



Our Vision is an Ethical World

Ethics Resource Center Fellows Program

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Fact Sheet

Who Are the ERC Fellows?

Chairman

Stephen D. Potts, Esq.

Former Director, U.S. Office of Government Ethics

Vice-Chair

Carol R. Marshall

Former Director of Ethics and Compliance, Lockheed Martin Corporation

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President, Ethics Resource Center

Founding Chairman

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Endowment

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Exec. Dir., Economic and Development Strategy
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Anne Marie Taylor

Associate Ethics Officer
Merck & Co., Inc.

Nancy Higgins

Vice President, Ethics and Business Conduct
Lockheed Martin Corporation

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ERC Fellows Program: Building New Knowledge



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Supporting Fellows

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Chief Compliance Officer
American Express Company

Thomas McCormick
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Dow Chemical Company

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General Motors Corporation

Thomas Gottschalk
General Counsel and Senior Vice President
General Motors Corporation

Patricia J. Ellis
Director, Business Ethics & Compliance
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Fellows

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Vice President, Ethics & Business Conduct
The Boeing Company

Thomas Mayer
Director, Office of Business Practices
Caterpillar, Inc.

Allen Stewart
Director, Ethics and Compliance
Duke Energy Corporation

Deborah Severs
Chief Ethics Officer
Eaton Corporation

Sam Piazza
Director, Office of Business Practices
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Margaret Sperry
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Robert Echols
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Director of Corporate Contracts
Science Applications International Corporation

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Shell Oil - U.S.

Dennis Jorgensen
Senior Vice President, Ethics, Business
Conduct & Administration
Tenet Healthcare Corporation

Earnie Broughton
Ethics Office Coordinator
USAA

Patrick Gnazzo
Vice President, Business Practices
United Technologies Corporation

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Invited Fellows

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Former President
Ethics Resource Center

Richard S. Shreve
Adjunct Professor of Business Ethics
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George G. Brenkert
Georgetown Business Ethics Institute
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Professor of Organizational Behavior
Pennsylvania State University

Bart Victor
Cal Turner Chair of Moral Leadership
The Owen Graduate School of Management
Vanderbilt University

Gary Weaver
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University of Delaware

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Worldwide
University of Notre Dame

Frank Vogl
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Vogl Communications

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Non-Profit Center Members

W. Michael Hoffman
Executive Director
Center for Business Ethics
Bentley College

Ed Petry
Executive Director
Ethics Officer Association

Rushworth Kidder
President
Institute for Global Ethics

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Government Office Liaisons

Paula J. Desio
Deputy General Counsel
United States Sentencing Commission

Barbara B. Hannigan
Ethics Counsel
Securities Exchange Commission

Jack Covalesski
Deputy Director for Agency Programs
U.S. Office of Government Ethics

Gaston Gianni
Inspector General
Federal Deposit Insurance Corporation

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February 20, 2004

United States Sentencing Commission,
One Columbus Circle, N.E.
Suite 2-500, Washington, D.C.
20002-8002,

Attention: Public Affairs.

This letter is on behalf of the Ethics Resource Centers (ERC) Fellows Program. The Fellows Program is made up of corporate, academic, non-profit and government representatives who focus on questions of ethics in business. The Fellows Program appreciates the opportunity to comment and the tremendous effort that both the Ad Hoc Advisory Group and the entire United States Sentencing Commission have spent in clarifying and modifying the current organizational sentencing guidelines.

There are many excellent improvements that the proposed guidelines offer. We think the change in §8B2.1(b)(3) is a good one. The new language in this section and the commentary to this section, provide a much more objective standard by which to judge the substantial authority personnel.

The change to §8C2.5(f)(3) is also a positive change. We think creating only a rebuttable presumption as to the effectiveness of the program based on high-level personnel participation in the alleged misdeed provides a more balanced approach. Rogue employees can be found at all levels and if only one of many high-level employees acts contra to the program the entire program should not be discounted.

The Fellows Program does have some concerns with several of the proposed changes. The following sections will discuss the concerns, plus propose possible modifications.

Expanding the definition of Violation of Laws:

Under the current Chapter 8 Guidelines, §8A1.2, Application note (k), the Sentencing Commission defines an "effective program to prevent and detect violations of law" as "a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct." This is the requirement that organizations have been basing their compliance and ethics effort on for the past thirteen years. It is also logical and consistent with the mission of the United States Sentencing Commission, to focus on criminal conduct.

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The Fellows Program does have some concern about the proposed §8B2.1, Application note 1 definition of the concept "violations of law". The proposal would expand the scope of violations of law to include, "criminal or noncriminal (including a regulation) for which the organization is or would be liable, or in the case of Application note 4(A), for which the individual would be liable."

Part of the rationale for expanding the definition is cited in the Ah Hoc Advisory Group's Report (pp.54):

The consideration of an organization's prior efforts and success in preventing violations of law beyond just criminal offenses is consistent with existing provisions of the organizational sentencing guidelines that treat prior civil and administrative offenses (§8C2.5(c)) and prior misconduct leading to restrictive court orders (§8C2.5(d)) as relevant sentencing considerations justifying elevated organizational fines.

Closer inspection of these current Guideline provisions may not justify the expansion of violations of laws to include "violation of any law, whether criminal or noncriminal (including a regulation) for which the organization is or would be liable. §8C2.5(c)) currently states:

If the organization (or separately managed line of business) committed any part of the instant offense less than ten years after (A) a criminal adjudication based on similar misconduct; or (B) civil or administrative adjudication(s) *based on two or separate instances of similar misconduct* (emphasis added by author) ...

§8C2.5(d)(1) Violation of an Order seems to provide even less of a rationale for expanding the definition of laws to include criminal and noncriminal. This section states:

(A) If the commission of the instant offense violated a judicial order or injunction, other than a violation of a condition of probation; or (B) if the organization (or separately managed line of business) violated a condition of probation by engaging in *similar misconduct* (emphasis added by author) to that for which it was placed on probation.

While these sections do mention prior civil or administrative offenses, and violations of orders, they require separate instances of SIMILAR MISCONDUCT. This is potentially very different than the proposed expansion of violation of law to include any criminal or noncriminal violations.

Since the Sentencing Guidelines recognize that you can still have a violation when you have an effective program, it would be unfair for organizations to not receive credit for their program due to any civil compliance weakness. An organization could conceivably have an effective program to prevent and detect violations of the Foreign Corrupt Practices Act and still have an FCPA violation. Under the existing Guidelines, you would still be able to prove due diligence and gain the benefit of having a program. But

under the proposed amendments, you could lose that benefit if you did not also have a program for something as unrelated as appropriately training your groundskeepers to assure compliance with local regulations regarding interfering with wildfowl nesting areas. While this may be important, failure to conduct this type of training should not be an indictment of your compliance program, sufficient to affect the organization's sentencing for an FCPA violation.

Recommendation: Keep the status quo and do not expand the definition of "violation of law" to include noncriminal (including a regulation) offenses.

Risk Assessment:

The Fellows Program acknowledges that assessing risks for criminal violations is at least an implied part of the current guidelines, but has a concern about how "risk assessment" has become a formal requirement of an effective program to prevent and detect a violation of laws. This is especially true, if the concept of violation of laws would be expanded to include both criminal and noncriminal laws. §8B.2(c) states, "In implementing subsection (b), the organization shall conduct ongoing risk assessment and take appropriate steps to design, implement, or modify each step set forth in subsection (b) to reduce the risk of violations of law identified by the assessment."

The Fellows foresee two potential problems with the proposal: (1) scope, and (2) formality. Regarding scope, it would be extremely difficult to evaluate all laws, both criminal and noncriminal. The formality of the term "risk assessment" conjures up a very detailed and extensive analysis of every possible criminal and noncriminal risk. The Fellows would prefer the concept of "assessing the relevant risks" be used in place of the term risk assessment.

Recommendation: Eliminate §8B.2(c), and amend §8B2.1(b)(1) to state, "The organization shall assess the relevant risks, then establish compliance standards and procedures to prevent and detect violations of law."

Confidentiality:

§8B2.1(b)(5) states that the organization shall take reasonable steps: "(C) to have a system whereby the organization's employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms that allow for *anonymous reporting*." The Fellows Program commends the Sentencing Commission for recognizing the importance of anonymous reporting, but would encourage the Commission to follow the Sarbanes-Oxley Act of 2002 in its call for reporting which is either confidential or anonymous. §301 (m)(4) of the Sarbanes-Oxley Act of 2002, defines an audit committee's duty to include, "Complaints – Each audit committee shall establish procedures for ... (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."

In this section of the Sarbanes-Oxley Act of 2002, Congress saw the wisdom in requiring either "confidential" or "anonymous" submissions. These terms may appear identical, but in reality could have a very different meaning. "Anonymous" reporting typically means that a company can not disclose the identity of reporting sources, because they do not know their identity. "Confidential" usually means that a company does know the identity of reporting sources, and tries to protect their identity. This could be done by removing all information from a report that would identify the reporting source. All of the remaining information would be available for review by other parties, both within and outside the organization.

It may be preferable to have "confidential" reporting because the person receiving the information (e.g. ombuds, ethics officer, human resources, legal, or compliance officer) can use the face to face conversations to establish a trusting relationship, address misconceptions and gather additional information. It is also much easier to have follow-up conversations with the reporting source when their identity is known. This type of program has effectively been implemented at major corporations like United Technologies and they have successfully protected the reporting source's identity, even when sought through litigation.

Recommendation: To be consistent with the Sarbanes-Oxley Act of 2002, the Fellows would request that the Sentencing Commission change proposed §8B2.1(5)(C) to read "to have a system whereby the organization's employees and agents may report or seek guidance regarding potential or actual violations of law without fear of retaliation, including mechanisms that allow for *confidential*, anonymous reporting.

Managerial Oversight:

The Proposed Guidelines §8B2.1(b) (2) states, "The organizational leadership shall be knowledgeable about the content and operation of the program..." Given the importance of ethical leadership, the statement that "the organizational leadership shall be knowledgeable about the content and operation of the program" could be much stronger. Simply sending a report to the executive team once a year could be seen as satisfying that requirement.

Recommendation: §8B2.1(b)(2) language should be changed to: "The organizational leadership shall provide direction to and be knowledgeable of the content and operation of the program."

Consistent Discipline:

Proposed §8B2.1 (b)(6) focuses on incentives and disciplinary measures. First, it is difficult to provide "incentives" for legal compliance. It does not make sense to most people to "reward" day to day legal or ethical conduct. Rather, this section should focus more on the messages sent by standards and procedures about what is rewarded and punished in the organization.

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Recommendation: §8B2.1(b)(6) language should be changed to: "Compliance with the law ...shall be encouraged and supported consistently through standards and procedures that holds employees accountable for appropriate conduct and incorporates such accountability into regular promotion and compensation decisions. In addition, legal compliance should be enforced through appropriate disciplinary measures for engaging in violations of the law and for failing to take reasonable steps to prevent or detect violations of the law."

Internal Controls:

§8B2.1 Application note 1 defines compliance standards and procedures as "standards of conduct and internal control systems that are reasonably capable of reducing the likelihood of violations of law." The Fellows Program believes that effective internal controls can be an important part of a program to prevent and detect violations of law for large and small organizations. Instead of referring to "internal controls systems", the Commission should consider the more generic term of "internal controls" as a process. Many small organizations may not have adopted a formal internal control system (such as COSO), but still need effective internal controls (e.g. segregation of duties or requiring two signatures to authorize a check).

Recommendation: §8B2.1, Application Note 1, should change the words "internal controls systems" to "internal controls".

One final request would be that the United States Sentencing Commission work with the Department of Justice to make information available to the business community about what, if any, credit is given to organizations with an effective program to prevent and detect violations of law in charging decisions and criminal settlements. Most large corporations that have violations settle before trial. This information could be extremely helpful to ethics and compliance officers in demonstrating the positive impact their programs had with their discussions with the Department of Justice.

The ERC Fellows Program understands that the US Sentencing Commission is considering a public hearing on the proposed changes on March 17, 2004. The Fellows Program would be very happy to have a representative testify at that hearing.

Regards,
Mr. Stephen D. Potts, Esq.
Chairman
ERC Fellows Program

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