible when an employee or agent of that corporation or organization commits a crime. We believe the prevention, detection, and prompt disclosure of organizational offenses by organizations themselves can and do dramatically reduce criminal behavior, and can limit the damage when crime does occur. The organizational sentencing guidelines, and complementary policies pioneered by the Antitrust Division and other components of the Justice Department, the Department of Defense, the Office of the Inspector General of the Department of Health and Human Services, and the Environmental Protection Agency, recognize this fundamental principle of organizational behavior. We believe the organizational sentencing guidelines have been a dramatic step forward in corporate criminal law and organizational management.

But as recent events have clearly demonstrated, much more work needs to be done, including greater efforts in enforcement and in incorporating best compliance practices within a greater number of organizations – including for profit, not-for-profit, and governmental. Overall, we believe the organizational sentencing guidelines as currently constituted are fundamentally sound, and our current experience does not suggest the need for wholesale change. However, we believe some limited and important changes in the organizational sentencing regime are

warranted. Further, we believe it is time for Congress to increase the maximum fine which may be assessed against organizations in order to provide greater deterrence than can be achieved through existing law.

In the remainder of this testimony, we will first address our view of corporate criminal responsibility and why we think the organizational guidelines "carrot and stick" approach is the right one. Second, we will lay out three significant ways that we believe the organizational sentencing regime can be improved. Finally, we will spell out answers to the six specific questions posed by the Advisory Group in its August 21, 2002 Federal Register publication and Request for Comment.

THE OVERALL APPROACH TO ORGANIZATIONAL CRIME REFLECTED IN THE GUIDELINES IS SOUND

The criminal prosecution of business organizations is an important weapon in the government's arsenal to seek criminal punishment for corporate crimes in appropriate cases. The organizational sentencing guidelines are based on the premise that not all organizational defendants are alike and thus not all should treated alike when something goes wrong within the organization. We wholeheartedly endorse this basic principle.

The organizational sentencing guidelines and Department of Justice policy recognize that despite every effort by company managers to prevent and uncover wrongdoing, sometimes things do go wrong within a company when an employee or agent acts criminally. If such a company is

prosecuted criminally, the guidelines appropriately mitigate the punishment if the company promptly reports the wrongdoing to authorities and fully cooperates in the investigation of the employee and company conduct.

The guidelines also recognize that sometimes corporate managers deliberately ignore wrongdoing, and in some cases, encourage or even direct the commission of crime. Importantly, crimes can include obstruction of justice for attempting to "cover up" the wrongdoing of others. For these companies, where the responsibility properly lies, at least in part, with management, organizational criminal prosecution is an important enforcement tool for at least three reasons. First, criminal prosecution can ensure that corrupt companies are held accountable. Criminal prosecution can lead, for example, to swift and full restitution for all victims. Second, criminal prosecution acts as a significant deterrent to other companies. For example, we believe the recent prosecution of Arthur Andersen LLP has likely caused other accounting firms – and firms far afield from the accounting industry – to review their policies on document retention and destruction to ensure that no criminal obstruction of justice occurs in the future. Third, criminal prosecution, together with mandatory sentencing guidelines, can create a powerful incentive for corporations to institute appropriate compliance, investigative, self-reporting, and other crime-controlling measures.

What makes the organizational guidelines really work, we believe, is the fact that they are mandatory and that therefore punishment is more predictable. Under the guidelines, sentences are clearly tied to how well a corporate defendant has undertaken compliance measures, with the

result that there are clear and strong incentives for companies to employ such policies and practices. Before the federal sentencing guidelines, a corporate manager contemplating the use of regular self-audits, for example, would be faced with an untenable dilemma – audit oneself and risk uncovering corporate liability but with no assurance that these good corporate practices would have any impact on the extent of any criminal penalty if wrongdoing were discovered. Under the guidelines, corporate managers know that effective policies and actions taken to prevent and detect criminal conduct will mitigate any corporate penalty and potentially convince the government not to prosecute the corporation itself.

It is this mandatory penalty scheme that makes the organizational guidelines such good policy. For example, when organizations act in the public interest by self-reporting, cooperating, and accepting responsibility as good corporate citizens, they are penalized less severely once the difficult decision is made that a prosecution is necessary. On the other hand, poor corporate citizens are severely punished. This penalty scheme not only provides just punishment, but also fosters appropriate organizational self-governance, including internal crime-control efforts. We strongly believe that these efforts by managers can significantly reduce the likelihood and impact of organizational crime. Full cooperation by a company, including voluntary disclosure of previously undiscovered criminal conduct, can mean that responsible individuals are held accountable, harms minimized, and victims made whole. For example, if accounting irregularities are discovered and disclosed to regulators early, damage to shareholders and markets can be minimized and those responsible brought to justice. Moreover, strong corporate compliance holds out the promise of fewer violations in the first place.

We also believe the organizational sentencing guidelines, as a regulatory scheme, strike the correct balance of specificity in encouraging compliant organizational behavior. As you know, the organizational guidelines are used to sentence very small organizations with dozens or fewer employees, global, multi-billion dollar corporations with tens of thousands of employees, and municipal entities of varying sizes. No single set of sentencing rules issued by a centralized regulatory body can correctly specify exactly what good management practices and actions should be for all shapes and sizes of organizations, nor should they in a system of free enterprise. The organizational guidelines properly set forth basic principles and lay out a model framework of the good corporate citizen, leaving it to the courts – which are best positioned to properly evaluate and judge individual organizational defendants once cases are prosecuted – to determine the level of compliance and culpability within the framework and to determine a just sentence. This system takes advantage of the organizational strengths of the Commission and the courts alike: the Commission to help institute the broad national policies set out by the executive and legislative branches and craft a national framework, and the courts to judge case-specific and organization-specific facts and craft sentences within the Commission's parameters.

ROOM FOR IMPROVEMENT: THREE WAYS FEDERAL ORGANIZATIONAL SANCTIONS CAN BE IMPROVED

Despite our admiration for the organizational guidelines and the federal organizational sanctions regime as a whole, we do believe that there are areas that can be improved. We focus here on three: (1) the maximum fine which may be assessed against an organization, (2) the length of probation, and (3) greater incentives for self-reporting.

Maximum Organization Fine. The reality of current statutory sentencing provisions, which do not envision the incarceration of an organization, is that the deterrent value of a possible maximum fine, is diminished in relation to the size of the organization. The maximum $500,000 alternative fine for an organization set forth in Section 3571 of Title 18, United States Code, may have significant deterrent value for a small corporation, but would be barely a pinprick for a multinational corporation with a net worth exceeding $500 million. While Section 3571 will authorizes a larger fine if twice the actual loss exceeds $500,000, this exception is notably ineffective in the face of non-economic crimes or crimes where loss is not readily susceptible to calculation, for example, obstruction of justice, destruction of corporate records, false statements and regulatory crimes. The sentence of Arthur Anderson to the maximum fine of $500,000 vividly illustrates the need for a higher limit for corporate fines in this situation. We hope this Advisory Group, and ultimately the Commission itself, will consider joining the Department of Justice in seeking higher statutory penalties in this area.

Length of probation. Our experience and that of many others have shown that changing a corporate culture is a very significant undertaking that often can require many years of vigilant management and oversight. While some organizations have significant employee turnover rates, which can mean a reengineered corporate culture in only a few years, other corporations require significantly more time. In several cases, we have found that the maximum available period of probation has been inadequate to bring about the needed change in corporate culture.

A prime example is the case in the Southern District of New York against Con Edison, the local utility company which was convicted of environmental reporting and false statements crimes arising out of its deliberate concealment of the release of 200 pounds of asbestos in the wake of a steam manhole explosion in Manhattan. Con Edison had a dismal corporate culture of failing to comply with the environmental laws, and was placed on three years probation to develop an effective environmental compliance program under the supervision of a court-appointed monitor. While the monitorship was extremely successful, three years was far too brief for the new compliance program to be designed, implemented, and fully effective given the entrenched corporate culture. Con Edison agreed to a court order to continue to maintain its environmental compliance program under the standards established by the sentencing guidelines for an additional period of two years and to allow the government to retain an expert or consultant to review any aspect of the program and compliance, during the second year. During those two years, Con Edison delayed too long in reporting PCBs contained in another serious spill, and the company agreed to extend its obligations for two additional years, and authorized a government consultant (the former monitor) to conduct an intensive examination of its compliance program. After seven years, the criminal supervision of Con Edison is now over.

The Con Edison case illustrates that courts should have the flexibility to impose periods of probation that are longer than five years and to extend probationary periods if the original period proves to be too brief to develop and fully implement an effective compliance program. We suggest that the Advisory Group and ultimately the Commission itself consider recommending to Congress an increase in the maximum period of probation for organizational offenders. We

recognize that it may be appropriate to have the sentencing court evaluate whether there is a continuing need for oversight before providing an extended period of probation beyond the current statutory maximum. However, providing the court with that flexibility will address what we believe is a significant problem in the current federal organizational sentencing regime.

Greater incentives for self-reporting and full cooperation. While the organizational guidelines already appropriately encourage auditing, monitoring, and self-reporting, we believe the incentive for self-reporting could be enhanced. Management and boards of directors of organizations clearly have an inherent fiduciary duty to stockholders and investors to maintain internal oversight procedures. We think the guidelines appropriately build on this. In terms of self-reporting, though, we believe stronger incentives within the guidelines are critical to achieving the overall crime-control objectives of the organizational guidelines. Specifically, we would recommend an additional two-level enhancement when a company does <u>not</u> self-report in a timely way following discovery of criminal behavior. We think that, in combination with existing guidelines provisions, such an enhancement would foster greater self-reporting.

We also believe the guidelines appropriately encourage and reward full and meaningful cooperation by permitting a corporation to reduce its punishment by lowering its culpability score if the corporation thoroughly discloses all pertinent information – specifically information that is sufficient for the government to identify the nature and extent of the offense and the individuals responsible for the criminal conduct. Cooperation, like self-reporting, reflects a decision by the corporation to clean house and begin to change what may be a bad corporate culture into a

culture of good citizenship, enables the government to gather the facts before they are stale, assists the government in fully investigating the wrongdoing and wrongdoers so it can prosecute and hold accountable those responsible for the criminal activity, and assists in minimizing victims' losses and maximizing restitution. What constitutes full and thorough cooperation will necessarily vary in every case and therefore it would be unwise, if not impossible, for the guidelines to prescribe the specifics of what constitutes cooperation. At a minimum, however, it must be recognized that if the corporation has learned precisely what has happened and who is responsible, these facts must be disclosed to the government if the corporation wants to earn credit for cooperation. How the corporation discloses the facts will vary, and the government does not require any particular method, so long as all pertinent facts are disclosed, including the identification of all culpable individuals, all relevant documents, and all witnesses with relevant information. For example, a corporation may disclose the full facts of the criminal activity in a detailed briefing, and voluntarily provide relevant documents and the results of witness interviews. Or a corporation may provide the government with a general briefing, identify the relevant witnesses and bring them in for interviews to provide the government with the detailed facts. Depending on the nature and type of disclosure, some work-product protection may have to be waived.

Several important points need to be made here, because the privilege issue has been clouded by a good deal of rhetoric. First, the government does not require a corporation to waive work product protection. It is a corporation's decision, and the corporation's alone, to seek leniency by disclosing all relevant facts to the government. This is a decision the corporation

makes in the context of trying to persuade the government to exercise its discretion not to file charges and in the context of trying to minimize punishment under the guidelines if charged. In either context, if the facts can be fully disclosed without a waiver of any privileges, Department of Justice policy does not require a waiver as a measure of full cooperation.

Another important distinction is the one between work product protection and the traditional attorney client privilege. Indeed, Department of Justice policy specifically notes that waiver of the core attorney client privilege – the advice given to clients -- will rarely be necessary when a corporation is cooperating with the government. Where, for example, employees disregard advice of counsel that a particular course of conduct would violate the law, successful prosecution of those employees may require government access to that advice of counsel. But again, such cases are the rare exception rather than the rule.

The guidelines also reward cooperation in a different manner, by permitting the government to file a motion for a downward departure when the corporation provides substantial assistance in the investigation or prosecution of another organization or an individual not affiliated with the corporation. This is the corporate equivalent of the traditional substantial assistance 5K1.1 motion for individuals, and such motions are committed to the discretion of the government, limited only by the requirement that the government act in good faith and without an unconstitutional motive. It would be unwise for the guidelines to try to prescribe under what circumstances the government should make such a motion.

In sum, the relevant cooperation guidelines properly focus on whether a corporation has cooperated, and that should remain their only focus. The guidelines should not be amended to provide that a waiver of privileges is not required in order to cooperate, precisely because in some situations the only way a corporation can cooperate, if it chooses to do so, is by waiving certain privileges.

CONCLUSION

The swift and certain punishment of financial and other organizational crimes is critical if our country, and in particular if our country's economy, is to thrive. The prosperity of the United States and all the good that flows from it are made possible by the federal, state, and local laws that bring a degree of order and predictability to commerce and protect citizens from the criminals who use a pen or a computer rather than a knife or a gun. We believe the same principles of deterrence, and fair, certain, and swift punishment that apply to street crime apply to white collar crime as well. They apply when the defendant is a business organization as they do when the defendant is an individual.

We believe the mandatory organizational guidelines have brought a level of certainty to organizational sanctions that simply was not present before the guidelines. This certainty has, in turn, brought more just punishment, led to greater restitution for victims, and fostered more ethical behavior in corporate America. But as we have indicated, recent events, if nothing else, have shown that there is room for improvement. We look forward to working with this Advisory Group, with the Sentencing Commission itself, with Congress, with other relevant federal, state,

and local agencies, with corporate America, and with other organizations both big and small to bring about greater organizational compliance and a reduction in crime.

ANSWERS TO ADVISORY GROUP QUESTIONS

1. Should the Chapter Eight Guidelines criteria for an "effective program to prevent and detect violations of law" at §8A1.2, comment 3(k)(1-7), be clarified or expanded to address the specific issues designated below? If so, how can this be done consistent with the limitations of the Commission's jurisdiction and statutory authority at 28 U.S.C. §994 et. seq.?

a. *Should § 8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2) further define what is intended by "specific individual(s) within high-level personnel of the organization" (see also, §8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"*

Answer: We think it is important that the guidelines not try to prescribe the details of appropriate corporate compliance programs. The Sentencing Commission is not in a position to accurately determine what type of programs will best serve to limit criminal activity across the range of organizations covered by the organizational guidelines. Rather, we believe each corporate compliance program ideally will be creatively tailored to the unique characteristics of each organization's individual structure and business in the context of a broad guideline framework. It is more likely that organizations will be encouraged to do more, rather than less, and to construct a successful compliance program with guidelines that more generally describe elements which could be included as part of an "effective" program.

We do believe it is critical that compliance officers have a direct reporting line to the CEO, the Board of Directors, the outside auditors, or some independent committee of the Board. This access is key, we believe, to uncovering and preventing criminal activity by high ranking corporate managers. It may be necessary as well to provide alternative reporting lines so that the compliance officer can report if the primary reporting manager is suspected of improper conduct.

We also think it may be helpful for the Commission to provide in commentary examples of effective corporate compliance structures.

b. *To what extent, if any, should Chapter Eight specifically mention the responsibility of boards of directors, committees of the board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?*

Answer: The Commission should avoid incorporating hard and fast rules regarding how meaningful oversight over a compliance program should be designed. However, it is clear that sufficient independent oversight over the compliance program is especially important where corporate officers may have committed wrongdoing, which might otherwise be successfully concealed. What is needed is a mechanism which would ensure stockholders, investors, the Board of Directors, and the Audit Committee that a compliance program not only is working, but also will continue to work even when one or more of the company's "high-level personnel" are involved in corporate wrongdoing. For this purpose, a corporate compliance program needs to provide reliable pathways for the reporting of corporate wrongdoing which bypass the alleged wrongdoers and reach members of the Board of Directors or of the "high-level personnel" group when appropriate.

To make this clear, it would be appropriate to add to Section 8A1.2, comment 3(k)(i), the following sentence relating to corporate governance in larger corporations: "A larger corporation should also have in place established corporate governance mechanisms that can effectively detect and prevent misconduct even by high-level personnel."

c. *Should modifications be made to §8A1.2, comment 3(b) (defining "high-level personnel") and '8A1.2, comment 3(c) (defining "substantial authority personnel")? Should modifications be made to §8C2.5, comments 2, 3, or 4, relating to offenses by "units" of organizations and "pervasiveness" of criminal activity?*

Answer: No. The current definitions are not ambiguous. We believe the application of these terms to specific situations will always be a fact question to be determined properly by the sentencing court. However, it would be appropriate to add to comment 3(b) a final sentence equivalent to that in comment 3(c), namely, "Whether an individual falls within this category must be determined on a case-by-case basis." In addition, as we stated above, examples may be useful within the guidelines commentary.

d. *Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?*

Answer: No. The current commentary is not ambiguous. We believe the application of this comment will always be a fact question to be determined properly by the sentencing court.

e. *Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently §8A1.2, comment 3(k)(4) provides:*

"The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required." (Emphasis added).

The use of the "e.g." can be interpreted to mean that "training programs" and "disseminating publications" are illustrative examples, rather than necessary components, of "communicating effectively." The use of "or" can be interpreted to mean that "training programs" and "disseminating publications" are alternative means for satisfying the "communicating effectively" requirement.

Should the preceding language be clarified to make clear that both training and other methods of communications are necessary components of "an effective" program? *If so, should the term "disseminating publications" be replaced by more flexible language such as "other forms of communications?"*

Answer: The language should be clarified to make clear that "training" <u>and</u> "other methods of communications" are necessary components of "an effective" program by changing the "or" to an "and." However further modifications to permit broader flexibility in designing the components of "an effective" program should be adopted with care so as not to permit elimination of written communications. For example, if the guidelines were to replace "disseminating publications" with the phrase "other forms of communications", organizations would no longer necessarily provide written materials to employees which could be readily referenced as questions arose. Rather any "form of communication" would suffice, potentially leaving compliance with organization standards to random conversations with supervisors, or the memory of an employee.

Instead, the operative language should be revised to permit supplementing, but not replacing "disseminating publications" with "other forms of communications. We also would encourage an amendment that would even more strongly discourage passive compliance programs; for example, those that consist of nothing more than generating a compliance manual that, while disseminated, then sits unread on employees' desks and plays no meaningful role in the corporation's activities. Accordingly, we would suggest that the commentary be amended to read: "The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents. What steps are necessary to accomplish this

must be determined on a case by case basis. At a minimum, however, the organization should have disseminated publications that explain in a practical manner what is required and followed up with training programs and other forms of communications to ensure that the need to comply with those requirements is understood. An organization's implementation of a strictly passive compliance program will not satisfy this requirement. For example, mere periodic dissemination of publications, without training or additional steps to ensure compliance with the requirements set forth in those publications, will not constitute effective communication of standards and procedures."

f. *Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage:*

> i. *whistleblowing protections;*
> ii. *a privilege or policy for good faith self-assessment and corrective action e.g., 15 U.S.C. §1691(c)(1) (1998));*
> iii. *the creation of a neutral or ombudsman office for confidential reporting; or,*
> iv. *some other means of encouraging reporting without fear of retribution?*

Answer: The inclusion of internal whistleblower protections is an important measure of an organization's commitment to have an "effective program." Similarly, the creation of an ombudsman or similar neutral office may also be an important measure (although, as we stated above, we think the guidelines should not dictate specifics), as would creation of other means of encouraging reporting without fear of retribution. Such "other means" could include a mechanism to *confidentially* report to the Board of Directors, or the Board Audit Committee where appropriate, without fear of retaliation. However, the guidelines should not incorporate any provisions which would encourage employees or organizations to think internal self assessment and correction would be subject to a privilege, since such a privilege may not exist in law.

g. *Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?*

Answer: Yes. It is critically important to regularly audit compliance programs to ensure that they are working effectively and to identify which aspects of the program may need to be modified.

h. *Should §8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, e.g., should there be credit given to organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected in rewards and compensation?*

Answer: No. This would involve the Commission in the details of organization functions which we do not believe would be appropriate.

2. *While the Chapter Eight Guidelines currently provide a three-level decrease in the culpability score of organizations that are found to have implemented an "effective program to prevent and detect violations of law" (at §8C2.5(f)), should this provision be amended to provide an increase for organizations that have made no efforts to implement such a program? If so, what is the appropriate magnitude of such an increase?*

Answer: We recommend against a blanket rule for organizations of all sizes requiring an increase in the culpability score for failure to implement an "effective program to prevent and detect violations of law". The existing guideline incentive is sufficient to encourage small companies to implement meaningful programs.

We do recognize that the extent of an effective compliance program will be dependent, at least in part, on the size of the organization, and we believe that additional commentary may be needed on this issue. We also believe that for large publicly-traded corporations the absence of any compliance program will signal a significant deviation from recognized practice and thus justifies an increase in the guideline offense level.

Rather than amending the Guideline, the Advisory Group might consider adding an Application Note to U.S.S.G. § 8C2.5(f)'s Commentary stating that the failure to have an effective program to prevent and detect violations of law could be weighed against larger organizations as evidence that "an individual within high-level personnel of the organization . . . condoned, or was willfully ignorant" of the criminal conduct. See U.S.S.G. § 8C2.5(b)(1)(A)(i).

3. *How can the Chapter Eight Guidelines encourage auditing, monitoring, and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?*

Answer: As a practical matter, self-reporters will always bear the risk of third-party litigation or action by government enforcement personnel. This dilemma, however, cannot be resolved by changes to the organizational guidelines. The Chapter Eight

guidelines already appropriately encourage auditing, monitoring, and self-reporting. Beyond that, management and boards of directors of organizations have an inherent fiduciary duty to stockholders and investors to undertake such prophylactic activities. In addition, Congress included a new whistleblower provision in the Sarbanes-Oxley Act of 2002 which was directed to the protection of those who report suspected misconduct and potential illegalities through the enactment of a new criminal offense for retaliating against whistleblowers, 18 U.S.C. §1514A.

Notwithstanding existing law, we believe current incentives in the guidelines to self-report could be improved. Specifically, we would recommend an additional two-level enhancement when a company does not self-report in a timely way following discovery of criminal behavior. Self-reporting allows law enforcement and regulators to begin an investigation before evidence is stale, minimizes victim losses, conserves funds for restitution, and starts the corporation on the road to correcting corporate culture. It should be strongly encouraged.

4. *Are different considerations or obstacles faced by small and medium-sized organizations in designing, implementing and enforcing effective programs to prevent and detect violations of law? If so, does §8A1.2, comment (k)(7)(I) adequately address them? If not, how can Chapter Eight better address any unique concerns and obstacles faced by small and medium-sized organizations? What size organization requires unique/special treatment (e.g., 50 employees, 200, 1000, 5000)?*

Answer: The guidelines, in §8A1.2, comment (k)(7)(I), adequately provide sufficient leeway to sentencing courts in considering whether to reduce the culpability score of an organization and whether to differentiate between the nature of an effective program required of different organizations depending on their size. An attempt to prescribe the nature of the compliance programs required of organizations falling within specific size ranges would involve the Commission in a consideration of the details of corporate organization, size, and function. Adoption of this approach would require the sentencing court to conduct time-consuming fact-finding to establish with specificity which category each organization fits into.

a. *How frequently do small and medium-sized organizations implement "effective programs[s] to prevent and detect violations of law" within the meaning of Chapter Eight of the Sentencing Guidelines? If the frequency is low, to what factors is this attributable, and how may Chapter Eight be modified to promote increased awareness and implementation of effective compliance programs among small and medium-sized organizations?*

Answer: Our experience shows that the small and medium sized organizations, which are prosecuted, rarely have an effective compliance program or even any compliance program at all. We believe the guidelines can have some impact on this

but that to promote enhanced implementation of effective compliance programs is something far beyond what the guidelines themselves can accomplish. A concerted effort by the corporate community, and especially the small business community, would certainly help in this regard.

b. *According to §8C2.5(f), if an individual within high-level personnel or with substantial authority "participated in, condoned, or was willfully ignorant" of the offense, there is a rebuttable presumption that the organization did not have an effective program to prevent and detect violations. Does the rebuttable presumption in §8C2.5(f), for practical purposes, exclude compliance programs in small and medium-sized organizations from receiving sentencing consideration? If so, is that result good policy and why?*

Answer: If an organization were small, many, if not all, within the organization would likely fall under the umbrella of the category "high-level personnel" and therefore the rebuttable assumption applied to the broader category of "substantial authority personnel" in §8C2.5(f) would not be relevant in these cases. Also, the smaller the organization the less likely it will have a formal "effective program."

c. *In addition to the rebuttable presumption in §8C2.5(f), §8C2.5(b) also provides an increase in the culpability score (from 1 to 5 points) where an individual within high-level personnel or with substantial authority participated in, condoned, was willfully ignorant or tolerant of the offense. Is that good policy and why?*

Answer: A major thrust of congressional action on corporate malfeasance this year has been to increase the accountability of corporate officers and managers. The increase in culpability score in §8C2.5(b) surely would be considered good policy. Eliminating this enhancement would send exactly the wrong signal in the face of the wave of corporate officer malfeasance which is still under intense investigation. We believe the entire structure of §8C2.5 should be left intact.

d. *Should the rebuttable presumption in §8C2.5(f) continue to apply to large organizations and if so, why?*

Answer: Yes. This provision has not proved problematic and provides important flexibility to the sentencing court to ascertain whether the criminal conduct occurred despite the good faith efforts to detect and prevent such activity. Unfortunately, not every variation on every criminal scheme can be anticipated. And if the rebuttable presumption were repealed, then the corporation would never reap the sentencing benefit of implementing an

"effective program" whenever "high-level personnel" were involved. This would be extremely counter-productive and would discourage organizations from retaining "effective programs." Repealing this provision would defeat the prophylactic purpose of this provision.

5. *Should the provision for "cooperation" at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?*

Answer: **Neither the provision for "cooperation" pursuant to § 8C2.5, Application Note 12, nor the policy statement relating to downward departure for substantial assistance pursuant to § 8C4.1 should be revised to state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in culpability score or as predicate to a substantial assistance motion by the government. The issues under these particular guidelines are whether a corporation has fully and thoroughly cooperated, or rendered substantial assistance to an investigation or prosecution. The very ability of a corporation to cooperate or render substantial assistance may well depend on whether the organization waives its legal privileges, and such a waiver may also be an important measure of the significance and usefulness of cooperation or assistance.**

Indeed, with respect to "cooperation" as discussed in § 8C2.5, Application Note 12, full cooperation may well necessitate a waiver of an organization's attorney client privilege and/or attorney work product protection. For example, if an organization uncovers criminal conduct during counsel-conducted internal investigation interviews, then, in order to cooperate, the organization may need to waive the attorney client privilege and/or attorney work product protection and provide the privileged interviews or their factual content to the government because such interviews would certainly be "pertinent information known to the organization." § 8C2.5, Application Note 12.

With respect to downward departures based on substantial assistance pursuant to U.S.S.G. § 8C4.1, it is important to remember that the decision whether to move for such a departure is reserved to the prosecutor. The prosecutor may determine that waiver of an organization's attorney client privilege and/or attorney work product protection is necessary to earn such a departure motion. For example, if counsel's internal investigation interviews uncover criminal conduct involving another corporation or an unaffiliated individual, then the organization, in order to merit a substantial assistance motion may well have to waive the attorney client privilege

and/or attorney work product protection and provide those privileged interviews or their factual content to the government.

It is important to note that in both of the above examples, the government would not be seeking waiver of the attorney client privilege with respect to the advice that counsel gave the organization. Rather, the waiver would only encompass the information found by counsel during counsel's internal investigation.

Finally, organizations already have many guidelines and non-guidelines incentives to self-report. If additional Chapter Eight incentives are needed to encourage greater self-reporting and cooperation, those incentives should be in the form of a stick, not a carrot – a stick that increases the penalties for organizations that knowingly fail to self-report.

6. *Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?*

Answer: Yes. Such is the purpose of offering a reduction in the culpability score of organizations that have an "effective program" in place. However, much of the behavior of organizations is overseen by regulatory bodies such as the Securities and Exchange Commission and the Financial Accounting Standards Board, which traditionally have the primary jurisdiction to require compliance with the intent of regulatory schemes rather than mere technical compliance. The use of the criminal laws, and by association, the guidelines, to implement such a "culture" is problematic where due process requires that a criminal statute be sufficiently specific in stating the proscribed illegal conduct. The guidelines should not get involved in the minutiae of this exercise which would likely require different approaches, for example, for organizations in different industries and service sectors of the economy.