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U.S. Sentencing Commission
One Columbus Circle, N.E.
Suite 2-500, South Lobby
Washington, DC 20002

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Re: Proposed Amendments to Chapter Eight

Dear Commissioners:

The United States Sentencing Commission has published and requested comments on proposed amendments to Chapter Eight of the Sentencing Guidelines relating to compliance programs. I offer the following comments as a practitioner in the compliance and business ethics field and as one with a strong interest in the success of the Sentencing Commission's efforts to promote effective compliance programs in organizations¹. I previously had the opportunity to testify in the Ad Hoc Advisory Group's information gathering process and to provide other information for the Group's use prior to the submission of the proposed amendments. I would be happy to testify regarding these comments or any other matters relating to the proposed amendments, should the Commission desire such testimony during this amendment cycle.

The proposed amendments are a positive step

The Sentencing Guidelines have brought clarity and commitment to the field of compliance. Indeed, one can fairly mark the emergence of compliance as a discrete field to the date the Guidelines went into effect. If this is so, then it could fairly be asked, why is a change necessary? Perhaps the best answer is that the proposed amendments are not really so much of a change as they are a recognition that this field has evolved and changed over time. The proposed amendments, in effect, actually recognize the reality of industry best practices and bring the Guidelines up to date.

Moreover, these revisions serve to strengthen organizational compliance programs and drive them to be more effective. We need programs that will withstand the circumstances we have all seen in the cases, from Enron to Andersen, and from WorldCom to Parmalat. The proposed changes show excellent insight into the dynamics of compliance programs, and what it takes for them to be truly effective.

Comments on question 4

¹ Partner, Compliance Systems Legal Group; Vice-Chairman, Integrity Interactive Corporation; Co-editor, *ethikos*. These comments reflect my personal opinions and may not necessarily reflect the views of any organization with which I am associated.

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The Commission asks for comment on four questions. These comments address one of those questions.

The challenge: Can we reach smaller organizations? Question four asks if there are factors that could encourage smaller organizations to develop and maintain compliance programs. I strongly believe the answer is "yes." Of course, government could try the stick approach – make it mandatory, legislate or regulate it, etc. But none of these strong-arm approaches will cause companies to be creative and to take initiative in making their programs truly effective. And they will be accompanied by protests about overregulation and expensive bureaucratic requirements. The preferred approach is to provide a real incentive for companies to adopt programs – the same model that worked for larger organizations in 1991.

The Guidelines now offer all organizations the one incentive of lower fines (and avoiding forced imposition of a program through probation). In truth, however, what has meant more to companies is the prospect that prosecutors and regulators will take good corporate citizenship into account when deciding whether to prosecute any company. It is the same carrot and stick model as the sentencing process, but because this carrot occurs so much earlier in the process, and so few major companies take criminal cases to actual trials and sentencing, it is the carrot of not being prosecuted that stands out as being truly worthwhile to larger companies.

Experience shows that larger companies have been much more influenced by the Sentencing Guidelines. Partly this is because just about any large organization knows it is likely to be in the crosshairs of a prosecutor or regulator at some time and place. Perhaps even more importantly, while larger companies have their own in-house legal departments and are more likely to consider such government initiatives, smaller organizations are notorious for being focused primarily on survival and growth. While long-term wellbeing is important to all companies, short term survival and growth opportunities are the greater, sometimes all-consuming demand on the time of managers at smaller companies.

What will actually reach these smaller organizations? The best incentive is an economic one that has real-world meaning for competitive businesses. For this the most practical approach is to look to the supply chains of the larger companies that are committed to compliance and ethics programs. If the leading companies were to ask their suppliers and contractors about having compliance and ethics programs, and if this became a significant factor in winning business and benefits from these larger companies, such a change could cause a dramatic transformation of the compliance landscape.

Just to give one example, Integrity Interactive Corporation, the online compliance training company I co-founded, has grown dramatically and has instituted its own compliance program, with its own compliance officer, required employee training, and a code of conduct. In 2003 it became a member of the Ethics Officer Association. Integrity Interactive did this because it was the right thing to do, but also because we believed it was something our customers should expect of any substantial supplier.

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In contrast, the company has simply not seen compliance officers from the major law firms joining the EOA, or contacting Integrity Interactive for training, or doing any of the other things that Integrity and its customers do. We have not seen stories in the compliance press about the major US law firms adopting Sentencing Guidelines-type compliance programs; even though they are as much "organizations" as the companies they advise.

If law firms and other service providers can successfully offer compliance-related services to compliance sensitive major companies without even being asked if they have compliance programs themselves, this suggests very little market incentive for others to adopt such programs.

It should be noted that many of these smaller organizations may have the type of subject-specific "programs" that were characteristic of large corporations before the Guidelines – perfunctory EEO training, signs over the copiers warning people about copyright infringement, unread labor standards fliers on a bulletin board – but nothing that matches the management focus and rigor of the Guidelines.

How could larger companies make this change happen? I would not recommend that companies be expected to require that all of their suppliers have compliance programs, or that they be expected to police their entire supply chain. Such a demand would not be realistic, and could be an enormous distraction for companies. On the other hand, the current environment in which companies do not even ask such compliance-sensitive suppliers as their outside counsel whether they have a compliance program, is hard to justify.

Large companies could require that some suppliers in sensitive areas, such as those who handle their hazardous waste, have rigorous programs. (The risk is so high, this is likely already a common practice) But they could also just enquire of other suppliers whether they have such programs. Companies could make it clear that having such a program is a plus factor in selecting suppliers. Any indication that a compliance program at a supplier represents a competitive advantage could have a dramatic effect on this next tier of the economy. Compliance advocates in all companies look to be able to sell management on the advantages of having an effective compliance program, but usually must rely on scare tactics; imagine the impact of being part of the team that actually wins business because of the compliance program; few things could matter more.

What would be the rationale for larger companies to take this step? Perhaps the best reason is that it helps strengthen their own compliance programs and could help cut off problems at the source. For example, a supplier with a strong compliance program is less likely to offer gifts and hospitality that are unethical. It is less likely to get its customer into trouble for environmental violations or improper overseas payments. Its employees are less likely to engage in harassment which could also be attributed to its customer. And it is less likely to engage in the types of aiding and abetting in financial fraud that are alleged to have happened in the Enron case. A contractor, agent, or consultant is less

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likely to aid a customer's employees in engaging in misconduct if that supplier has instituted strong procedures to ensure legal and ethical conduct.

How would this fit into the Guidelines standards? There are several options. It could be included in item 1, through the Commentary, as one of the standards and procedures a company would adopt. A reference could also be added in commentary on item 4, to the effect that to the extent it was appropriate to have compliance communications to agents, this element could be discharged by having one's agents institute programs of their own. The risk assessment discussion could note that an organization that uses third parties to perform functions for it may require that those third parties themselves adopt compliance programs. Attached is copy of the proposed Guidelines amendments with these insertions marked in.

Comments on the "litigation dilemma" and the Commission's role

Finally, these Comments second a point made by the Advisory Group about the role of the Commission as a catalyst for change. The litigation dilemma identified in the Advisory Group's report needs to be examined, and policy makers need to consider how best to promote compliance consistently. It is also absolutely essential that the Department of Justice and other enforcement and regulatory arms of the government understand how important their role is in getting organizations to energize their compliance programs. If the Department were to be more public about how it takes compliance programs into account and how it measures them, this could add enormous clout to in-house compliance people. For example, if the government were publicly to consider it a sign of bad faith for a company to fail to ask its outside counsel and accountants about those legal and accounting firms' compliance programs, this could change the compliance landscape in entire sectors of the economy.

The Commission is the agency best able to foster the needed discussion in these areas, based on its unique mandate and independent position in the government. I encourage the Commission to formally undertake this mission as a catalyst for change going forward.

Sincerely,



Joseph E. Murphy

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The proposed revisions addressing question 4 are in black, in the Commentary.

2. PREVENTING AND DETECTING VIOLATIONS OF LAW

§8B2.1. Effective Program to Prevent and Detect Violations of Law

- (a) To have an effective program to prevent and detect violations of law, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (c)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

- (1) exercise due diligence to prevent and detect violations of law; and
- (2) otherwise promote an organizational culture that encourages a commitment to compliance with the law.

Such program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting violations of law. The failure to prevent or detect the instant offense leading to sentencing does not necessarily mean that the program is not generally effective in preventing and detecting violations of law.

- (b) Due diligence and the promotion of an organizational culture that encourages a commitment to compliance with the law within the meaning of subsection (a) minimally require the following steps:

- (1) The organization shall establish compliance standards and procedures to prevent and detect violations of law.
- (2) The organizational leadership shall be knowledgeable about the content and operation of the program to prevent and detect violations of law.

The organization's governing authority shall be knowledgeable about the content and operation of the program to prevent and detect violations of the law and shall exercise reasonable oversight with respect to the implementation and effectiveness of the program to prevent and detect violations of the law.

Specific individual(s) within high-level personnel of the organization shall be assigned direct, overall responsibility to ensure the implementation and effectiveness of the program to prevent and detect violations of law. Such individual(s) shall be given adequate resources and authority to carry out such responsibility and shall report on the implementation and effectiveness of the program to prevent and detect violations of law directly to the governing authority or an appropriate subgroup of the governing authority.

- (3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any

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individual whom the organization knew, or should have known through the exercise of due diligence, has a history of engaging in violations of law or other conduct inconsistent with an effective program to prevent and detect violations of law.

- (4)
 - (A) The organization shall take reasonable steps to communicate in a practical manner its compliance standards and procedures, and other aspects of the program to prevent and detect violations of law, to the individuals referred to in subdivision (B) by conducting effective training programs, and otherwise disseminating information, appropriate to such individual's respective roles and responsibilities.
 - (B) The individuals referred to in subdivision (A) are the members of the governing authority, the organizational leadership, the organization's employees, and, as appropriate, the organization's agents.
 - (5) The organization shall take reasonable steps—
 - (A) to ensure that the organization's program to prevent and detect violations of law is followed, including using monitoring and auditing systems that are designed to detect violations of law;
 - (B) to evaluate periodically the effectiveness of the organization's program to prevent and detect violations of law; and
 - (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 to allow for anonymous reporting.
 - (6) The organization's program to prevent and detect violations of law shall be promoted and enforced consistently through appropriate incentives to perform in accordance with such program and disciplinary measures for engaging in violations of law and for failing to take reasonable steps to prevent or detect violations of law.
 - (7) After a violation of law has been detected, the organization shall take reasonable steps to respond appropriately to the violation of law and to prevent further similar violations of law, including making any necessary modifications to the organization's program to prevent and detect violations of law.
- (c) 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 risk assessment.

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Commentary

Application Notes:

1. Definitions.—For purposes of this guideline:

"Compliance standards and procedures" means standards of conduct and internal control systems that are reasonably capable of reducing the likelihood of violations of law. To the extent that an organization's culture and ability to comply with the law are affected by those third parties who provide it services, its control systems may include efforts to have such third parties adopt their own programs to prevent and detect violations of law.

"Governing authority" means the (A) the Board of Directors, or (B) if the organization does not have a Board of Directors, the highest level governing body of the organization.

"Organizational leadership" means (A) high-level personnel of the organization; (B) high-level personnel of a unit of the organization; and (C) substantial authority personnel. The terms "high-level personnel of the organization" and "substantial authority personnel" have the meaning given those terms in the Commentary to §8A1.2 (Application Instructions - Organizations). The term "high-level personnel of a unit of the organization" has the meaning given that term in the Commentary to §8C2.5 (Culpability Score).

Except as provided in Application Note 4(A), "violations of law" means violations of any law, whether criminal or noncriminal (including a regulation), for which the organization is, or would be, liable.

2. Factors to Consider in Meeting Requirements of Subsections (a) and (b).—

(A) In General.—Each of the requirements set forth in subsections (a) and (b) shall be met by an organization; however, in determining what specific actions are necessary to meet those requirements, the organization shall consider factors that include (i) the size of the organization, (ii) applicable government regulations, and (iii) any compliance practices and procedures that are generally accepted as standard or model practices for businesses similar to the organization.

(B) The Size of the Organization.—

(i) In General.—The formality and scope of actions that an organization shall take to meet the requirements of subsections (a) and (b), including the necessary features of the organization's compliance standards and procedures, depend on the size of the organization. A larger organization generally shall devote more formal operations and greater resources in meeting such requirements than shall a smaller organization.

(ii) Small Organizations.—In meeting the requirements set forth in subsections (a) and (b), small organizations shall demonstrate the same degree of commitment to compliance with the law as larger organizations, although generally with less formality and fewer resources than would be expected of larger organizations. While each of the requirements set forth in subsections (a) and (b) shall be

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substantially satisfied by all organizations, small organizations may be able to establish an effective program to prevent and detect violations of law through relatively informal means. For example, in a small business, the manager or proprietor, as opposed to independent compliance personnel, might perform routine audits with a simple checklist, train employees through informal staff meetings, and perform compliance monitoring through daily "walk-arounds" or continuous observation while managing the business. In appropriate circumstances, this reliance on existing resources and simple systems can demonstrate the same degree of commitment that, for a much larger organization, would require more formally planned and implemented systems.

- (C) Applicable Government Regulations.—The failure of an organization to incorporate within its program to prevent and detect violations of law any standard required by an applicable government regulation weighs against a finding that the program was an "effective program to prevent and detect violations of law" within the meaning of this guideline.

3. Application of Subsection (b)(2).—

- (A) Governing Authority.—The responsibility of the governing authority under subsection (b)(2) is to exercise reasonable oversight of the organization's efforts to ensure compliance with the law. In large organizations, the governing authority likely will discharge this responsibility through oversight, whereas in some organizations, particularly small ones, it may be more appropriate for the governing authority to discharge this responsibility by directly managing the organization's compliance efforts.

- (B) High-Level Personnel.—The organization has discretion to delineate the activities and roles of the specific individual(s) within high-level personnel of the organization assigned overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent violations of law; however, the individual(s) must be able to carry out their overall and direct responsibility consistent with subsection (b)(2), including the ability to report on the effectiveness and operation of the program to detect and prevent violations of law to the governing authority, or to an appropriate subgroup of the governing authority.

In addition to receiving reports from the foregoing individual(s), the governing authority or an appropriate subgroup thereof typically should receive periodically information on the implementation and effectiveness of the program to detect and prevent violations of law from the individual(s) with day-to-day operational responsibility for the program.

- (C) Organizational Leadership.—Although the overall and direct responsibility to ensure the effectiveness and operation of the program to detect and prevent violations of law is assigned to specific individuals within high-level personnel of the organization, it is incumbent upon all individuals within the organizational leadership to be knowledgeable about the content and operation of the program to detect and prevent violations of law pursuant to subsection (b)(2), and to perform their assigned duties consistent with the exercise of due diligence, and the promotion of an organizational culture that encourages a commitment to compliance with the law, under subsection (a).

4. Application of Subsection (b)(3).—

- (A) Violations of Law.—Notwithstanding Application Note 1, "violations of law," for purposes of subsection (b)(3), means any official determination of a violation or violations of any law, whether criminal or noncriminal (including a regulation).
- (B) Consistency with Other Law.—Nothing in subsection (b)(3) is intended to require conduct inconsistent with any Federal, State, or local law, including any law governing employment or hiring practices.
- (C) Implementation.—In implementing subsection (b)(3), the organization shall hire and promote individuals consistent with Application Note 3(C) so as to ensure that all individuals within the organizational leadership will perform their assigned duties with the exercise of due diligence, and the promotion of an organizational culture that encourages a commitment to compliance with the law, under subsection (a). With respect to the hiring or promotion of any specific individual within the substantial authority personnel of the organization, an organization shall consider factors such as: (i) the recency of the individual's violations of law and other misconduct (i.e., the individual's other conduct inconsistent with an effective program to prevent and detect violations of law); (ii) the relatedness of the individual's violations of law and other misconduct to the specific responsibilities the individual is anticipated to be assigned as part of the substantial authority personnel of the organization; and (iii) whether the individual has engaged in a pattern of such violations of law and other misconduct.

5. Application of Subsection (b)(4).— To the extent it is appropriate to provide training and otherwise disseminate information to the organization's agents, an organization may satisfy this provision if the agent adopts its own program to prevent and detect violations of law that includes such training and dissemination of information.

6. Risk Assessments under Subsection (c).—Risk assessment(s) required under subsection (c) shall include the following:

- (A) Assessing periodically the risk that violations of law will occur, including an assessment of the following:
 - (i) The nature and seriousness of such violations of law.
 - (ii) The likelihood that certain violations of law may occur because of the nature of the organization's business. If, because of the nature of an organization's business, there is a substantial risk that certain types of violations of law may occur, the organization shall take reasonable steps to prevent and detect those types of violations of law. For example, an organization that, due to the nature of its business, handles toxic substances shall establish compliance standards and procedures designed to ensure that those substances are always handled properly. An organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish compliance standards and procedures designed to prevent and detect price-fixing. An organization that, due to the nature of its

business, employs sales personnel who have flexibility to represent the material characteristics of a product shall establish compliance standards and procedures designed to prevent fraud. An organization that uses third parties to perform functions for it may require that those third parties themselves adopt programs to prevent and detect violations of law.

(iii) *The prior history of the organization. The prior history of an organization may indicate types of violations of law that it shall take actions to prevent and detect. Recurrence of similar violations of law creates doubt regarding whether the organization took reasonable steps to prevent and detect those violations of law.*

(B) *Prioritizing, periodically as appropriate, the actions taken under each step set forth in subsection (b), in order to focus on preventing and detecting the violations of law identified under subdivision (A) as most likely to occur and most serious.*

(C) *Modifying, as appropriate, the actions taken under any step set forth in subsection (b) to reduce the risk of violations of law identified in the risk assessment.*

Background: *This section sets forth the requirements for an effective program to prevent and detect violations of law. This section responds to section 805(a)(2)(5) of the Sarbanes-Oxley Act of 2002, Public Law 107-204, which directed the Commission to review and amend, as appropriate, the guidelines and related policy statements to ensure that the guidelines that apply to organizations in this Chapter "are sufficient to deter and punish organizational criminal misconduct."*

The requirements set forth in this guideline are intended to achieve reasonable prevention and detection of violations of the law, both criminal and noncriminal, for which the organization would be vicariously liable. The prior diligence of an organization in seeking to detect and prevent violations of law has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense.

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