TESTIMONY OF GREGORY J. WALLANCE BEFORE THE UNITED STATES SENTENCING COMMISSION

March 17, 2004

My name is Gregory J. Wallance. I am a partner at Kaye Scholer LLP, a New York based law firm. I served for five years as an Assistant United States Attorney in the Eastern District of New York. My practice involves white collar defense representation of both individuals and corporations, internal investigations and advising corporations on corporate compliance.

I thank the Commission and the Commission staff for the opportunity to serve as a member of the Ad Hoc Advisory Group.

Violations of Law

Several of the comment letters, and some of today's testimony, disagree with our Report's recommendation that an effective compliance program should seek to deter all violations of law and not just criminal violations. These arguments, in my view, are off the mark.

The Congressional mandate to the Commission under 18 U.S.C. 3553 (a) (2) is to ensure that appropriate sentences reflect, among other things, "adequate deterrence to criminal conduct." The issue is whether Guidelines that offer fine leniency to organizations whose compliance programs

deter *all* violations of law – as opposed to only those that are criminal – will better achieve that objective. The answer is self-evident.

A compliance program that only seeks to deter violations of criminal law, while offering employees no guidance or incentive in complying with other laws and regulations, is on its face deficient. I know of no such compliance program. Every compliance program with which I am familiar seeks to prevent and detect violations of all laws, regardless of penalty.

Many crimes by organizational employees are distinguishable from non-criminal violations only by the employee's state of mind. To be effective in deterring criminal violations, a compliance program must deter the illegal act regardless of the state of mind with which it was committed. Illegal acts performed with non-criminal intent, unless deterred, risk becoming illegal acts performed with criminal intent.

The existing Chapter Eight guidelines, in fact, require companies to deter non-criminal conduct to be eligible for fine leniency. For example, Application Note 3 (k) (iii) states that "an organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable government regulation weighs against a finding of an effective program to prevent and detect violations of law." The reference to "applicable government regulation" is unmistakable. An organization's compliance program will be judged by whether it had complied with regulations carrying no criminal penalties. This commentary has never been challenged as outside

the Commission's authority.

In short, deterring and preventing violations of criminal law can not be accomplished with half-measures. If an organization seeks fine leniency, it must be prepared to demonstrate that it attempted to prevent all violations of law.

Waiver of Privilege

The Advisory Group struggled with the effect of privilege waivers. On this issue, there is a well-known divergence of views between the Department of Justice and the defense bar. Our recommendation offered a compromise amendment to the Commentary at Application Note 12 of existing Section 8C2.5 and for a new Application Note to existing Section 8C4.1. The recommendation was the product of an 18 month dialogue between the Department of Justice representative on the Advisory Group and the Group's white collar defense attorneys, several of whom had served in senior positions at the DOJ.

The compromise recommendation was a positive step forward. We were assured that this recommendation had been approved by the DOJ. Only after the recommendation was submitted as part of our Report – without dissent from the DOJ's representative – did the DOJ oppose the recommendation.

In the context of Application Note 12 to Section 8C2.5, concerning cooperation, the DOJ proposes adding a sentence giving "substantial weight" to the government's evaluation of the defendant's cooperation and whether waiver is necessary. The DOJ opposes the new Application Note 2 in Section 8C4.1, concerning substantial assistance, outright.

The DOJ's position is short-sighted, unnecessary and contrary to its own interests. The DOJ should be encouraging the dialogue that the Advisory Group began. It should be working with the defense bar to further identify areas of common ground, not widening the gap.

As to co-operation, the Advisory Group's recommendation left the DOJ free to argue to a court that an organization had not co-operated because it failed to waive privilege. The DOJ is also free to argue that its evaluation of the defendant's cooperation should be given "substantial weight." There is no need to afford the DOJ, in effect, a presumption of good judgment.

As to substantial assistance, the DOJ's opposition to the new Application Note to Section 8C4.1 likewise is unnecessary. Nothing in that Application Note changes the DOJ's exercise of discretion whether to file a substantial assistance motion or expands remedies available to a defendant from a failure to file such a motion.

The DOJ has a strong interest in encouraging organizations to adopt more rigorous compliance standards. To do that, it must also re-assure organizations that their compliance efforts

will not be used against them either by the government or in third-party litigation. The DOJ's proposal, following a year and a half of our efforts to find common ground with its representative on the Advisory Group, sends exactly the wrong message.

I spoke with the Chair of the Advisory Committee, Todd Jones, who advised me that the position presented by the DOJ on the waiver issue is not consistent with the Advisory Group's recommendation.

Where do we go from here? First, I urge the Commission to reject the DOJ's proposal and to adopt the Advisory Group's recommendation. Second, the Commission, through its unique status and powers, should advance the debate. Our report discusses a number of proposals including legislation before Congress, section 4 of "The Securities Fraud Deterrence and Investor Restitution Act." That provision, if enacted, would create a selective waiver doctrine as to documents or information produced to the SEC. Significantly, this provision was sought by the SEC, which wisely recognizes that it has a common interest with defense counsel in assuring organizations that their compliance programs and cooperation will not impale them on the horns of the litigation dilemma.

Culture of Compliance

The Advisory Group carefully considered whether to include "ethical standards" among the minimum requirements of an effective compliance program. We decided not to do so for several

reasons.

First, to be meaningfully implemented, the compliance criteria must be objective and easily understood. In our view, vaguely defined "ethical standards" or "set of values" do not satisfy this standard. A number of comment letters advocated adding an ethics criteria. None provided clear and workable definition of ethics.

Second, we adequately addressed the concern that Chapter Eight should do more than, to quote from one comment letter, "merely" encourage compliance. We recommended that an effective program compliance should create an "organizational culture that encourages a commitment to compliance with the law." We stressed that such a culture would be achieved by implementation of the more rigorous individual criteria that our report recommended. Our purpose was to provide an overall objective for compliance programs, an overarching theme, that transcends the individual criteria. We drew upon a variety of statements by the SEC, the DOJ and the business sector stressing the need for such a culture.

Finally, nothing in our recommendations limit the flexibility of an individual organization to encourage ethical behavior or to point to such efforts in seeking fine leniency.

Confidential Reporting by Employees

The Advisory Group carefully considered whether to recommend that the minimum criteria include a means for employees to report on both an anonymous and confidential basis. We recommend only that the criteria require a means for anonymous reporting.

The distinction is important. Organizations who receive reports from their employees of possible criminal violations must have the flexibility to disclose such information to law enforcement agencies and, where required or appropriate, to the public. Indeed, the Guidelines currently place a premium on such self-reporting, pursuant to Section 8C2.5(f), by blocking the 3 point culpability score reduction for an effective compliance program if the organization unreasonably delayed reporting an offense. Government agencies, such as the Antitrust Division, offer amnesty to a company that is the first to self-report a criminal antitrust violation. Securities law disclosure obligations may, depending on the circumstances, require a company to disclose violations of law in its public filings.

A requirement that an effective compliance program *assure* employees of confidentiality deprives organizations of the option to self-report and, indeed, may conflict with affirmative reporting obligations. The judgment whether to give such confidentiality assurances to employees should be left to the individual organization and not made a requirement of an effective compliance program.

Comment letters point out that the Sarbanes-Oxley Act of 2002 requires the "confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or

auditing matters." With all respect to the drafters of that legislation, the inclusion of the word "confidential" was ill-considered. While it may have been intended to encourage more employee reports, absent clarification, this provision, in fact, may hamstring companies in their ability to make the kinds of disclosure that the Act seeks to encourage.

Thank you.