

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

BREAKOUT SESSION I

LEADERSHIP, ACCOUNTABILITY AND CORPORATE GOVERNANCE

November 14, 2002

1:30 p.m. to 4:00 p.m.

Held at:

Thurgood Marshall Building

One Columbus Circle, N.E.

Judicial Conference Center

Washington, D.C. 20002

1 MODERATOR

2 RON JAMES

3 IN ATTENDANCE

4 ED PETRY

5 JANE NANGLE

6 GRETCHEN WINTER

7 JAMIE CONRAD

8 FRANK DALY

9 DAVID GREENBERG

10 JOSH HOCHBERG

11 BOB OLSON

12 PAT HARNED

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1 B-R-E-A-K-O-U-T S-E-S-S-I-O-N

2 MR. JAMES: My name is Ron James. I
3 am a member of the Advisory Group to the United
4 States Sentencing Commission.

5 Let me welcome you, and on behalf of
6 my colleagues, Ed Petry and Jane Nangle. We're
7 really glad that you could take time away from
8 busy schedules to be with us.

9 A brief moment about the proceedings
10 for the day first for those of you that weren't
11 able to be here for the full morning session.
12 And then I'd like to do some quick introductions
13 and handle a couple of logistics.

14 This afternoon's session follows this
15 morning's session. It was more formal; we had
16 two plenary breakout groups. Those groups each
17 spoke and the Advisory Group members had a chance
18 to ask them questions to clarify positions and
19 see direction.

20 This afternoon's sessions are in four
21 different breakout groups. This one is focused

1 primarily on leadership, accountability and
2 governance and also looking at ethical culture.
3 One of the things we'd like to do this afternoon
4 though is create an opportunity to go perhaps a
5 little deeper than we have this morning in
6 discussion. We have two-and-a-half hours, and so
7 the way we'd like to proceed is ask each of the
8 panel members to take about 10 minutes or so, 10
9 to 15 minutes and review your position -- in a
10 lot of cases you've submitted your testimony.
11 You can follow that and share it with us so that
12 we'll understand exactly what the issues are from
13 your perspective. We will walk through each of
14 the panelists so that we've had a chance to hear
15 from each of you, and then we're going to open it
16 up and have just some free-flowing dialogue.

17 I think you, as panelists, should feel
18 free to ask questions of each other; we'll feel
19 free to ask questions of you as well. In
20 addition, we have some people that have also
21 joined us that may not necessarily be on the

1 panel, but you're free to ask questions and
2 engage in the dialogue as well.

3 Again, we'll try and move it along and
4 keep it interactive. Both Ed and Jane and I, the
5 attempt is for us to listen. We will ask
6 questions, but typically it's to clarify to make
7 sure we're clear on positions so that we can put
8 together an analysis that helps inform the rest
9 of the Advisory Group as we get toward making
10 some decisions about what to recommend back to
11 the United States Sentencing Commission.

12 That will be our flow for this
13 afternoon. Our plan is to go to 4:00 p.m.; we
14 will be adjourning at that particular time.

15 Now, in terms of your presentations,
16 with one exception, you will be representing your
17 positions. However, Gretchen, I understand
18 that you will be representing your views with
19 Baxter International, and you will also have an
20 additional position from your role in working with
21 the Ethics Officer Association Board of Directors.

1 and some testimony as well.

2 And so we'll welcome that. The only
3 thing we would ask is please make sure we know
4 which hat you're wearing. Just identify whether
5 or not it's the EOA position that you're
6 representing at the appropriate time, or whether
7 or not you're representing the Baxter position.

8 Okay. We might, if we could take a
9 moment, I'd like to just walk around and do some
10 introductions. While we'll run this session
11 informally, you should be aware we've got a court
12 reporter here who will be documenting the session
13 so that we can use it in our deliberations later.

14 The first time at least that you start
15 talking, we're going to ask that you introduce
16 yourself and give your name so that we've got
17 that on the record, and then Geoff will be pretty
18 good about keeping track. For the participants
19 that are in the back of the room because you are
20 at his back, we'll ask you to introduce
21 yourselves. And you may have to move up towards

1 the table if you have a question because the
2 microphones are actually on the table, and we'll
3 be glad to respond to those.

4 Okay. With that, let's just do a
5 quick round-up of introductions and then we'll
6 begin.

7 Gretchen, you want to start please.

8 MS. WINTER: Sure. I'm Gretchen
9 Winter, I'm Vice President and Counsel for
10 Business Practices with Baxter International.

11 MR. CONRAD: I'm Jamie Conrad, and I'm
12 of counsel with the American Chemistry Council
13 which was formerly known as the Chemical
14 Manufacturers Association. It's a trade
15 association for chemical companies.

16 MR. DALY: Frank Daly, I'm the
17 Corporate Director of Ethics and Business Conduct
18 for Northrup Grumman Corporation.

19 MR. GREENBERG: I'm David Greenberg,
20 Senior Vice President and Chief Compliance
21 Officer for the Philip Morris Companies.

1 MR. HOCHBERG: Josh Hochberg, I'm with
2 the Department of Justice. I'm Chief of the
3 Fraud Section in the Criminal Division.

4 MR. OLSON: I'm Bob Olson, with
5 Alliance for Health Care Integrity.

6 MS. RYAN: I'm Pat Harned, the
7 Managing Director for Programs for the Ethics
8 Resource Center.

9 MR. JAMES: Okay. Well, to begin, as
10 you know, this group is focused in really three
11 areas and it's about the role of leadership in
12 insuring; that there's an effective compliance
13 program, number one; number two, what the role of
14 the Board, if any, in ensuring that there's an
15 effective compliance program; and then thirdly,
16 we want to delve into the subject of ethical
17 culture, does it make a difference in building
18 effective compliance programs.

19 Those were questions 1A and B and
20 Question 6 in the document that you were sent.
21 We'll follow the line up in the agenda, but Jamie

1 if you would start, and I know that you did give
2 us an overview this morning, but there's some
3 people that may not have been here, so we're
4 going to ask you to repeat the key elements of
5 your testimony, please.

6 MR. CONRAD: All right. I thought
7 though what I would do, if that was amenable, was
8 to sort of zoom in on the part of it that really
9 bears on corporate governance. And really as I
10 kind of dug into that what it came down to for me
11 was surveying the relevant elements of the
12 Sarbanes/Oxley Act, and relevant New York Stock
13 Change or NASDAC proposed, or final rules that
14 either pre-dated or post-dated, but which bear on
15 the same subject matter.

16 And if everyone is very familiar with
17 those, then we can stop and we could go to the
18 next speaker because that's really what I'm
19 prepared to talk about, I guess, if that's
20 amenable.

21 MR. JAMES: I think you should go

1 ahead.

2 MR. CONRAD: Okay. It seemed as I
3 looked through the list of questions that the
4 Commission -- that the advisors had asked there
5 were really four -- I guess you've really focused
6 on the two aspects of question one, which is
7 basically whether the guidelines ought to
8 articulate the responsibilities of the CEO or the
9 CFO or other high level overseers in terms of
10 their overall responsibility for overseeing
11 compliance.

12 That's question 1A. And then question
13 B whether the guidelines -- whether Chapter 8
14 generally should mention the responsibilities of
15 the board or committees of the board, or
16 equivalent, in terms of overseeing compliance
17 programs and supervising senior management's
18 compliance with the same.

19 There are two other questions that
20 while they're not on the -- they're not in the
21 section that was assigned to this group, they're

1 in this Statute and they relate and I may, if I
2 may, talk a little bit about those.

3 There was question 1F which has to do
4 with whistleblowing, and then Question 6 which is
5 about encouraging organizations to foster ethical
6 cultures, to ensure compliance with the intent of
7 regulatory schemes as opposed to mere technical
8 compliance, because these concepts are very much
9 inviting this legislation as well. And if I may,
10 I thought I would talk about those as well.

11 And it's actually this concept of
12 ethical cultures that I find most prevalent in both
13 the Sarbanes/Oxley and in the actions of the
14 self-regulatory organizations. Sarbanes/Oxley in
15 Section 406 required a Code of Ethics for senior
16 financial officers which are basically the chief
17 financial officer and -- the CFO or his
18 equivalent and the comptroller, the chief
19 accounting officer or his equivalent. And what
20 actually -- what that section of course actually
21 requires is not that they just have to have one;

1 it rather interestingly says that they have to
2 disclose in their periodic reports of 10Ks and
3 10Qs whether they have one, and if they don't,
4 why they don't have one. Sort of an interesting
5 way of -- the information disclosure way of
6 regulation.

7 And then in addition to disclosing
8 whether or not they have such a code they also
9 have to disclose immediately by electronic means,
10 website or other electronic means, any change in
11 the code or any waiver of the code with respect
12 to anyone. That's got to be disclosed
13 immediately.

14 And then this section of the bill also
15 describes what the elements of a Code of Ethics
16 are that meets the requirements of the Statute,
17 and those are such standards as are reasonably
18 necessary to promote honest and ethical conduct,
19 including the ethical handling of actual or
20 apparent conflicts of interest between personal
21 and professional relationships, full fair

1 accurate, timely and understandable disclosure in
2 the periodic reports required to be filed by the
3 issuer.

4 And disclosure of course includes
5 under the SEC rules compliance matters under reg
6 SK, Section 101 and 103. And then specifically
7 the Code of Ethics has to refer to -- has to
8 include compliance with applicable governmental
9 rules and regulations.

10 This section of the Statute is to be
11 implemented by SEC regulations. Those I think
12 have already been proposed and are due to be
13 final on January 26th. So we really don't know
14 the full requirements of those regulations until
15 late January.

16 One of the things I think is most
17 interesting about this from talking to my former
18 colleagues in the corporate legal world is while
19 the Code of Ethics speaks -- the Code of Ethics
20 was chief for senior financial officials. In
21 fact there's not a lot about what those folks do

1 that is just unique to them, and it's somewhat
2 artificial to sort of high hawk their ethical
3 requirements from those of other corporate
4 officers.

5 And so the recommendation at least of
6 my former Wall Street law firm, but also I think
7 of other counsels, in general it makes sense to
8 have a single corporate Code of Ethics, and this
9 enactment, while it's restricted to senior
10 financial officers is likely to lead to the
11 creation or the updating of corporate codes of
12 ethics across the board.

13 So that's the first piece of this
14 Statute and it also happens to be kind of
15 complemented by initiatives of both the New York
16 Stock Exchange for securities -- Sarbanes/Oxley
17 of course is for publicly traded companies of all
18 sorts. The Stock Exchange is for companies
19 listed on the Stock Exchange and NASDAQ for
20 companies listed on the NASDAQ. The New York
21 Stock Exchange has -- and I called it -- I'm not

1 sure if they're existing -- I think they're
2 existing rules that require governance
3 guidelines, a code of business conduct and
4 ethics, and key committee charters to be phased
5 in over -- these requirements to be phased in
6 over a six-month period. And the code of
7 business conduct -- and this is not just for
8 financial officers. This is for corporate
9 management across the board -- the code of
10 business conduct must address at a minimum
11 conflict of interest, corporate opportunities,
12 confidentiality, legal compliance, fair dealing
13 in reporting of illegal and unethical behavior.
14 So you can put the whistleblower concept in there
15 as well.

16 I believe actually that that is final
17 from the Stock Exchange and is actually being
18 reviewed by the SEC now.

19 For its part the NASDAQ similarly has
20 I believe a proposed rule that requires its
21 companies registered on it to adopt a code of

1 conduct that addresses at least conflict of
2 interest and legal compliance and establishes
3 compliance.

4 So you have, between Sarbanes/Oxley
5 and the two principle exchanges, three different
6 somewhat overlapping provisions affecting ethical
7 cultures as well as the responsibilities of
8 senior management pending and likely to be final
9 within a period of about maybe three or more
10 months.

11 The second one that I wanted to turn
12 to is, and this does relate specifically to the
13 question before this panel, is whether Chapter 8
14 should -- 1B -- whether a Chapter 8 should spell
15 out the responsibilities of the board or
16 committees of the board or their equivalents in
17 terms of overseeing compliance programs and
18 supervising compliance with those, and with
19 respect to that, Section 301 of the
20 Sarbanes/Oxley Act requires all public trading
21 companies to have audit committees. And if they

1 don't have an audit committee, then the board
2 becomes the audit committee for purposes of this
3 enactment. And the Statute sets out requirements
4 for -- for one thing requires the audit
5 committee, or the entire board if there isn't an
6 audit committee, to be independent and to
7 establish among other things procedures for the
8 receipt, retention and treatment of complaints
9 received by the issuer regarding internal
10 accounting controls or auditing matters. And for
11 the confidential, anonymous submission by
12 employees of the issuer of concerns regarding
13 questionable accounting or auditing matters.

14 So there are requirements within --
15 and this is to be implemented either by SEC
16 regulations -- or either directly by SEC
17 regulations or by the SEC's adoption of rules
18 adopted by the Stock Exchange and NASDAQ. And
19 the way the securities laws tend to work in many
20 cases that the requirements are established by
21 these self-regulatory organizations and then the

1 SEC adopts them and makes them the law of the
2 land if you will.

3 Those regulations are not due to be
4 promulgated finally until April 26th. So some of
5 the things again that the Advisory Group is
6 looking at are a good almost six months out in
7 terms of what their final shake will look like.

8 Again, there is a requirement within
9 the New York Stock Exchange, similar subject
10 matter, there's a requirement right now that's
11 actually required that the audit committee have a
12 written charter and some of the provisions of
13 that include that the committee assist in board
14 oversight of the company's compliance with legal
15 and regulatory requirements. On Stock Exchange
16 listed companies there are I believe now already
17 effective Stock Exchange rules that require the
18 audit committee to be supervising legal and
19 regulatory requirements, which sets up an
20 interesting question if one were to adopt the
21 recommendation of one of this morning's speakers,

1 that because really the audit committee is pretty
2 busy and we ought to make sure some other
3 committee has that responsibility.

4 Well, if it's a Stock Exchange listed
5 company, they don't have that choice. I mean
6 those two committees would have to be the same
7 committee if that were permissible, and maybe it
8 wouldn't be the way the guidelines would work
9 out.

10 The third matter I wanted to talk
11 about today, also on the purview of this group,
12 are the responsibilities of in Question 1A and
13 that's the responsibilities of the CEO and the
14 CFO, or other high level corporate managers, and
15 whether it should articulate particular
16 responsibilities of these individuals for
17 overseeing compliance. And this may be the -- if
18 you know one thing about Sarbanes/Oxley, and what
19 you tend to hear is that it requires the CEO and
20 the CFO to file certifications -- to assign
21 certifications every quarter with each 10Q, and

1 then annually with the 10K, essentially attesting
2 personally to the validity -- to the correctness
3 and adequacy of those disclosures. And to some
4 extent they're not even qualified by (Inaudible)
5 and in one case not even qualified by a knowledge
6 provision, which is kind of -- there are actually
7 two, one in Section 302 which is to be
8 implemented by SEC regulations that are already
9 have been made final, and the other is section
10 906 which is self-implementing and which, unlike
11 302, doesn't have any statement about to the best
12 of his knowledge.

13 But in either case these
14 certifications require the CEO and the CFO to
15 state that the disclosures fairly present in all
16 material respects the financial conditions and
17 result of the operations of the issuer. Under
18 the SEC rules the financial condition of the
19 company, and subsumed within that the legal
20 compliance issues, and as I mentioned before reg
21 SK, Sections 101 and 103, and then the separate

1 piece of reg SK which is Section 303, and I think
2 has to do with management's discussion and
3 analysis of the business, require the financial
4 to contain discussion of certain legal and
5 compliance matters.

6 And so through the action of this
7 statute, there is both immediately effective and
8 under regulations requirements for the senior
9 management to be evaluating personally the legal
10 status of -- the status of important legal
11 compliance matters, and to be certifying at the
12 pain of tremendous significant criminal
13 liability, the completeness of the discussion of
14 those things.

15 So that seems to be driving a certain
16 amount of attention by senior management to
17 compliance matters.

18 MR. JAMES: Jamie, pardon for the
19 interruption, but you're down to about two
20 minutes of your 15 minutes, so I'm going to ask
21 you --

1 MR. CONRAD: Well, I only have about
2 two minutes left.

3 MR. JAMES: So I'm going to ask you to
4 wrap up, but then you'll have a chance in the "Q"
5 and "A" to engage more if you'd like.

6 MR. CONRAD: Sure. The last part I
7 was going to cover is whistleblowing, and that's
8 question 1F, and whether whistle-blower
9 provisions should be made more specific.

10 Recognizing there's already language
11 in the comments of 325 about whistleblowing,
12 Sarbanes/Oxley has two provisions regarding
13 whistleblowing. Section 806 provides for a civil
14 action by whistleblowers against their employers
15 if reprisals are taken against them for having
16 blown the whistle on the company. And as I
17 believe is administered by the Labor Department
18 administratively, and then is a district court
19 civil action.

20 Section 1107 makes it a crime if the
21 reprisal against a whistleblower is knowing. So

1 there's at least two statutory provisions now
2 about whistleblowers as well as I mentioned
3 before, the provision for the audit committee
4 requires for its receipt of whistleblowing kinds
5 of complaint of notices from employees.

6 So that's the sort of survey that I
7 could find of provisions in pending law and
8 regulations, all of which seem to bear on a lot
9 of the questions that were asked.

10 It's probably my guess that none of
11 those things really have happened, so my general
12 kind of recommendation is, and this will be my
13 concluding thought, these things are all relative
14 to the guidelines in two ways. One is they are
15 or will all become positive law. Then the
16 issuers will have to comply with these things.
17 It's not a matter of oh, and by the way you ought
18 to do these things because that way you'll get a
19 lower sentence if you get convicted of something.
20 You have to do them because they're the law.

21 Secondly, because they're the law,

1 they will become, as it were, sort of
2 incorporated by reference or picked up in the
3 existing guidelines, the provisions that are
4 within the guidelines now regarding effective
5 compliance systems. Those effective compliance
6 systems will now have to include effective
7 systems to ensure compliance with these
8 requirements, which I guess includes having
9 compliance with them to make sure you have a
10 compliance system. But that is the law now.

11 MR. JAMES: Thank you, very much,
12 Jamie. We're going to keep working down the
13 list, so Frank Daly, if you would go next,
14 please.

15 MR. DALY: Yeah, my name is Frank Daly
16 and I'm the Corporate Director of Ethics and
17 Business Conduct at Northrup Grumman, and the
18 immediate Past Chairman of the Board of the
19 Ethics Officer Association. I also serve on the
20 working group for the Defense Industry Initiatives
21 and have been involved as a business ethics

1 practitioner since 1986.

2 Like Alan Yuspeh and Bill Lytton, this
3 morning Northrup Grumman knows and supports the
4 fact that I'm here, but I'm not the spokesman for
5 the company. I'm working from my own background
6 as a practitioner, which in essence has taken
7 place for the last 16 years at Northrup Grumman.

8 I'd like to direct some remarks in
9 response to Question 6. And the way it's stated,
10 should Chapter 8 of the sentencing guidelines
11 encourage organizations to foster ethical
12 cultures to ensure compliance with the intent of
13 regulatory as opposed to technical compliance that
14 can potentially circumvent the purpose of law or
15 regulation.

16 And I certainly think that they should
17 do that, and I think there are loads of examples
18 of companies out there, 200 companies for
19 example, are members of the EOA and I'm happy to
20 see that Sarbanes/Oxley and others are beginning
21 to catch up with best practices that have been in

1 place for actually quite a number of years.

2 But the question says, it seems to me
3 and I'm not sure whether it's simply literally or
4 actually, fostering ethical cultures in
5 opposition to technical compliance. And when you
6 hear a discussion, frequently you hear that this
7 difference is made. Well, there's compliance and
8 then there's ethics.

9 It was interesting, Bill Lytton and
10 one of the things that he said this morning was
11 that they have to be in his internal and external
12 complement in the program. And in the internal
13 part he talked about making judgments about
14 whether you have good people, whether you've
15 hired good people and whether you have in place
16 the things that will enable people to continue to
17 be good people, while at the same time of course
18 is the value of sanctions. It's kind of like the
19 go to heaven go to hell thing, we'd like you to
20 do the right thing because we want you to go to
21 heaven, but in case you can't be convinced by

1 that, remember there are things that will help
2 you go to hell if you don't.

3 So I think that rules and values
4 basically have to be allied in this, and I think
5 there are some people who don't see that to be
6 the case.

7 Business ethics trends is often
8 defined by a description of two main components,
9 namely, values of the ethical environment on the
10 one hand, and compliance with laws and
11 regulations on the other. The difference can be
12 described in terms of that between rules-based
13 and values-based programs.

14 But a discussion between these two
15 elements has focused largely on the fact that
16 they are divergent, when in fact they are not
17 divergent. They're really working in the same
18 direction and the dichotomy I believe is
19 artificial.

20 Now, how that's borne out in actual
21 practice, for example, is if you take the word

1 like a code of conduct. I'm not an attorney, and
2 I don't say that as a disclaimer just as a
3 description, but attorneys generally take a code
4 of conduct in the sense of the Sarbanes/Oxley, or
5 the Code of Federal Regulations, or the
6 California Code, etcetera. Practitioners and
7 employees take -- in other words, a legal
8 document. Practitioners and employees, though it
9 may be a misnomer, on the other hand take the
10 code to be a communication document which talks
11 to people about the values of the corporation and
12 the broad categories of behavior that they must
13 in fact act within, and refers them to the
14 policies and procedures of the corporation which
15 is really to codify (inaudible) --

16 So even when we talk about something
17 such as that, when we talk for instance about a
18 hotline, a hotline is frequently talked by people
19 who have solely a narrower compliance view as a
20 hotline, namely it's for reporting violations.

21 The best practices in companies who've

1 been doing it now for -- some of them as many as
2 15 or 16 years -- uses other language like help
3 line or open line that invites people to rise
4 things up.

5 So for instance we call it open line
6 at Northrup Grumman. Twenty to 25 percent of our
7 calls are questions. That has a prophylactic
8 effect in terms of leading people astray or
9 having them falling into error in the work place.

10 I'd like to suggest then that the
11 dichotomy between the programs oversimplifies the
12 issues. Law and regulation and company policy do
13 address some issues and questions clearly and
14 decisively, there's no question about that.

15 But it's equally true that some issues
16 and questions reside in gray areas presenting
17 challenges that rules do not address as clearly.
18 Employees need guidance in making decisions where
19 rules do not apply, where the application is not
20 clear and especially where the employee may be
21 unaware that even the rule is there.

1 In those cases we need to provide
2 communication and resources, and a set of values
3 or emphasis in the culture so that an employee in
4 that quandary says I'd better get help because I
5 don't know what to do, but I do know one thing,
6 that's not the way we operate around here.

7 So the culture has to give up some of
8 these kinds of things and guidelines that may not
9 be apparent or available. It's a little bit like
10 what our culture does. I have never stood in an
11 ATM line in the same fashion in which I stand in
12 a line to get a bus ticket or in a supermarket,
13 etcetera. I know that there's an invisible line
14 on -- I've never seen one marked by the way, but
15 I know that there's one on the street that says I
16 stand behind that when someone else is at the
17 machine because our culture sends us a very
18 strong message about the importance of privacy.

19 And what we're talking about when
20 we're talking about cultural orientation is
21 fostering cultures that sends those kinds of

1 message to employees in the work place.

2 And frankly, I believe that the
3 history of the Commission has shown more than an
4 informal interest in this approach. The
5 Commission has joined with the Ethics Officer
6 Association, an organization that embraces this
7 broader approach and presenting workshops around
8 the country. I don't know exactly how many, but
9 they've been multiple.

10 And Judge Conoboy, the previous
11 Chairman of the Commission, in a speech
12 that he gave at a symposium called Corporate
13 Crime in America, Strengthening the Good Citizen,
14 the Good Citizen Corporation, said the following,
15 "You must take on the obligation to lead this
16 effort to be in the forefront not only by working
17 to ensure that your company's employees follow
18 the law, but by embracing and placing at the very
19 top of your company's priorities the basic good
20 citizenship values that make law abidance
21 possible."

1 Judge Murphy also in a speech to the
2 Conference Board last May asked the question,
3 "Can a compliance system work if it doesn't have
4 ethics at its heart?"

5 And our Chairman, Jim Cressa
6 (phonetic) has said when he describes ethics
7 "it's about creating the kind of climate in which
8 people are encouraged to make the right decisions
9 in the first place."

10 I would conclude that the guidelines
11 should send the message that a legal compliance
12 approach is necessary but not sufficient.
13 Companies must encourage the good values that the
14 overwhelming number of our employees bring to
15 work.

16 The need to develop and foster
17 structures in a climate that rewards employees
18 for following those values at work is as
19 essential -- this is a bit of an
20 overstatement -- it's analogous to a healthy
21 corporate ethos as respecting privacy and

1 honoring freedom is to our national leaders.

2 All that having been said, the task of
3 incorporating this into the guidelines which are
4 essentially a legal scheme is a challenge. The
5 federal acquisition regulation might guide the
6 way. In the Anti-Kickback Act they give a whole
7 theory of possible ways that they call reasonable
8 procedures that a company might take to show that
9 they in fact are in agreement -- or in compliance
10 with the provisions of that.

11 Company ethics rules, education
12 programs, procurement procedures, they call these
13 reasonable procedures that are indicated and I
14 believe that the Commission can also come up with
15 reasonable procedures that are indicated, and
16 from which a company could choose given the
17 difference in its size, start size, style of
18 management or demographics.

19 For example, it may not be necessary
20 to ask every company to have a code of conduct,
21 but a code of conduct may be a good indicator of

1 the seriousness of the company in some settings.

2 In a smaller company, for example,
3 periodic presentations by the leader of the
4 organization of the importance of values and
5 integrity to the business and the way you do
6 business can in fact have the same effect if the
7 leader of the smaller company has the kind of
8 visibility that obviously someone doesn't have in
9 a company of 100,000 people.

10 So I'm reluctant to suggest that these
11 steps should be a requirement, but at the same
12 time reluctant to leave it at that and say forget
13 them because I think they should be indicators,
14 included by the Commission as indicators that
15 companies have gone beyond simply observing the
16 letter of the law and in fact are serious, not
17 just about covering themselves, but in fact
18 giving birth to a culture or maintaining a
19 culture where employees know what the right thing
20 to do instinctively; and secondly know that they
21 can get support if they get into the kind of

1 pressure situation where it's difficult for them
2 to do the right thing.

3 So these are basically the comments I
4 would like to make on Chapter 6.

5 The final view is that I do not --
6 I've said this many times and asked someone to
7 challenge me and have never been challenged. So
8 I'd enjoy it if someone would do it here, it
9 would be a learning experience.

10 I do not know any successful ethical
11 or moral system that does not have rules, but I
12 don't know any either that doesn't have an ethos
13 and a philosophy that goes beyond rules.

14 Thank you.

15 MR. JAMES: Frank, thank you, very
16 much. David.

17 MR. GREENBERG: I'm David Greenberg,
18 Senior Vice President and Chief Compliance
19 Officer of Philip Morris Companies, and I'm
20 delighted to be here.

21 Philip Morris Companies, just to set

1 the context, is a holding company that has seven
2 operating companies, but four very large ones,
3 Philip Morris, USA, Philip Morris International,
4 Kraft Foods North American, Kraft Foods
5 International.

6 Each of those four by themselves would
7 be a Fortune 100 company, which is important when
8 I talk about how structure relates to our
9 activities. And two of our companies are
10 actually listed, New York Stock Exchange listed
11 companies, Philip Morris Companies is, as is
12 Kraft Foods, Inc.

13 I want to be a bit humble and modest
14 here in my objectives. Frank said he had I think
15 over 16 years in this field, and I have under 16
16 months. So I'm probably the least experienced
17 person at the table and want to stick to what I
18 know.

19 I do think what we've done in the last
20 16 months at Philip Morris does bear on the
21 questions that this group is interested in

1 talking about, i.e. leadership, accountability,
2 governance, and ethical culture. So that's what
3 I want to focus on are the lessons that I've
4 learned in my 15 or 16 months doing this.

5 The first is that it's critical to
6 engage the board, the senior management, and the
7 entire organization on what we call compliance
8 and integrity issues, the compliance and
9 integrity functions.

10 Second, needs absolutely to be viewed
11 as a critical business function.

12 Third, as such it needs to operate in
13 sync with the businesses and their processes and
14 not fight them or be incremental to them or
15 marginal to them.

16 Fourth, it needs visibility,
17 resources, the ability to communicate, and the
18 perception that it makes a difference.

19 From my point of view these lessons
20 actually describe the process of making
21 compliance and integrity part of an

1 organization's ethos and culture. And from this
2 I have two big take aways that I think are
3 relevant to the discussion we've had this
4 morning.

5 The first bears on the question of
6 high level personnel and what that means and what
7 the implications of that ought to be now and
8 going forward. And my conclusion from my own
9 experience is having a full-time independent
10 senior officer, compliance officer, makes a huge
11 difference in a major company. In our structure
12 the chief compliance officer is one of six senior
13 vice presidents of the enterprise; the others
14 being the chief financial officer, the general
15 counsel, and the senior VPs of mergers and
16 acquisitions, human resources and corporate
17 affairs.

18 The position also sits on the 12
19 member corporate management committee which is
20 composed of those senior vice presidents and the
21 CEO and the CEOs of the four principle operating

1 units, and that is if you will the most senior
2 operating group and decision-making group of the
3 company, the other being the board.

4 I've even found in this endeavor that
5 real estate makes a difference. The chief
6 compliance officer position is located on the
7 chairman and chief executive's floor, on which
8 there are only eight people, and in at least
9 certain corporate cultures location matters a
10 lot, I think probably in all, but I only know
11 ours.

12 The position is set up so that it
13 attends and presents at the board's annual
14 strategy retreat where sort of the mission and
15 objectives are set for the year. There's regular
16 reporting to the audit committee including in
17 executive session.

18 Having set the position up this way it
19 means that when my colleagues see me, all they
20 think is compliance and integrity, so if they owe
21 me something, or I owe them something it's not --

1 it's clear and it's not confusing, they're not
2 thinking about a matter of law or a matter of
3 finance, or a matter of management, they're
4 thinking exclusively, you know, oh, oh, I asked
5 Greenberg for "X" and he didn't deliver, or he
6 asked me for "Y" and I didn't deliver. And that
7 makes a big difference, it really elevates the
8 issue and the function.

9 I wouldn't pretend that as sort of a
10 new function and a new senior officer the
11 compliance and integrity issue automatically has
12 attained the importance and the recognition in
13 the company that things like finance or law have,
14 but I think it's on its way and I think that the
15 only way it ever gets there is by the kind of
16 positioning it has.

17 It also means that in our operations
18 and management I can speak as a co-equal with the
19 CEOs of the operating companies which in the end
20 is where, you know, 168,000 out of the 170,000 of
21 our people live and work, the corporate staff is

1 relatively small, so where the real action is is
2 at the operating company level. And the
3 importance of compliance and integrity at the end
4 of the day is carried out in the operating units.
5 We may set the standards at corporate, but if
6 it's going to touch the lives of our people, what
7 matters is what happens, you know, from the
8 factory floor on up.

9 So there are strong compliance
10 structures in each of those units reporting
11 either to the operating company's CEO, or one of
12 his or her senior people. But my presence on the
13 corporate management committee, and my ability to
14 speak to the operating company's CEOs as a
15 colleague and an equal really enhances the
16 ability of the compliance and integrity
17 initiative to be ambitious and to deliver both at
18 corporate and at the operating companies.

19 The positioning of the job has also
20 created the kind of authority and flexibility
21 that's necessary to move through the inevitable

1 internal barriers in a corporate setting to
2 getting things done. Not because an organization
3 doesn't want to get things done in the compliance
4 and integrity area, but because in a large
5 organization, it's often hard to get anything new
6 done because people are busy.

7 There has been very little in the way
8 of that, establishing task forces, deciding to
9 draft and implement a comprehensive code,
10 developing a system of enterprise-wide standards
11 to be endorsed by the board, and best practices
12 under them, deciding to create a very broad scale
13 web-based training initiative, organizing a
14 world-wide series of focus groups to take a look
15 at our code, deciding that the two leading
16 web-based training vendors we'd identified should
17 be subjected to a world-wide field test among 600
18 or so of our employees.

19 Each of those things could in another
20 context have taken, you know, months or years to
21 drive through a system, and basically with some

1 consultation and collaboration in our systems,
2 the chief compliance officer was basically just
3 able to decide and move things through.

4 It's also true in terms of
5 investigating issues that arise in our hotline
6 calls, having access to all of the reports of our
7 internal auditors, all budget reviews, all
8 strategy reviews. All of that really makes a
9 difference.

10 Of course, what goes along with that
11 is the seniority and visibility of the function
12 leads to a claim on the resources necessary to
13 get the job done, and it's also meant that allied
14 functions from communications to HR to law have
15 all been anxious and willing to cooperate.

16 It's also led to -- I guess one of the
17 tests would be whether it really leads to
18 integration when new things come up, and when we
19 took a look at the requirements of Sarbanes/Oxley
20 and the certifications that Jamie was talking
21 about, the company decided it needed to set up a

1 disclosure controls and procedures committee to
2 review each 10Q and get it ready for CFO and CEO
3 certification. And the group that was created
4 for that included the CEO, the CFO, the general
5 counsel, the head of corporate affairs, the
6 controller, and the chief compliance officer.

7 So, again, I think the visibility and
8 positioning of the job made it obvious that to
9 people that we couldn't take on the
10 Sarbanes/Oxley task on the one hand over here and
11 have compliance and integrity over here. They
12 needed to be integrated.

13 My second major point of learning has
14 been that -- and it reflects a lot of what we
15 heard this morning -- whatever system a large
16 organization adopts needs to be designed to match
17 that business. There is not one approach.

18 As I said we're a holding company with
19 four huge operating units, so a centralized
20 compliance and integrity function per se wouldn't
21 work, wouldn't match the way we run the business.

1 So we established senior compliance teams and
2 cross-functional counsels at each operating
3 company, but then again, that's how the real work
4 gets done in those companies.

5 But there is a mandate and a mission
6 at the corporate level, and for that we agreed a
7 set of enterprise-wide standards that cover every
8 operating company and every corporate function
9 that are backed up by an explicit set of best
10 practices and kind of yield our own reverse
11 engineered approach fit to our company of what
12 the federal sentencing guidelines mean. And I
13 think many other companies have adopted a similar
14 scheme.

15 So ours requires each of our companies
16 to have an explicit compliance structure,
17 compliance accountabilities, objectives, and
18 priorities. It requires them to have a risk
19 assessment that reaches legal policy and
20 reputational risks. It requires senior
21 management in each of the companies and functions

1 to communicate explicitly on the importance of
2 compliance and integrity. It requires compliance
3 training across the board tied to the risks all
4 employees face in their jobs.

5 It requires a clear system for
6 employee advice and reporting, system standards
7 and procedures for investigations and sanctions,
8 and explicit approach to monitoring, auditing and
9 evaluation, a requirement of documentation, and a
10 system of reviewing the results with the
11 corporate management committee and the audit
12 committee of the board.

13 In sum, these requirements are rolled
14 up in our system by having -- requiring each
15 operating company to prepare an annual compliance
16 and integrity plan that meets each of those
17 standards, and that plan requires the explicit
18 approval of the operating company's chief
19 executive officer and also me.

20 So my ultimate check on the system is
21 both at the level of creating the standards and

1 also approving the plans and then reporting to
2 the board.

3 I think to sort of answer one of Ron's
4 questions, having a full-time senior independent
5 person with visibility and clout, and then
6 designing a system designed to match the way the
7 business works, those are two elements really of
8 how you drive something into a culture because it
9 becomes part of how you do business. You match
10 the way business is done in an organization with
11 the overarching objectives of having ethical
12 conduct and you insert that into the way the
13 business organizes itself, structures itself,
14 plans itself, and executes against that.

15 MR. JAMES: Thank you. Joshua.

16 MR. HOCHBERG: Our perspective
17 obviously is completely different at the
18 Department of Justice in that we don't design
19 programs we react to them, we sit in judgment
20 over them in many instances.

21 That said I agree in large part with

1 some things Jamie said and some things David
2 said. One that from our perspective the legal
3 changes in the new laws are driving much of this
4 agenda and we will -- all companies will have to
5 react to that.

6 And our basic position in our
7 submission is that the Sentencing Commission
8 should not enmesh itself in the minutiae of any
9 given program, it should set broad guidelines,
10 give some indication of examples of compliance
11 programs, but the world is too complex, big
12 companies, small companies, different industries,
13 to try to define exactly what is a good
14 compliance program for any given industry or
15 company size.

16 Frankly, you know, at the end of the
17 line if it goes as far as a criminal trial and a
18 contested proceeding, these issues will all be
19 litigated ad nauseam as to whether there was an
20 effective program, as to whether the two points
21 make any sense.

1 And from our perspective we look at it
2 a little differently. I don't know if this is
3 helpful to your ultimate question, but it may
4 give some of the people some ideas on how we
5 consider things.

6 Our first decision is whether or not
7 to charge a corporation, and we applied many of
8 the principles in the guidelines, but much more
9 significant I think to the company than any
10 possible fine at the end of the day is the
11 charging decision. And that often is the crucial
12 argument. We extensively debate that with
13 defense counsel. At the point where we're
14 inclined to charge a corporation, we've often
15 found high level management is involved, and then
16 many of the issues which we're discussing,
17 because one of the key determining factors is how
18 high level the involvement was in the criminal
19 activity.

20 After we charge or we decide to charge
21 a corporation, we often function in a regulatory

1 environment and many of the discussions involve
2 what we call global settlements where we're
3 working both with our Civil Division, the
4 criminal side, and the administrative agency. In
5 those global settlements, to bargain is often the
6 key issue. Again, something that comes well
7 before a fine restitution, comes often
8 (Inaudible) well before any calculation of
9 criminal fine. Debarment is often a factor, the
10 charging decision is often the factor.

11 Frankly, we often defer to the
12 regulatory agency as to what good corporate
13 governance is, and in a sense this is
14 prospective. We let the regulatory agencies
15 define corporate integrity agreements going
16 forward. We don't feel we have the expertise.
17 We consult with them or they work out those
18 issues, because they're going to make the
19 decision -- especially with government
20 contracting-type situations, of whether this
21 company is fit to do business with the government

1 in the future and what assurances they need that
2 the company going forward is a good corporate
3 citizen.

4 A third way we view the guidelines is
5 in our settlement discussions. We often run the
6 calculations, though it might be helpful for you
7 to understand that the sentencing guidelines
8 calculations are being done, albeit before there
9 is a prosecution. And sometimes the settlements
10 involved explicit discussions of this is what
11 would happen after you're convicted, and this is
12 where we're setting the threshold of any plea
13 agreement.

14 So we do apply the guidelines quite
15 literally in those contexts. Most of the
16 corporate cases are settled, there is some other
17 agreement or some negotiated plea. The risk to a
18 corporation of going forward are quite drastic
19 and we're well aware of that.

20 We think -- another perspective that's
21 a little different is because of where we get

1 involved in the situation. To us the voluntary
2 disclosure side of the coin is obviously of even
3 greater importance than the compliance. We're
4 not seriously involved in the situation unless
5 there has been some sort of break down, and to us
6 the importance is to minimize the effect on the
7 public, the ensure the certainty of punishment
8 for the individuals responsible. So to the
9 degree that voluntary disclosure makes it
10 possible for us to do our job efficiently in
11 these days of reduced resources we take that into
12 a lot of account, and much of our comments this
13 morning and in our submission is geared to
14 encouraging disclosure, encouraging cooperation.

15 That said we're fully aware that, you
16 know, good compliance programs make our job
17 easier, we're not interested in having more cases
18 we're interested in having less.

19 And, you know, we work within, as I
20 said, the regulatory framework where we realize
21 that different of the administrative agencies

1 have very much different policies. We've done a
2 lot of health care prosecutions, health-care
3 related prosecutions, and HHS has seen fit to put
4 out integrity compliance type ideas that are very
5 specific to ambulance companies, to durable
6 medical enterprises, their expertise applied to
7 that situation. Whether it's wise to be that
8 detailed I don't know, but that is something we
9 would defer to the administrative agencies' view
10 of it.

11 Similarly with the SEC they will be
12 promulgating the rules as denoted, and
13 Sarbanes-Oxley seeks to sort of legislate
14 corporate responsibility, and that's only
15 something we clearly can react to.

16 The thrust of our comments is that the
17 broad outlines of good programs, ideas like the
18 alternate reporting requirements, the ability to
19 report directly to the board, the flexibility in
20 who you can report to, especially in the current
21 corporate environment where many high level

1 managers and CEOs were involved in criminal
2 activity.

3 There's need to design programs that
4 allow flexibility going forward for those types
5 of crimes that we haven't envisioned yet. People
6 who want to do the right thing should be allowed
7 to do it and be able to report it in a way where
8 obviously they won't be harassed, and where they
9 can get it to people who might do something about
10 the criminal behavior. So we encourage alternate
11 reporting paths.

12 One of the specific items in the
13 questions was the issue of creating a new self
14 testing, self-correction privilege. We oppose
15 that. We think this is occurring in an area that
16 has become far too complex already, creation of
17 privileges. I don't think -- if such privileges
18 were to be created, I don't think the guidelines
19 is the place to do that. It requires a different
20 kind of policy debate.

21 We don't know if the privilege would

1 be recognized, and in some ways it's counter
2 intuitive because the privilege would be used to
3 shield information from us where our whole bent
4 is to get as much disclosure as possible.

5 So our essential bottom line is to
6 resist the temptation to revise the guidelines to
7 include hard and fast rules. These become
8 measurement criteria that don't really measure
9 effectiveness. They just become a checklist in
10 our view of items that a corporation, you know,
11 since I have this in place it doesn't necessarily
12 mean it's a good compliance program, it becomes
13 more of a formality.

14 And to set just the general tone of
15 what a good compliance program is, get perhaps
16 some examples, and if it has to be litigated, it
17 will be litigated, whether that makes sense for
18 that particular industry and that size company.

19 MR. JAMES: Thank you, Joshua. Bob.

20 MR. OLSON: Yes, my name is Bob Olson
21 and I'm with the Alliance for Health Care

1 Integrity, and I appreciate this opportunity to
2 speak before you, particularly since you've --
3 we've probably oversubmitted in terms of our
4 comments and testimony we have. I have gone
5 through that testimony and those comments and
6 tried to once again distill from those some
7 things -- I don't know if this will taste like
8 fine Cognac, but it is something we present some
9 remarks too.

10 The Alliance for Health Care Integrity
11 was actually inspired by two of the -- well, one
12 person that we listened to today and one
13 organization that's largely in some of the
14 proceedings, that is Lynn Sharp Paine and her
15 distinction between compliance based and
16 values-based financial program, and on the other
17 hand at the beginning as we were getting going
18 the defense industry initiative, Number 501 C3
19 and the advocate for industry-wide model
20 standards that are designed, delivered and
21 verified by major industry stakeholders. In some

1 ways I suppose it's an expanded comprehensive
2 self specimens, that seems kind of innovative.
3 On the other hand probably a back to the future
4 considering the impressive MTII standard.

5 If I could make a prediction, which is
6 very -- if I could make a prediction, I'd say
7 that it's ethics that's pressuring the discussion
8 today, ten years later. Ten years from now my
9 guess is this whole issue of multi-stakeholder
10 and self-design and direct (Inaudible) will
11 probably be pressuring (Inaudible) -- we'll see.

12 Anyway, let me begin by recalling
13 remarks that (Inaudible) had made in his
14 testimony, realizes that ten years ago a major
15 emphasis for the development of the guidelines
16 was the realization that in the area of alleged
17 corporate, malfeasance judges have paid scant or
18 little attention and appropriate efforts to
19 condemn malfeasance and provide government
20 regulations.

21 Now, ten years later I'd wager given

1 the recent research, that if we look at those
2 same organizations, we'd find that the most
3 effective compliance efforts were found in
4 corporations where there were already strong
5 ethical cultures. In fact I'd suspect that even
6 today compliance efforts work best in
7 organizations with strong ethical cultures and
8 work very poorly or not at all in organizations
9 without those same kinds of cultures.

10 Today the Sentencing Commission has an
11 opportunity once again to break new ground, to
12 move the notion of compliance to a whole new
13 level and shift the paradigm to a law and order
14 orientation, (Inaudible) development to a
15 universal, ethical, principle orientation.

16 The candid quotes in Alan Yuspeh's
17 testimony before us and repeated this morning
18 exercises function as a bully pulpit.

19 How can the guidelines be updated
20 then? The short answer I think is to find that
21 key, or find that menu page that says find and

1 replace, and go to all the occurrences with the
2 word "compliance and guidelines and to be
3 replaced with ethics, dash, compliance, where
4 compliance is the minimum standard, tip of the
5 iceberg if you will, and ethics is the optimal
6 standards for the rest of the iceberg.

7 The long answer, however, can be
8 summarized this way, and what I would encourage
9 is, at least looking at the adoption of language
10 that promotes the integration of ethics and
11 compliance in organizations using a whole system
12 change technology, a way of organizational change
13 that really drives down into the organization.

14 I was interested in the availability
15 of a code of conduct, for example, on websites,
16 and yeah, that'll be all right, that looks nice.

17 The difference between that and really
18 going through the organization across function,
19 across level, to find out what the organization
20 values given all these employees represented
21 different groups, and building core values out of

1 that. And then as Lynn Paine was suggesting,
2 gee, how do we get those, we can operationalize
3 those in a similar fashion and really put some
4 meat on the bones.

5 I agree with Frank Daly that the
6 dichotomy between compliance and ethics is
7 probably a false one, a compliance after all is
8 compliance to these regulations. It might make
9 more sense to talk about the difference between
10 compliance programs and commitment programs, or
11 look at them in terms of their end product in the
12 laws and regulations for ethics. I think the
13 interaction of these programs is probably much
14 more important as you do if you substantiate.

15 The other type of language that you
16 might look at would be the establishment of model
17 standards, perhaps based on (Inaudible) 1999 memo
18 developed by major stakeholder groups. It's in
19 an organization, I've heard -- I think you talked
20 about it too as a way to do this, and I think
21 that's very laudable -- is to look cross

1 organization and cross function to see that
2 you're coming up with standards that are going to
3 work with your organization. You're looking at
4 an entire industry. Of course you'd want to
5 bring in various stakeholder groups, everyone
6 from consumers and communities and government
7 regulators, trade unions, professional
8 associations, make sure you're going down the
9 right path.

10 And then finally it would include I
11 hope a verification of organizational commitment
12 to those standards, again, by the stakeholders
13 who have developed them and have a stake in them.

14 By verification I mean not only say
15 evaluation at a profit level, in other words head
16 counting, yes, we gave out this many codes of
17 conduct, had this many people sign them, so many
18 people participating in our training, but also
19 it's the level of impact of those interventions
20 in that particular organization specifically
21 where there are changes in knowledge, attitude,

1 and short-term practice, whether those practices
2 for example were skills and moral reasoning,
3 enhanced ethical culture, or more specifically a
4 CEO insisting on an ethics officer involvement in
5 strategic decisions.

6 And then finally verification at the
7 level of outcome, has there been decreased
8 malfeasance in the organization. I know that's
9 complicated and I know you had some suggestions
10 on what that might look like this morning.

11 It is our belief that since Commission
12 once again has an opportunity to exercise more
13 leadership as what it did in the past, and we
14 think that's what it can do today, this time by
15 promoting corporate integrity and with that
16 increase in corporate integrity, hopefully we
17 would see an increase in public trust in the
18 corporate world.

19 MR. JAMES: Bob, thank you. Gretchen.

20 MS. WINTER: Thank you, very much for
21 the opportunity to be here today. I really

1 appreciate the chance to speak with you and to
2 listen to the thoughts of so many colleagues on
3 these very important subjects.

4 I am Gretchen Winter, I'm Vice
5 President and Counsel for Baxter International,
6 Inc. It's a position that I've held for more
7 than six years. I've worked for Baxter for about
8 13 years and I've practiced as an attorney for
9 almost 20.

10 I also serve, as was noted earlier, as
11 Vice Chair of the Ethics Officer Association
12 Board of Directors. That organization has
13 separately submitted testimony for your
14 consideration and I'll talk a little bit more
15 about their positions at the very end of my
16 remarks.

17 Unlike my colleague Frank Daly, I am
18 here speaking today on behalf of my company and
19 am very happy to be doing that. So let me give
20 you a little bit of background about Baxter
21 International.

1 Our products and services are used in
2 the treatment for thousands of patients with
3 critical medical conditions that occur from
4 traumatic injuries, immune disorders, kidney
5 failure, as well as hemophilia and a series of
6 other disorders. We're a global health care
7 company with more than \$8 billion in sales and
8 48,000 team members in 100 countries world wide.

9 While our financial success is
10 important, even more important to us is how we do
11 business. At Baxter we try to live our shared
12 values each and every day by acting in a
13 transparent manner, engaging in dialogue with our
14 stakeholders, and by taking a progressive
15 approach towards corporate governance and leading
16 by example.

17 I hope to talk to you a little bit
18 about those things today in the context of the
19 questions that I've been asked to look at,
20 questions 1A through 1B and Question 6. So a
21 total of five questions.

1 Let me begin however with the general
2 observation, one that echoes the point made not
3 only in the Ethics Officers Association
4 testimony, which was submitted, but I think by
5 virtually every speaker here today. The
6 organizational guidelines should maintain their
7 flexibility and their non-prescriptive nature.
8 That approach really allows organizations of all
9 sizes in all industries to develop
10 company-specific compliance and ethics programs
11 that respond to the guidelines requirements as
12 well as to the needs that might exist in those
13 particular industries or companies.

14 Let me now go to the questions
15 themselves. I would really like to walk through
16 each one of the questions I was asked to address.
17 I know you spent a lot of time framing those
18 questions, so I'd like to try to respond to those
19 to the extent that I can.

20 Question 1A specifically asks about
21 high level personnel, and specifically asks that

1 we look at comment 3K(2) and then further reflect
2 on comment 3B when it talks about high level
3 personnel of the organization and their overall
4 responsibility to oversee the guidelines.

5 And the question is either should
6 these be changed. Generally our answer to that
7 question is no, no, they should not be changed.
8 Specific articulation of the responsibilities of
9 the CEO, the CFO, or other persons responsible
10 for high level oversight could we believe
11 unnecessarily, and perhaps unintentionally, limit
12 the responsibilities of those folks to the
13 articulated items and therefore encourage a more
14 limited role of the high level personnel in an
15 effective compliance program. That we believe
16 would be detrimental to the success of a
17 compliance program within the organization.

18 As we see in Section 8A1.2, comment
19 3B, sufficiently defines the term "high level
20 personnel of the organization" and provides
21 sufficient examples so that organizations should

1 understand what level of person should take on
2 responsibility for the program.

3 Let me give you an example. Within
4 Baxter we have established a comprehensive
5 business practice program that involves a wide
6 variety of high level personnel of the
7 organization. We have a corporate responsibility
8 office, of which I am a member. It is made up of
9 five individuals, including two senior leaders
10 who are also corporate officers who are in charge
11 of major business or functional units of the
12 company. At this particular time they are in
13 charge of one of our largest business units
14 called Medication Delivery, and the other person
15 heads up our entire Research and Development
16 organization globally.

17 In addition to those two individuals
18 the General Counsel, the Vice President of
19 Corporate Audit and I, as the Vice President of
20 Business Practices, round out our corporate
21 responsibility office.

1 To carry out this group's activities
2 on a global basis, we've established five
3 regional business practice committees. The
4 members of those regional committees is very
5 similar to the membership of the corporate
6 responsibility office with senior regional
7 business unit leaders serving as the chair and
8 the vice chair, and with members from Business
9 Management and appropriate staff functions
10 rounding out that membership. Typically those
11 groups include Human Resources, Law, Audit,
12 Finance and Business Practices.

13 In sum, while the guidelines current
14 language allows flexibility in program design, I
15 think the inclusion of illustrative examples is
16 very helpful to those trying to design effective
17 programs.

18 Let me move on now to Question 1B.
19 Question 1B asks to what extent if any should
20 Chapter 8 specifically mention the responsibility
21 of the boards of directors, the committees of the

1 board, or equivalent governance bodies in
2 overseeing compliance programs and supervising
3 senior management's compliance with such
4 programs.

5 Again, I think there's been a great
6 deal of discussion on this point today, so let me
7 summarize our view of this matter.

8 In light of the court decisions such
9 as CAREMARK and its progeny legislative
10 initiatives such as Sawbones/Oxley, and
11 regulatory requirements such as the NASDAQ and
12 the NYSE listing requirements, we believe that
13 additional federal guidelines outlining board
14 responsibilities are not necessary.

15 However, and based on the conversation
16 that has occurred so far today, if this advisory
17 group believes that boards of directors have a
18 role to play, then it makes sense to articulate
19 that so we all know what it is. But I think,
20 like Jamie mentioned a bit ago, the way that the
21 law is evolving in this area is fairly clear.

1 There is certainly a requirement that people
2 comply with the existing laws and consequently
3 it's probably not necessary to go further in the
4 guidelines on this point.

5 Frankly for a number of companies the
6 boards of directors are already involved in this
7 process. In Baxter's case, our company's board
8 of directors oversees the entire business
9 practice program and compliance programs. They
10 receive a report on the status of those programs
11 at least once each year, and the bylaws of
12 Baxter's Board of Directors specifically gives
13 the Public Policy Committee of the Board
14 responsibility for reviewing the policies and the
15 practices of the company to assure that they are
16 consistent with the company's responsibility to
17 employees, to customers, and to society.

18 As part of that responsibility the
19 Public Policy Committee oversees the ethics and
20 business practice standards. The Vice President
21 of Business Practices -- that would be me --

1 reports to that committee on substantive matters
2 and I appear before the committee at least twice
3 each year.

4 Now, while greater specificity is a
5 guideline about the reporting relationship
6 between the ethics and compliance officer and the
7 board could encourage greater focus on this issue
8 within organizations, and again, I think I heard
9 that opinion expressed by David and certainly by
10 Alan this morning, I think it's clear based on
11 Baxter's experience that the Board of Directors
12 can be engaged in the process without specific
13 guidance from the guidelines.

14 Question 1C asks whether modification
15 should be made to several of the comments
16 defining high level personnel, defining
17 substantial authority personnel, and then changes
18 made in the comments relating to offenses by
19 units of organization and pervasiveness of
20 criminal activity.

21 Again, I think the comments that I

1 made earlier about the addition and the use of
2 illustrative examples would be very helpful here.
3 So if there are specific examples or best
4 practices that the Advisory Committee and the
5 Sentencing Commission would like to highlight, it
6 would certainly provide clarity and ideas for
7 organizations as they create their compliance
8 programs.

9 If the passage of time has given the
10 Advisory Committee additional examples of reason
11 to revise the specifics, then those changes ought
12 to be made.

13 This morning I think Win Swenson
14 opened the conversation about whether government
15 would speak with one voice and whether there is
16 conflicting advice that comes from a variety of
17 agencies. Obviously, this is a rather widespread
18 problem. Let me illustrate with one particular
19 point to make the following observation.

20 If there are other governmental
21 organizations that have issued specific guidance

1 that could be construed as conflicting with the
2 guidelines, then it would be useful if the
3 guidance that's issued by those organizations and
4 the guidance issued by these guidelines could in
5 fact be harmonized.

6 Most recently in our world the
7 Department of Health and Human Services, Office
8 of the Inspector General, issued something called
9 the Draft OIG Compliance Program Guidance for
10 Pharmaceutical Manufacturers, which happens to be
11 relevant to us.

12 Footnote 7 of that draft document
13 said, "The OIG believes it is generally not
14 advisable for the compliance function to be
15 subordinate to the pharmaceutical manufacturers
16 general counsel or comptroller, or similar
17 financial officer. Separation of the compliance
18 function helps to ensure independent and
19 objective legal reviews and financial analysis of
20 the company's compliance efforts and activities.

21 "By separating the compliance function

1 from the key management positions of general
2 counsel or chief financial officer, where the
3 size and structure of the pharmaceutical
4 manufacturer makes this a feasible option, a
5 system of checks and balances is established to
6 more effectively achieve the goals of the
7 compliance program."

8 I don't know whether that statement
9 reflects or does not reflect the view of the
10 Advisory Committee, but it is specific, it is
11 fairly clear, it is detailed, and frankly it
12 gives any reader very clear guidance on where
13 they ought to go when they are establishing a
14 compliance program. That kind of guidance, those
15 kinds of examples, to the extent they could be
16 included would be useful supplemental commentary
17 to include in the guidance.

18 Let me move on now to Question 1D.
19 That's something that I have not really heard
20 anybody talk about yet today in detail. Question
21 D asks us to look at comment K3 to Section 8A1.2,

1 and that talks about the delegation of
2 substantial discretionary authority to persons
3 with a propensity to engage in illegal
4 activities.

5 And the question you pose is whether
6 that particular section ought to be clarified or
7 modified. My answer to that is yes, I think it
8 should. The comments should be expanded
9 specifically I think to include some of the
10 illustrative examples that you have used in other
11 parts of the guideline. Over the years I think
12 it is quite possible that there are examples of
13 methods that organizations have effectively used
14 to obtain knowledge of a propensity to engage in
15 illegal activities, and again, I think it would
16 be helpful for organizations that are seeking to
17 establish effective programs that meet the
18 requirements to understand exactly what's
19 expected.

20 Some organizations say doing a
21 background check is sufficient to meet that

1 guideline. Other organizations that work in
2 industries that have more extensive lists
3 available to them may believe that it is also a
4 requirement that they conduct background checks
5 in accordance with those particular sets of
6 requirements. To have a thorough and effective
7 program that effectively accomplishes that goal,
8 really additional guidance is needed I think in
9 that particular area.

10 Now, let me turn to Question 6, one
11 that talks about the role of the sentencing
12 guidelines in encouraging and fostering ethical
13 cultures. Again, something we've talked rather
14 extensively here today so far.

15 I think the question all by itself
16 suggests that this advisory group is looking
17 beyond the narrow focus of the sentencing
18 guidelines on criminal behavior, and I think that
19 is a positive thing.

20 Because of failure to comply with laws
21 and regulations does not always result in a

1 criminal violation, and because many
2 organizations compliance and business practice
3 programs are in fact values-based programs that
4 focus not only on compliance with laws and
5 regulations that have criminal consequences, but
6 also want compliance with laws and regulations
7 that do not have criminal consequences. And in
8 addition to that suggest that employees have a
9 responsibility to comply with the values of the
10 organization. We believe it makes sense for the
11 guidelines to expand in some way to encourage the
12 creation of ethical cultures.

13 Such encouragement could be
14 incorporated into the comments under Section
15 8A1.2, comment 3K, and its subparts.

16 The question also asks about the
17 measurement or evaluation of compliance with that
18 particular piece of guidance, and frankly, I
19 think that that would have to be performed on a
20 case-by-case basis. I think that point has been
21 made several times today, although we did talk

1 about measurements this morning that might be
2 looked at, but I do think it's a case-by-case
3 evaluation in each case, and again refer to,
4 Section 8A1.2, comment 3C, which uses
5 case-by-case evaluations as a method for
6 evaluating compliance in another context.

7 Let me tell you a little bit about
8 Baxter's culture in the context of my comments.
9 Our culture, as I mentioned, is based on a set of
10 shared values. One of those values is the value
11 of integrity, and one piece of the definition of
12 that value requires legal and ethical conduct by
13 all employees.

14 It is important, however, for all of
15 us to remember that guidelines, rules and
16 policies do not in and of themselves make
17 employees, or any of us, honest, and in and of
18 themselves they do not drive legal or ethical
19 conduct. They only mark the pathway that we
20 follow. Because we are individuals, we each have
21 our own way of thinking about the rules that we

1 read, and according to our own moral code, our
2 own view of true north, we will figure out the
3 proper way to apply them in each circumstance.

4 This is why it's so important it seems
5 to us that ethical decision-making be an active,
6 dynamic and proactive process within our
7 respective organizations. And this is an
8 important piece because each and every day
9 individuals at all levels of the organization all
10 around the world are making hopefully ethical
11 decisions in the course of conducting business on
12 behalf of our company.

13 Baxter's corporate responsibility
14 office, our CEO, our CFO, or the other high level
15 personnel referenced in the guidelines will not
16 be standing over any individual's shoulder to
17 direct to the outcome. So everything that we do
18 through constant communication, training and
19 tools is designed to ensure that the individuals
20 have the tools, the wiring, and the fundamental
21 set of values that will drive their decision

1 making process.

2 An encouragement by the U.S.
3 Sentencing Commission to foster ethical cultures
4 with that set of expectations in mind I think
5 would be welcomed by organizations such as ours.

6 That concludes my testimony on behalf
7 of Baxter, and at this point I would like to read
8 a couple pieces of the Ethics Officer Association
9 Board of Directors' testimony.

10 Thank you. The Ethics Officer
11 Association Board is composed of individuals
12 representing 21 organizations that are EOA
13 members. The comments that I will present are
14 those of the EOA Board as an entity and may not
15 represent the views of all EOA member companies.
16 That's my disclaimer.

17 This testimony is meant to address
18 Question 6 which talks again about ethical
19 cultures.

20 "The effective prevention of criminal
21 activity necessitates the development of an

1 organizational culture that is supported with
2 full compliance and ethical business conduct. It
3 is the view of the EOA Board that organizations
4 should foster a compliance and ethical culture
5 through conduct expectations and organizational
6 values.

7 "By identifying conduct expectations
8 and values that must be universally applied
9 employees are provided with a basis for business
10 decisions when complex legal requirements may be
11 unclear, or when the law fails to specifically
12 address behavior that may be in conflict with the
13 interests of employees, investors, and society.

14 "A commitment to ethics strengthens an
15 organization's compliance program. The need to
16 address business conduct in corporate culture is
17 recognized in the Sarbanes/Oxley Act as in the
18 Securities and Exchange Commission proposed rules
19 that were issued earlier this month."

20 Actually earlier last month. "The SEC
21 rules specifically address the need for a Code of

1 Ethics which is defined as a codification of
2 standards that is reasonably necessary to deter
3 wrongdoing and to promote honest and ethical
4 conduct, avoidance of conflict of interest, full,
5 fair, accurate, timely and understandable
6 disclosure, compliance with applicable government
7 laws, rules and regulations, prompt internal
8 reporting of code violations, and accountability
9 for adherence to the code.

10 "The listing standards of the NYSE
11 also proposed a requirement that companies must
12 adopt and disclose a code a conduct and ethics
13 for directors, officers and employees, and
14 promptly disclose any waivers of the code for
15 directors or executives.

16 "As stated in the NYSE proposal, the
17 code of conduct and ethics will focus the board
18 and management on ethical risk, provide guidance
19 to personnel to help them recognize and deal with
20 ethical issues, and to provide the mechanisms to
21 report unethical conduct and to foster a culture

1 of honesty and accountability.

2 "The NYSE proposal also mandates that
3 the code of conduct and ethics for each
4 organization specifically require organizations
5 to proactively promote compliance with laws,
6 rules and regulations.

7 "The EOA Board recommends that the
8 organizational guidelines be revised to focus
9 more directly on the need to communicate to
10 conduct expectations and organizational values.
11 This change would be consistent with
12 Sarbanes/Oxley and the NYSE listing standards
13 recommendations. The EOA Board believes that
14 this change would enhance the effectiveness of
15 compliance management efforts and contribute to
16 the prevention of unethical business activities."

17 The EOA Board recommends some specific
18 language that could be added to Section 8A1.2(k)
19 of the organizational guidelines and I quote,
20 "The organization must have established and
21 communicated conduct expectations and

1 organizational values through a code of conduct
2 and ethics or other mechanism appropriate to the
3 organization. These conduct expectations and
4 organizational values must include the
5 requirement for full compliance with applicable
6 laws and regulations and must be periodically and
7 effectively communicated with employees."

8 That is the section of the EOA
9 testimony that is relevant to the conversation of
10 this particular break out session.

11 Thank you.

12 MR. JAMES: Thank you, Gretchen. And
13 thank you all.

14 Now, let's move to an open dialogue
15 and question and answer period. And I'd like to
16 start with my colleagues on the Advisory Group
17 and see if there are questions that you have,
18 please.

19 MR. PETRY: Thank you, Ron. Jane, did
20 you want to go -- I have -- I don't know where to
21 begin, I have so many questions. So if you have

1 one in mind --

2 MS. NANGLE: Go ahead and maybe you'll
3 cover one of mine.

4 MR. PETRY: Okay. I'd like to begin
5 at the end with Question 6. And my question is
6 more by way of clarification of one of the
7 positions.

8 The Department of Justice did
9 distribute its written testimony and I believe it
10 was only distributed to the ad hoc group, so the
11 rest of you don't have this but I understand it
12 is now a public document so there's no problem
13 with me reading from it?

14 MR. HOCHBERG: No problem. Unless it
15 changed overnight. It was being written last
16 night.

17 MR. PETRY: Well, Question 6, our
18 question said "ask about whether or not the
19 guidelines should have language to foster the
20 development of ethical cultures." And to be
21 precise it went on to say "to ensure compliance

1 with the intent of regulatory schemes."

2 Now, it seems to me, and I just want
3 to be sure I understand this, the Department of
4 Justice response really zeros in on that phrase
5 "intent of regulatory schemes," and reading now
6 from the DOJ, "The Securities and Exchange
7 Commission and FASBE (phonetic) have
8 traditionally had the primary jurisdiction to
9 require compliance with the intent of regulatory
10 schemes rather than mere technical compliance" --
11 and it goes on.

12 So, therefore, concluding that this is
13 really a jurisdictional matter and that there is
14 no real need to change the language of the
15 sentencing guidelines because FASBE (phonetic),
16 the SEC, and I imagine you have in mind the NYSE
17 listing requirements, are going to address that
18 issue of intent and therefore your position then
19 would be the same as Mr. Conrad's that
20 Sarbanes/Oxley, the SEC, the listing
21 requirements, are more appropriate to deal with

1 these issues of intent; is that --

2 MR. HOCHBERG: You have the overall
3 concept of effective programming. And certainly
4 within that larger context the -- encouraging the
5 culture is a prime indicator of whether the
6 program is effective. So I can't -- you know,
7 the dichotomy we faced is we didn't think the
8 guidelines could be too specific, the experts in
9 individual fields are legislating madly in this
10 area. We -- our overall approach was to
11 encourage examples, as Gretchen said, go back to
12 sort of basic concepts. The program has to be
13 effective without striving for a specific.

14 MR. PETRY: Could I ask a follow up?

15 MR. JAMES: Yes.

16 MR. PETRY: Suppose we had drafted
17 that Question 6 differently, and believe me it
18 went through a lot of different iteration.
19 Suppose we had drafted it in a way that was more
20 along the lines experience has shown that in
21 order for a compliance program to be effective,

1 it must be part of a broader values-based
2 initiative, and that, therefore, the sentencing
3 guidelines should have some kind of general
4 language to reflect that, or put that in the form
5 of a question, taking out the word "intent"
6 and --

7 MR. HOCHBERG: That would probably
8 garner a more positive response.

9 MR. PETRY: That would have?

10 MR. HOCHBERG: I think so, if I can
11 speak for the large group that wrote that.

12 MR. PETRY: And Jamie, could you
13 comment on that if we had phrased it that way.

14 MR. CONRAD: Then the experience has
15 shown that effective -- that the corporate
16 compliance programs are only effective if they
17 are based on ethical or --

18 MR. PETRY: I don't think we would
19 have gone quite that far, but experience has
20 shown that the effectiveness of a compliance
21 program is enhanced if the compliance program is

1 part of a broader based value -- I don't know how
2 we would have worded it precisely.

3 MR. CONRAD: But that sort of
4 statement though is sort of one of presuppose --
5 I mean I still would want to see what experience
6 was, if there really was a sort of a case that
7 were evidence that that was actually
8 substantiated in a case, I think we'd be more
9 favorably inclined toward that sentiment. I
10 guess the question I'm raising really is has
11 experience shown that, or do we really have much
12 confidence in that kind of a statement.

13 I guess the second observation is that
14 it's really a metric issue. I mean you're sort
15 of saying, well, how do we judge the
16 effectiveness of a program, and there was some
17 discussion this morning about sort of what are
18 the right kinds of metrics I guess, one of your
19 colleagues asked and I'm trying to find my notes
20 because I thought that was a pretty profound kind
21 of question.

1 As I -- the kinds of things people
2 talked about at that point were the sort of thing
3 like employee surveys and help line statistics
4 and so on, that seemed to ask whether this
5 particular program has in fact been effective
6 rather than sort of saying as a generic matter we
7 think these kinds of programs tend to be like
8 this. And so I guess we tend to be more disposed
9 towards the kinds of metrics that really look at
10 the particular program and say give us some
11 evidence to show that this program really was
12 effective rather than just to judge them
13 according to a kind of series of abstracts.

14 MR. PETRY: Last follow up, Ron. So
15 then what it would come down to if we had phrased
16 the question that way from your point of view it
17 would have come down to an empirical question,
18 that is, is there such data, research --

19 MR. CONRAD: Right.

20 MR. PETRY: -- experience I think was
21 the word I used. And then the second question

1 would be assuming that there is experience that
2 would warrant this how would it be done in a way
3 that would lend itself to assessment.

4 Then I think we come to Frank Daly's
5 suggestion that there is a way of doing this
6 that, you know, the federal acquisition
7 regulation has already done.

8 So a round about way of doing this,
9 but I guess what I'm asking --

10 MR. CONRAD: I mean I'm not real sure
11 what it is that the bar does --

12 MR. PETRY: Maybe you could explain
13 it.

14 MR. CONRAD: Well, basically --

15 MR. DALY: Actually it sets out a
16 whole series of options as to what people could
17 do to get to indicate that they in fact are
18 taking the bar seriously and putting it to work
19 in their culture. So it doesn't get specific and
20 say you must do this, or you must do that, but it
21 does say here's a list of ten things that you

1 could do that would send that message.

2 MR. CONRAD: So implying that
3 guidelines it would be more of a matter of the
4 government reviewing whether those things had
5 been done, or asking --

6 MR. PETRY: I assume it would be some
7 kind of illustrative examples in the commentary
8 that would then give guidance to all those who
9 have to assess the program.

10 MR. DALY: Which also leaves open the
11 issue of the applicability to different kinds of
12 organizations, because if you give a whole series
13 of options and things that people can do that are
14 equal indicators of their commitment then you can
15 accommodate difference in size, in style of
16 management, etcetera.

17 MR. CONRAD: And presumably these are
18 not things that somebody can check off by showing
19 you the binder and saying see, we did it. I mean
20 I know there was some discussion this morning
21 about it, you want a verification if you will

1 mechanism, evaluation mechanism that actually
2 looks at how these are applied as opposed to a
3 kind of paper check-the-box-type -- assuming that
4 that's how they would work.

5 MR. DALY: Well, someone would have to
6 evaluate them. And you'd have to come to the
7 conclusion whether or not this was simply a
8 covering operation or whether or not it had
9 larger implications.

10 UNIDENTIFIED SPEAKER: Well, I think
11 what's probably -- I think we have to be careful
12 about that kind of self-reported stuff too in
13 terms of evaluating the detriments. I mean it's
14 fine to say, gee, that was a really great program
15 and whatever. But in putting together a
16 training, it seems to me that we have to have
17 educational objectives and if you have
18 educational objectives, you know what it is in
19 advance that will determine whether or not the
20 program has been effective based upon the
21 evaluation. It's very easy to pre-test a

1 population and post-test a population. It
2 requires a lot of time and effort because it
3 forces you to try to determine ahead of time what
4 really is effective, what do I want them to know,
5 how do I want them to feel, and what I want them
6 to do after this program is over.

7 So I mean there are ways to evaluate
8 on an impact basis or short-term basis, whether
9 that intervention is effective. It's another
10 thing to take it more macro cosmically and look
11 at is the whole program effective. But I suspect
12 there are ways of doing that, too if you have a
13 strategic plan to guide over a period of time
14 what it is you want that program to accomplish in
15 terms of attitude, knowledge and change.

16 MS. NANGLE: In your experience if you
17 have a list -- examples of types of change a
18 company can do to show that they have an ethics
19 program and then a prosecutor is looking at the
20 ethics program to see if it's effective, how do
21 you get consistent decisions out of the various

1 ASUSAs all around the country because one could
2 look at it and say these three components make it
3 effective, and another one could say no, I don't
4 like those components as much as this one. How
5 do you --

6 MR. DALY: I don't know how you do
7 that. I think that was an issue that was raised
8 in the second session that I was at this morning
9 in terms of someone raising this, I think it was
10 Mr. Colman (phonetic), what he knew and what
11 other of his colleagues didn't know. I'm not
12 sure, you know, about the answer is.

13 MR. CONRAD: That blue sheet, what's
14 the name of that document --

15 MR. HOCHBERG: We call it the blue
16 sheet.

17 MR. CONRAD: But I forget the formal
18 name of it.

19 MR. HOCHBERG: Well, it's the U.S.
20 Attorney's manual.

21 MR. CONRAD: Would that be -- isn't

1 that --

2 MR. HOCHBERG: Well, we put the
3 principles of corporate prosecution -- or they're
4 slated to go in there. They're actually being
5 reviewed as we speak.

6 But again, they're guidelines. We
7 constantly hear that they out-lawyer our AUSAs.
8 Where we come across it at main DOJ is not a
9 guidelines issue, not, you know, adjudication of
10 fines but on the charging decision on major
11 corporations that usually comes up, they're
12 usually well represented, they know how to appeal
13 the decision, they usually work their way up the
14 line and then collateral consequences are always
15 a very large issue. So it usually -- it's up to
16 main Justice for review and for some consistency.
17 And that was the whole purpose we came up with
18 those principles of corporate prosecution to try
19 to give the defense part some standards. And on
20 cases -- I often sit on that appeal process. We
21 found that the defense very readily addresses

1 each of the principles of corporate prosecution
2 that we've articulated and will often just go
3 down the list and say, you know, we have an
4 effective compliance program, we -- you know,
5 this was -- we've made voluntary disclosure, the
6 collateral consequences will be very great, we
7 have no reason to prosecute, and address each of
8 the principles we've put out there.

9 MS. NANGLE: Let me ask Jamie a
10 question. You've made a case that so many of the
11 other of Sarbanes/Oxley and New York Stock
12 Exchange have already imposed ethical standards
13 and yet the business is regulated by the
14 exchanges and by the SEC are not the predominant
15 ones being sentenced. I mean most of the
16 businesses being sentenced are not listed
17 corporations they're very small corporations.
18 And so within the health care industry a great
19 many of the businesses are non-profit
20 organizations which are not listed.

21 So none of those laws -- there's a

1 great debate going on right now about how much of
2 Sarbanes/Oxley is going to be applied to the
3 non-profit sector even though it's not directed
4 specifically toward it.

5 So would that be a suggestion that
6 perhaps some of those same points should be
7 covered in the out- lines so that you have
8 consistency.

9 MR. CONRAD: Yeah. Well, I think that
10 most of our members are -- we have some family
11 health -- you know, (Inaudible) on some
12 family-held, privately-held members. But most of
13 our members are publicly traded and so they tend
14 to look at these questions and say well, but --
15 you know, this applies to us and so their real
16 anxiety is to make sure that when all is said and
17 done, they match up and that there aren't
18 differing or inconsistent kinds of requirements
19 as between the two.

20 You know, if you look to the universe
21 of companies that aren't listed -- I mean it may

1 be appropriate for the guidelines, and it would
2 be less of a concern of ours, if the guidelines
3 said for those organizations that are not
4 publicly traded companies the following elements
5 of the existing law should be -- an effective
6 corporate compliance organ for those
7 organizations would include these elements of
8 law, that while they don't apply to them, are,
9 you know, seen as hallmarks of an effective
10 compliance program.

11 I guess the only kind of thought we
12 urge in kind of thinking about that is the extent
13 to which they're really all amenable --
14 applicable to or appropriate to really small
15 businesses. I mean does every business have an
16 audit committee for example, things like that. I
17 mean when you get down to the really small kinds
18 of businesses.

19 But I would think with those kind of
20 provisos, I think we're a lot less concerned than
21 I think we were in terms of what I said this

1 morning.

2 MR. JAMES: I have a follow-up
3 question before we go forward, just back to the
4 culture. And a couple of you started with
5 examples of what it looked like to link a value
6 to an actual part of the compliance program, and
7 I'd like for you to expand on that if you could
8 for us. But one example I know you started with,
9 Gretchen, was talking about integrity being a
10 value and how that gets linked to behavior, i.e.,
11 compliance with the law.

12 And Frank, I know you started with
13 perhaps not a corporate example from your
14 organization, but I think it was being in the
15 line of the automated teller and standing so far
16 back there was a privacy norm that was there.
17 Can you maybe take a -- give me a better example,
18 or another example of what it looks like to
19 connect a value to a compliance effort and how
20 the two work hand-in-hand together?

21 MR. DALY: A couple things that we've

1 done -- let me talk about methodology rather than
2 the specific values, is originally when we
3 introduced our values we did a 360 review. In
4 other words we identified 80 behaviors that
5 linked up with the values. For example, we value
6 our people. One of the behaviors might be does
7 he act fairly in the -- we value integrity, did
8 he follow the law, we value our customers, for
9 example. We would include in that following a
10 law such as the Truth in Negotiation Act.

11 And so our people have to evaluate
12 themselves against those 80 behaviors and then
13 their peers and their customers and their direct
14 reports evaluated them, and they were all fed
15 back to them through a third party.

16 Now, what we did more recently in
17 terms of trying to review that is we gave our
18 employees scenarios to work out in the work
19 place, in other words in small groups. And one
20 of the things they had to do was identify the
21 company value that was offered in helping them to

1 resolve -- the principle that was offered that
2 was helping to resolve the particular problem
3 they had.

4 So tying it -- I mean even at that
5 level to how people learn, how they reaffirm,
6 etcetera, we think is one important way that you
7 can do that.

8 MS. WINTER: Ron, I would also talk
9 about our value of integrity and just explain a
10 little bit about how it gets translated into the
11 code of conduct. I talked about our core values,
12 we have seven of them. One of those values is
13 integrity. The value of integrity is defined for
14 our employees both within a paragraph-long
15 definition that talks about compliance with laws,
16 rules and regulations which I quoted in the
17 testimony.

18 It is also explained to people in the
19 form of our code of conduct. This represents --
20 this code of conduct represents what it looks
21 like to behave with integrity as a Baxter

1 employee. If you look at some of the specific
2 text of some of the standards that are here you
3 will see reference to some very specific
4 regulatory and legal requirements under the title
5 "Prohibition of Bribes, Kickbacks, Unlawful
6 Payments, and Other Corrupt Practices," there's
7 specific reference to the Foreign Corrupt
8 Practices Act of 1977. So you'd see some linkage
9 there in addition obviously to a series of other
10 things in the concept or in the policy under fair
11 competition and anti-trust we talk about some of
12 the basic principles of anti-trust laws to which,
13 you know, with which our employees must comply.

14 You know, with respect to our quality
15 section there's a reference to our quality
16 manual, and in the quality manual itself there
17 are details, pointers obviously to FDA
18 requirements, which is an agency we are required
19 to work very closely with over time.

20 So those are some examples about how
21 this works at -- I keep moving with my hand like

1 this because I think of it as a cascading sort of
2 thing. You have at the very top of the
3 organization these values and then you take the
4 value of integrity and you say how does that play
5 out in real life for employees and at each level
6 you get more and more specific. So the broad
7 values are great, the integrity value is defined,
8 the global business practice standards give you
9 more specific guidance, and then using the
10 quality policy as an example you have a quality
11 manual, and beneath that you have policies and
12 procedures that exist for each facility, each
13 manufacturing facility.

14 And below that you have requirements
15 for each job. So you see it cascading. In fact
16 that is all designed to drive compliance not only
17 with the specific rule that applies to the
18 manufacturing operator, but also to tie back to
19 the overall corporate commitment to its shared
20 values.

21 Does that help?

1 MR. JAMES: Yes, that helps, thank
2 you. And to connect I think with a point you
3 were making, Bob, and I believe it was in your
4 testimony, a way to measure that -- there's
5 several levels of even measuring that if I
6 understood you correctly. One is quantitative
7 where you just count people that were educated or
8 how many communications points did they have; but
9 a second in did we change behavior. And that's
10 more qualitative, if something different
11 happened, how did that show up, and what did that
12 look like.

13 And then a third would be almost
14 impact, you know, did the number of complaints go
15 down, are the cases where we might have seen a
16 break down occurring did that actually go down as
17 well.

18 Were those the things you were talking
19 about in terms of measurement and assessment?

20 MR. OLSON: I think those are
21 possibilities. When I was thinking about values

1 and (Inaudible) available, I mean once you've
2 identified that as a core value for the
3 organization if you followed through as both
4 Frank and Gretchen have how did that
5 operationalize at the level of accounting --
6 accountants for example or for finance. And if
7 you work it functionally to deal with that type
8 of a problem, and then apply those standards
9 within those two functions, and that can be done
10 in a training perspective, attitude change,
11 knowledge increase, certain behavior, a specific
12 impact. That would at least give us a handle on
13 whether or not the immediate intervention has any
14 impact, not withstanding whether on a much
15 broader scale you could somehow manufacture a
16 rigorous method that would tell you whether the
17 whole program was impacting the organization as a
18 result of a decrease in malfeasance.

19 MR. PETRY: Do you want to respond to
20 that?

21 MR. GREENBERG: The only additional

1 cut I have and I think it's similar to that
2 approach that many companies have which is to say
3 to try to encourage people that think beyond the
4 law and can connect law and integrity by saying
5 the first question you need to ask is -- when you
6 face a decision -- is it legal.

7 But if the answer to that is yes, then
8 you have to ask an additional question, does it
9 follow company policy because company policy is
10 often higher than the minimum legal threshold.

11 And beyond that there may be no
12 violation of company policy but it still may not
13 be the right thing to do, so you have to ask is
14 it the right thing to do. And even if you get
15 through all three of those screening, there's an
16 additional question in a modern big company,
17 which is will other people understand. Because
18 it may be legal, it may not violate policy, it
19 may not be the wrong thing to do, but if the
20 public doesn't understand you still have a huge
21 reputational issue at stake.

1 And so I think many companies
2 encourage decision making through a series of
3 questions like that.

4 MS. WINTER: I'd love to just echo
5 what David said, I think he's exactly right.
6 There really is a decision-making model that
7 accompanies an awful lot of these programs,
8 covers those topics.

9 We happen to have six questions that
10 we pose to employees to help get at that very
11 last piece of it, and really ask them, you know,
12 not only is it legal, does it follow our
13 policies, does it comport with our values, but
14 what would other people think, what would the
15 impact be on other people. And of course
16 everybody's favorite test, you know, the press
17 test, could you explain this if 60 Minutes showed
18 up at your door, and how would that sound.

19 So that often helps people put a lot
20 of these decisions into an entirely different
21 context.

1 MR. DALY: We use exactly the same
2 questions that David used, but we've also begun
3 thinking about the possibility of asking is it
4 the right thing to do as the first question,
5 because people have a sense of when they're faced
6 with a decision as to, you know -- Professor
7 Wilson that wrote the book The Moral Sense claims
8 that -- he's a criminologist -- he said that
9 other than sociopaths and psychopaths, you know,
10 normal people have a sense of right and wrong.
11 And so then, you know, you respond to that and
12 then you go into the, is it legal, etcetera,
13 etcetera.

14 And part of our thing is also consult
15 the company value to come to those decisions.
16 And then finally we're suggesting, because
17 frequently doing the right thing and doing the
18 ethical thing not always, but frequently, it has
19 a business benefit as well, as the final question
20 is does it go the extra mile. Which brings a
21 whole kind of sense of values over the particular

1 question that you're answering, and have people
2 deal with those issues and respond to those
3 questions.

4 And then of course everybody does the
5 newspaper thing.

6 MR. JAMES: Ed, Jane, ready to move
7 on?

8 MR. PETRY: Sure. I'd like to turn to
9 Question 1. There were really several components
10 in this Question 1. The question was asked was
11 should changes be made to the guidelines, and to
12 specifically articulate the responsibility of the
13 CEO, the CFO, and other persons responsible for
14 high level oversight; and then next should we
15 further define what is intended by specific
16 individuals within high level personnel of the
17 organization.

18 So first of all, am I right that
19 everything we've heard today -- I don't believe
20 I've heard anyone speak in favor of specific
21 language articulating the responsibility of the

1 CEO, or CFO; is that correct?

2 Okay, that's what I thought. The next
3 part, further articulating what is meant by, you
4 know, the specific person with high level
5 oversight.

6 I know David, you in your written
7 comments speak rather forcefully about that being
8 very important. I believe there were only two
9 other specific recommendations that were
10 submitted, and one by the Department of Justice
11 and one by Alan Yuspeh earlier this morning. So
12 I just want to read both of those and then if we
13 could get reaction to those.

14 The first -- and again, so we have
15 David who spoke in general terms about the
16 importance of having high level senior management
17 oversight, the Department of Justice which said
18 in response to Question 1A, we do believe it is
19 critical that compliance officers have a direct
20 reporting line to the CEO, the Board of
21 Directors, the outside auditors, or some

1 independent committee of the Board. This access
2 is key we believe to uncovering and preventing
3 criminal activity by high- ranking corporate
4 managers.

5 And then the next one would be Alan's
6 suggestion this morning for business
7 organizations with blank or more employees and
8 officer position must have been established as
9 part of the senior management of the organization
10 with the primary responsibility of overseeing
11 compliance with such standards and procedures,
12 promoting sound business conduct, and ensuring
13 overall organizational responsibility.

14 So those are the suggestions that are
15 really kind of on the table right now. Would
16 anyone like to react to those?

17 MR. OLSON: Yeah, I'd like to concur
18 with them. It seems to me that any organization
19 is aware that function is delegated down the line
20 at a 10 percent or 20 percent NTE, and I just
21 don't think you get the same impact. I've heard

1 strong testimony to that effect, that you really
2 need someone on the executive level who can take
3 charge of that role. I mean that's how the
4 employee down at the rungs is going to say, hmm,
5 they're up on the 25th floor, or whatever it is,
6 so it's not as important. It's been delegated to
7 someone who's doing eight other things, it's not
8 as important. And it's really critical to have
9 that sort of positioning within the corporation.

10 And I also think it's critical not
11 only to have those kind of direct reports but I
12 would add another report to it, and that would be
13 a strong sense of working with other stakeholders
14 outside of the corporation. I mean we all have a
15 lot invested in corporations and to some extent I
16 think it's incumbent upon the person in this
17 position to make sure that there is some
18 attention to the public good.

19 MR. JAMES: Other reaction?

20 MR. HOCHBERG: We didn't directly
21 address how high level the compliance officer

1 would have to be; on the other hand we did
2 strongly recommend access and if you have that
3 kind of access you've got to be fairly high level
4 or be perceived to have -- to be high level.

5 MR. DALY: Well, I think it's a good
6 idea. It might be perceived as self interest
7 inasmuch as would it get me a promotion.

8 (Laughter.)

9 MR. DALY: But I think you need to be
10 careful to make sure that you identify the
11 operational person because you could in fact have
12 the operational person be someone lower in the
13 organization and reporting to a senior vice
14 president who says I'm the ethics officer, when
15 in fact the ethics officer is really the
16 operational person.

17 I also think it's not the profile,
18 there are other ways. For instance we have dual
19 reporting. Now, remember a board of directors
20 for a large corporation meets maybe seven or
21 eight times a year, and I report directly to the

1 Public Issues and Policy Committee once a year on
2 what we've done, what we've accomplished, of what
3 the open line shows, what the profiler called
4 what trends are there. And we have a pretty big
5 risk discussion, what the surveys show in terms
6 of what's coming across to the employee, that
7 kind of thing, totally independent of me. The
8 internal audit group which audits us annually
9 reports to the Audit Committee of the Board of
10 Directors. And there's some crossover there
11 because some of the Audit Committee members are
12 also on the Public Policy Committee.

13 It seems to me that there are other
14 constructs to get the question raised in the
15 organization than a unitary one that says it's
16 got to be exactly this one, although I think
17 raising the level of it is certainly a good idea.

18 MR. JAMES: I guess I wanted to do a
19 follow up on Ed's question and maybe take the
20 opposite viewpoint. But I want to make sure I
21 understood it correctly. He went back to

1 question 1A and said do I understand this that
2 people don't feel that there needs to be a more
3 descriptive role for the CEO, CFO, board, in the
4 guideline. And people basically said no, it
5 doesn't need to be as prescriptive.

6 But I guess what I wanted to dig into
7 a little deeper is I heard several cases where
8 you have operating officer/CEO involvement on
9 oversight teams. I think, David, you talked
10 about having a -- being on a team of six that had
11 a high level oversight responsibility with the
12 CFO, the "M" and "A" person, and then in addition
13 to that you're on an executive council where in
14 your role when they see you coming you said, hey,
15 there's some issues that they know we need to
16 work.

17 And while that's not prescribed in the
18 guidelines today I guess my question is, is that
19 fairly typical in organizations and if it's not
20 should there be some encouraging signal sent to
21 organizations to say that this is one way to make

1 sure programs get visibility as well as people
2 have access to the various audiences we've been
3 talking about.

4 Do you follow the point I'm making?

5 MR. GREENBERG: From my experience
6 this has proven enormously helpful. The only
7 caveat is, you know there are lots and lots of
8 structures and approaches and systems of
9 operating, and my second point was that the
10 structure for compliance integrity and ethics in
11 a corporation or organization needs to match the
12 way that business functions.

13 And so, you know, one approach for
14 everyone probably isn't right, although I happen
15 to believe that Alan Yuspeh's suggestion would
16 drive change in a lot of places, and maybe in a
17 lot of the places that need change. And it
18 wouldn't necessarily drive change in places where
19 an excellent job is already being done. It would
20 not guarantee effective, but it would drive some
21 change, and I think either by example,

1 encouragement, or mandate it's definitely worth
2 you guys talking about it.

3 MR. JAMES: And you said it better
4 than I did, just to follow up. As opposed to
5 being silent on the issue of placement and access
6 would it be helpful if the guidelines said
7 something about that and the role that it could
8 play in helping to build an effective program.

9 Frank, I know you've got a plane to
10 catch, do you have any comments on that or any
11 other issues before you need to go?

12 MR. DALY: The question -- one of the
13 interesting things I think that's happened in
14 terms of the role of CEOs is one of the things
15 that Sarbanes/Oxley and certification has
16 enforced already is that certification doesn't
17 get done at the top of the corporation by the CFO
18 and the CEO sitting alone in the room, it gets
19 passed down. And so what you're seeing is the
20 senior officers of the corporation are having to
21 almost, in our setting, to certify up. That, you

1 know, the things that they need to do are in
2 place before the CEO and the CFO are going to
3 certify what they need to do.

4 So that kind of cascade is already
5 happening.

6 MR. JAMES: Thank you, very much for
7 being here, and thanks for taking the time out.

8 MR. DALY: Thank you.

9 MR. GREENBERG: One thing that I
10 wanted to come back to because in your
11 characterization of the answer to Ed's question I
12 think you may have gone one step too far. I
13 didn't hear people say that the guidelines
14 shouldn't acknowledge or recognize the role of
15 boards. I heard them say that probably it's not
16 necessary for CEOs and CFOs because that is so
17 inherent in so many other requirements, and those
18 people are seen as the chief leaders and value
19 setters, the CEO overall and the CFO in the
20 financial area.

21 You might get a different answer if

1 you ask, you know, if boards are not currently
2 recognized in the guidelines should their role be
3 acknowledged, and how. And I think you'd get a
4 lot of different answers about how, but I think
5 you might get some consensus about it seeming
6 strange for boards not to be mentioned.

7 I don't know if that's right, but
8 that's a gut --

9 MR. JAMES: Let's keep going. Are
10 there questions that the panel is getting for one
11 another before we go forward, based on what you
12 heard?

13 Or our guests, are there questions
14 that you have, or thoughts that you maybe would
15 like to share?

16 MR. CONRAD: I have a question but
17 it's off the topic.

18 MR. JAMES: Let's stay on this topic.
19 Sure, Ed, go ahead.

20 MR. PETRY: I'd like to turn to our
21 Question 1D. Really only Gretchen responded to

1 this question so I'd like to get more response.
2 The question was should so and so which refers to
3 the delegation of substantial discretionary
4 authority to persons with a propensity to engage
5 in illegal activities be clarified or modified.

6 I should add the Department of Justice
7 has also responded to that, and their response is
8 no, the current commentary is not ambiguous, we
9 believe the application of this comment will
10 always be a fact question to be determined
11 properly by the sentencing court.

12 And then I believe Baxter's position
13 was yes, it should be modified with illustrative
14 examples of what a company might do to comply.

15 Any other help you can give us on this
16 one? And I have to say over the years I've heard
17 from ethics officers that this is a problem, and
18 yet I'm not hearing that today.

19 MS. NANGLE: I'll have to add that I
20 have heard a lot of people ask what does this
21 mean, does this mean we have to do criminal

1 background checks on every single person we
2 employ, or you know, how far down the ladder is
3 discretionary authority. You know, because
4 everybody exercises some degree of discretion,
5 and it's those on the front lines at the lowest
6 level who can sometimes get you into the biggest
7 trouble.

8 And so I've gotten a lot of feedback
9 and there are questions on this.

10 MR. HOCHBERG: Gretchen, what kind --
11 I'm not aware of what kind of policies are in
12 place, and obviously background checks, maybe
13 polygraph, but beyond that --

14 MS. WINTER: I think no polygraphs,
15 but background checks I think tends to be the
16 thing I hear about most often, is that people do
17 to try to comply with this particular piece of
18 guidance. The better question is, you know, what
19 is a background check. There's so many companies
20 out there that do them, there's so many ways to
21 have them done, do you have to check somebody's

1 state record, federal records, driving records,
2 you know, credit records. What histories do you
3 really need to look at in order to make sure that
4 you're complying with it.

5 In the health care industry there are
6 a series of lists that the OIG publishes that,
7 you know, you shouldn't be doing business with
8 these folks if you're involved in international
9 trade, there's another whole list of people who
10 come out with this big list on the internet. You
11 could run potential employees against that
12 particular check.

13 You could spend an incredible amount
14 of time running a potential new employee's name
15 against all kinds of list that exist and paying
16 for external background checks in the hopes of,
17 one, making a good hiring decision, but two,
18 trying to demonstrate compliance with this
19 particular piece. And I think people wonder.
20 And in the HR world whether you take this sort of
21 requirement in and say okay, what are you doing.

1 Well, we talked to them, we have interviews, you
2 know. We make good decisions because, you know,
3 you make them from the gut. And that's the way
4 you hire people, and some people will say that
5 that's sufficient.

6 So you have a huge range of things
7 that people think are sufficient, you have
8 companies that are talking about are the costs to
9 do this, and what does it take in terms of
10 additional time to run a comprehensive background
11 check.

12 In addition to that -- and that's just
13 at the sort of entry level to the corporation.
14 Once you're in the corporation you don't sort of
15 stop acting as a human being, I mean there might
16 be all kinds of other things that you're doing
17 during the course of your employment that might
18 show that you have a propensity to behave badly,
19 right?

20 So are we also suggesting to people
21 that -- to companies that when people are

1 promoted, oh, there's another potential time to
2 run a background check on this person, is that
3 what is required? And I'd like to suggest no,
4 it's not. But, you know, it's a question that I
5 have heard discussed, Jane, like you in groups
6 where people are talking about what does this
7 mean, how often do I have to do it, with what
8 depth do I have to do it, and if I did decide to
9 run a background check on somebody every time
10 they were promoted what background check would I
11 be running at that particular moment in time.

12 So I think there's lots of questions
13 but unfortunately not a whole lot of answers.

14 MR. HOCHBERG: Well, I think it's very
15 difficult, but I mean we run credit checks on
16 some federal employees but I don't know how you'd
17 standardize it. Obviously in health care for
18 people with hands-on experience you would
19 probably require a different kind of background
20 checks than other places.

21 MS. NANGLE: And what is a propensity

1 to violate the law. I mean if you're hiring
2 someone to do a highly technical job that
3 requires a lot of expertise, whether it's
4 programming your computer or doing neurosurgery,
5 what if they have a string of traffic tickets; is
6 that a propensity to violate the law? Or even
7 bad checks. Should that preclude you from hiring
8 someone with a very sophisticated skill.

9 So I get a lot of feedback from people
10 that this is a difficult term to deal with.

11 MR. CONRAD: I'm the -- within my
12 organization I'm the lawyer for a group of folks,
13 essentially they're lawyers for companies that
14 have compliance responsibilities and there's
15 probably about 35 companies that are represented
16 in this group, and I've been doing this job now
17 for about nine years. And this was feature of
18 the organizational guidelines that has always
19 stuck in my mind as the most inscrutable, and the
20 one which over the years I have heard people say
21 all the sorts of points that you both made.

1 I'd have to say officially when our
2 group sat down to look at this, I think their
3 sense was if this were to be the issue that
4 triggered a whole reopening of the guidelines
5 it's better to live with the guidelines the way
6 they are rather than to fix this one and then
7 have 12 other things creep in. I think
8 politically that's why our comments have not
9 said, this is an outrage.

10 But it is -- of the existing aspect of
11 the guidelines it is the one part that I think
12 people to this day have not really wrestled to
13 the ground, or if they have, you know, they
14 better keep sitting on it because as soon as they
15 get up it will -- I mean, you know, they sort of
16 got in a posture where they're kind of
17 comfortable, but they're not really comfortable
18 it's just a static outcome.

19 MS. WINTER: Is there value in having
20 it, and I'm asking that now just as a human being
21 listening to this conversation as opposed to

1 taking any particular position on behalf of the
2 company. What is the value I might ask of having
3 that particular piece in the sentencing
4 guidelines?

5 MR. GREENBERG: I think that's hard to
6 answer because we don't know what it means, I
7 don't think anyone knows.

8 MR. CONRAD: Was anybody here when
9 this was developed in '90 or '89?

10 MR. PETRY: How was it used in --

11 MR. HOCHBERG: I've not come across
12 it. Obviously, you know, in an extreme case of a
13 corporation, you know, was closing controlled and
14 the key person had a prior run in with the law,
15 and you know, second offender-type situation, we
16 would maybe focus on it, but short of that --
17 short of some sort of willful disregard of what
18 would rationally apply.

19 And then the securities industry takes
20 care of, you know, you're debarred from that
21 industry.

1 MS. NANGLE: That's right. When I
2 first started preaching corporate compliance, and
3 teaching it to people in the health care
4 industry, we would say you don't want to hire a
5 convicted felon to be your CFO, or something like
6 that. But now we have the debarment and the
7 Medicare sanction checks which take care of most
8 of that. And so it's difficult to know exactly
9 how you apply it now.

10 MR. JAMES: And I'm gauging a reaction
11 to your question is yes, there needs to be some
12 clarification to what this actually means; is
13 that fair people, from the comments that have
14 been made so far?

15 MR. PETRY: Well, let me suggest that
16 between now and December 1st if any of you have
17 the time to submit some suggestions as to how
18 this might be modified, please do so.

19 MR. JAMES: I'd like to raise a
20 different question if I can go on from that point
21 you raised; is that okay to keep going?

1 MR. PETRY: Sure.

2 MR. JAMES: A different question,
3 perhaps David or Gretchen or Jamie in your
4 experience you might be able to respond to this,
5 and I'm going after the notion of small to
6 mid-size companies and how we think about ethical
7 culture within that context. Clearly you all
8 represent large organizations, their resources
9 that are focused on compliance and building good
10 ethical programs for the overall corporation, but
11 as we know there are a lot of small to mid-sized
12 organizations which may not have the same
13 infrastructure or resources to attack it quite as
14 you do.

15 I guess the question is in your
16 experiences in acquisitions where you maybe were
17 buying small to mid-size companies, or starting
18 them up, do you use a different model of
19 compliance and ethically based programs for those
20 because they perhaps can't handle the same
21 infrastructure that you do with the rest of the

1 divisions, or do you focus the same design on
2 them.

3 And I guess, Jamie, for you I know
4 this morning you said you represent large and
5 small companies. And so if you could think
6 about -- you talked about some of your larger
7 companies do practice good ethical behavior, I'm
8 also interested in your perspective as to how
9 that translates to small and mid- sized
10 companies.

11 Any reactions to that?

12 MR. CONRAD: I know in meetings that
13 you were referring to that -- where they often
14 will sit around and sort of benchmark compliance
15 systems and things like that, the question of
16 acquisitions comes up fairly often because there
17 are often situations where, you know, companies
18 of the sort of size that you find in General
19 Electric and so on, pick up fairly small
20 companies, and notwithstanding however much due
21 diligence they did before the acquisition -- well

1 I mean apart from if there was anything wrong,
2 yes, there's certainly many cases where they sort
3 of -- wow, we'll need to change the compliance
4 management system to sort of bring it in to the
5 sort of general gamut of the new parent company.

6 Offhand I can't recall whether they
7 sometimes sort of get phased in in a way where
8 you sort of well, you know, we'll get them to
9 doing this and then we'll get them doing that. I
10 mean there are often tests that they'll use to
11 judge how ready the company is to step into the
12 sort of, you know, new kind of -- the GE system,
13 to pick one example, or something. And often
14 those kinds of tests tend to be nothing but yeah,
15 this is a violation of that, violation, but you
16 know, are you aware of all of the different kind
17 of programmatic areas of regulation that are
18 required. Because if somebody is completely
19 missing one then that's usually a pretty red flag
20 thing that they're going to really need to sort
21 of police. That system will need to go under

1 sort of, you know, audit frequently time table
2 rather than the audit every three years kind of
3 time table.

4 What I will do is between now and
5 December 11th I've got sheafs of old notes and if
6 I find something that really bears on that
7 question I'll let you know because it's
8 interesting.

9 MR. JAMES: Other reactions, David or
10 Gretchen?

11 MR. GREENBERG: We probably acquire a
12 dozen businesses a year which is pretty normal
13 for a big company I think. And I don't know that
14 we would separate this issue from all the other
15 issues in integrating and from their financial
16 systems to their HR systems to everything else
17 about them. And I think that yes, there's a
18 certain time table for their full integration say
19 into craft. But it's 100 percent, and it's just
20 sort of a measured step-wise how quickly can that
21 business absorb a new set of systems and a new

1 set of requirements.

2 But normally those businesses become
3 part of larger entities and get sort of folded in
4 to an ongoing business. And so there's an
5 infrastructure ready to receive this.

6 But in any big business that grows in
7 part by acquisition, there seems to be very
8 little choice or desire to do anything but
9 integrate them into all aspects of the new
10 corporate life as quickly as possible.

11 So the only delay is how quickly can
12 you be effective in doing that.

13 MR. JAMES: And if I can just clarify
14 before we go a little further on that question,
15 while I think the getting them integrated aspect
16 is very valuable to the analogy what I'm really
17 after is how does this function in small to
18 mid-size businesses. And we've not had a lot of
19 experience in the broad market where it's
20 stand-alone small and mid-size businesses.

21 So what I'm wanting to draw out from

1 your experiences is since you have great plans as
2 you have worked with small to mid-sized
3 businesses in your firms what's been useful that
4 we might be able to learn from that and apply to
5 the broader industry.

6 Now, just as you mentioned earlier
7 too, you've got four or five different divisions
8 and you allow them some flexibility in terms of
9 how they build good programs. I'm making an
10 assumption here, or stretch, that may have a
11 bearing on size as well, even though you still
12 expect for them to comply with the corporate
13 policies how they go about building a program
14 might look different.

15 And that's what I'm wanting to push at
16 to see if there's anything you can share that
17 might help us there.

18 MR. GREENBERG: Well, again it's
19 driven by product line, by geography, by culture,
20 by history, by all sorts of variables that have
21 to do with how that business runs.

1 But I think that we're not a good
2 test, and I think most other large companies are
3 not a good test of that because one of the things
4 you do is immediately embrace this new smaller
5 business with all the systems and resources that
6 are characteristic of the corporate parent. And
7 so they cease from the day they're acquired being
8 that smaller or medium-sized business.

9 So then the only answer to your
10 question would be observations about what one
11 might have found in looking at those businesses
12 and comparing our systems to theirs. And I think
13 the major answer is just the smaller the business
14 the more informal the system.

15 But big businesses that acquire
16 smaller businesses always think they're acquiring
17 excellent businesses and excellent fits, and so,
18 you know, it would probably be more interesting
19 to look at the ones we walked away from. But I
20 never have done that.

21 MR. PETRY: Can we address that a

1 slightly different way? And that is not the
2 businesses that you acquire but your suppliers,
3 especially companies that are smaller. Is there
4 some standard that you hold them to, or that you
5 encourage them to meet?

6 MS. WINTER: We have begun working
7 with our suppliers within the last couple of
8 years to try to talk about our business practice
9 standards program and to help them understand how
10 it might apply to them. We have found them to be
11 very receptive to everything that we've done to
12 reach out. Many of them are small, some of them
13 are small divisions of larger organizations that
14 amazingly don't know whether their parent company
15 has an ethics program or not, which we always
16 find to be instructive.

17 But, you know, I would say that that
18 whole process of companies reaching out to their
19 suppliers on ethics and compliance programs is
20 really in its infancy, so I'm not sure that
21 there's a huge amount of learning that you might

1 take for your purposes here today.

2 With respect to the acquisitions I'd
3 agree with David, and I'm just thinking about a
4 couple of acquisitions that we made that had lots
5 of small locations which is maybe the closest
6 that I could come to try to provide you with some
7 input. But they had nothing before and frankly
8 were very excited, all of them have been very
9 excited to receive this information. The
10 employees have been just thrilled to see that
11 there are values, that there is a place they can
12 call if they've got questions or problems.
13 Generally my experience has been, whether it's a
14 small supplier or small parts of an acquisition,
15 people are very please to see that there is this
16 kind of a program and to want to be a part of an
17 organization that supports that sort of an
18 approach.

19 MR. HOCHBERG: My view is anecdotal,
20 but in the smaller companies we see regulatory
21 compliance and efforts at that, and maybe

1 programs at that, but not a comprehensive
2 compliance program. Quality control that's
3 important -- if a supplier to a major company
4 knows that product quality control is going to be
5 a key issue because they're supplying, you know,
6 medical stuff or government contracts, that will
7 filter down, internal controls will -- may be a
8 separate program. But a comprehensive corporate
9 compliance program we rarely see.

10 MR. JAMES: Pat, did you have a
11 comment?

12 MS. HARNED: Yes, my name is Pat
13 Harned and I'm from the Ethics Resource Center;
14 can you hear me?

15 I just wanted to add another dimension
16 to the discussion, which is sub contractors. We
17 very often see corporations asking sub
18 contractors to do a test that they are aware of,
19 the program in place at that company if they are
20 willing to abide by to the best of their ability
21 the measures that are in place. And so that's

1 another dimension to it.

2 So where we work with small companies
3 we find that the program is much more informal
4 but also very collaborative, so the role of a
5 leader in accepting responsibility for that
6 program is almost a given. The core values that
7 are chosen are very often agreed upon and defined
8 by a large portion of the company, but the
9 difficulty that goes along with that is that it
10 seems like reporting lines are very difficult.
11 Where you have a small company if someone reports
12 an instance of misconduct usually it's known who
13 that person is, so that adds another dimension of
14 difficulty in complying with the guidelines.

15 MR. JAMES: Okay, are there other
16 questions?

17 MR. PETRY: I have one more. I'm
18 sorry, they seem to have broken early --

19 I think this is a quick question, and
20 to Joshua. Can you just help me to understand if
21 there is a change to the guidelines will there

1 automatically then be an update to the principles
2 of corporate prosecution?

3 MR. HOCHBERG: No.

4 MR. PETRY: No, not necessarily?

5 MR. HOCHBERG: No. And those tend to
6 be generalized too, if you talk in terms of
7 effective compliance programs. So in evaluating
8 any particular situation, factual situation, it
9 has become relevant to a discussion of whether
10 it's an effective program.

11 But we had such trouble getting those,
12 they're still not official blue sheets, we hope
13 to make it an official blue sheet but I wouldn't
14 view it as something that changes really quickly.

15 MR. JAMES: Okay, are there other
16 comments or questions?

17 Any questions the panelists had for
18 each other or for us; or any of our guests, any
19 last minute comments?

20 If not, we really want to thank the
21 panelists and our guests for being here. But the

1 panelists we know took time out of your busy
2 schedules to review the questions that we asked
3 and to prepare testimony and to be here, and we
4 really appreciate your taking the time to do
5 that. Your information that you've shared really
6 will inform the Advisory Group as they begin
7 their deliberations.

8 So again thank you, and as Ed
9 mentioned earlier, December 1st is the last date
10 that we can take in public comment, and so to the
11 extent that you get on your way and something
12 comes to mind that says gee, I'd like to make
13 sure this is entered, don't hesitate to get that
14 in, and we'll be glad to make sure that that's
15 included with the testimony.

16 MR. CONRAD: Jim, I understand you'll
17 go an interim report; is that for the next
18 deliverable -- and what do you expect to be the
19 timing of that?

20 MR. JAMES: We're still in the
21 discussion stages but right now we're looking at

1 about the March kind of time frame because by
2 next fall we've got to deliver a final report,
3 and I believe our plan is to do something in the
4 March time frame.

5 MR. PETRY: There is a meeting of the
6 Commissioners in March and the current plan is to
7 have an oral report to them at their March
8 meeting. But that will be publicly available.

9 MR. CONRAD: In other words, the text
10 of the oral report will?

11 MR. PETRY: I believe so.

12 MS. WINTER: I have a question for you
13 as well, and that is it's my understanding that
14 Sarbanes/Oxley asks, and I think this is
15 reference to this morning perhaps by Jamie's
16 comments, or maybe somebody else's, but there is
17 a piece of Sarbanes/Oxley that requires the
18 Sentencing Commission to do a couple of things,
19 to take a look at what they currently have in
20 place and to determine whether or not the
21 guidelines are adequate. Is the effort that we

1 are participating in today related to that, not
2 related to that, what efforts are being made to
3 harmonize that if any, and maybe you don't know
4 the answers to that yet, but I'm just curious.

5 MR. JAMES: You mean -- Amy Shriver
6 from the United States Sentencing Commission
7 staff has joined us.

8 Amy, can you give us a hand with that?

9 MS. SHRIVER: There is obviously some
10 relationship in the subject matter. They asked
11 the Commission to look at look at -- which is
12 chapter, a very general reference to Chapter 8.
13 But the Commission is on a much shorter deadline
14 to respond to the Sarbanes/Oxley bill, and I
15 think that's some time in December, and so they
16 do know on the Hill that there has been this
17 Advisory Group convened. But I guess I would
18 tell you to look at the original charter for the
19 Advisory Group and that is something more
20 specific than the general question that
21 Sarbanes/Oxley raises. And so to that extent is

1 unrelated, and so something that's gone to the
2 Commission, and something the Commission has to
3 deal with which is the general question getting
4 advice later next year from the Advisory Group.

5 MS. WINTER: I'm just sitting here
6 sort of thinking if changes are made as a result
7 of the charter -- or to the Sarbanes/Oxley
8 requirement, if changes are made in the
9 guidelines as a result of the Sarbanes/Oxley
10 requirement then will we be convening another
11 hearing, or requesting additional commentary or
12 simply accept those changes and move on.

13 And again, you may not know the answer
14 to that but I'm just wondering if these things
15 are going to overlap at all in any way, and you
16 may not know.

17 We don't know the specifics, and Amy,
18 correct me if I'm wrong here, I think what the
19 staff is going to work hard at doing is
20 responding to Congress's request through the
21 Sarbanes/Oxley legislation, but acknowledging the

1 work of the Advisory Group and the input that's
2 being searched for, and then ensuring that
3 they're aware of the time table that we're
4 working on to deliver a finished product from
5 that standpoint. So I think that hopefully will
6 leave open some room for this input to come in as
7 well.

8 If it doesn't then I think you're
9 right, I think that's a question the Advisory
10 Group will have to work with the Commission on,
11 and that's what's the role of the Advisory Group
12 in that context. And I don't think we know the
13 answer at this point.

14 MS. WINTER: Thank you.

15 MR. JAMES: Well, again, thanks
16 everybody for being here and safe travels.

17 (Breakout Session adjourned 4:00 p.m.)

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