THE FEDERAL SENTENCING GUIDELINES FOR ORGANIZATIONS AT TWENTY YEARS

A Call to Action for More Effective Promotion and Recognition of Effective Compliance and Ethics Programs

ABOUT THIS REPORT

Marking 20 years since the enactment of landmark federal sentencing guidelines to spur development of strong organizational compliance/ethics programs, the Ethics Resource Center (ERC) created a special panel to assess the impact and policy implications of those Federal Sentencing Guidelines for Organizations (FSGO). The distinguished 21 member panel includes federal judges; former Justice Department, Sentencing Commission, and Congressional officials; current and former general counsels; senior in-house compliance practitioners; and professors of law.

Over a period of 11 months, the Advisory Group (AG) convened by telephone and in person in order to review and consider information gathered through a research study of enforcement agencies, two surveys of compliance and ethics practitioners, meetings with members of Congressional Oversight Committees, and to contribute their own professional experiences as thought leaders themselves. On November 1, 2011, the Advisory Group released a discussion draft of its report, and the AG subsequently revised the document based on comments received from the public.

The following is the final report of findings and recommendations from the Advisory Group.

ABOUT THE ETHICS RESOURCE CENTER

The Ethics Resource Center (ERC) is America’s oldest nonprofit organization devoted to independent research and the advancement of high ethical standards and practices in public and private institutions. Since 1922, ERC has been a resource for public and private institutions committed to a strong ethical culture. ERC’s expertise informs the public dialogue on ethics and ethical behavior. ERC researchers analyze current and emerging issues and produce new ideas and benchmarks that matter — for the public trust.
ETHICS RESOURCE CENTER’S
INDEPENDENT ADVISORY GROUP ON THE
20TH ANNIVERSARY OF FSGO

Co-Chairs:

Patricia Harned
President, Ethics Resource Center

Win Swenson
Partner, Compliance Systems Legal Group; formerly Deputy General Counsel,
U.S. Sentencing Commission

Members (in alphabetical order):

Scott Avelino
Principal, Compliance Systems Legal Group

Jeff Benjamin
Retired Chair of the Ethics & Compliance Committee of Novartis Corporation; formerly Member,
Board of Directors, Ethics and Compliance Officer Association

Judge Ruben Castillo
U.S. District Court, Northern District of Illinois; formerly Member, U.S. Sentencing Commission

Paul Fiorelli
Professor, Legal Studies, Xavier University

Scott Harshbarger
Senior Counsel, Proskauer; formerly Massachusetts Attorney General

Ben Heineman, Jr.
Senior Fellow at Harvard Law School and Harvard Kennedy School; formerly Senior Vice
President for Law and Public Affairs, General Electric

Nancy McCready Higgins
Vice President & Chief Ethics and Compliance Officer, Bechtel Group, Inc.

Hon. Sven Erik Holmes
Vice Chairman, Legal, Risk and Regulatory and Chief Legal Officer, KPMG; formerly U.S. Chief
District Judge

Michael Horowitz*
Partner, Cadawaler, Wickersham & Taft, LLP; formerly Deputy Assistant Attorney General and
Chief of Staff in the Criminal Division of the U.S. Department of Justice

*Michael Horowitz served as a member of the Advisory Group until his confirmation as the new Inspector General of the
Thurgood Marshall, Jr.
Partner, Bingham McCutcheon, LLP; formerly Assistant to the President of the United States and Secretary to the Cabinet

Paul McNulty
Partner, Baker & McKenzie, LLP; formerly Deputy Attorney General, U.S. Department of Justice

Judge Diana Murphy
U.S. Court of Appeals for the Eighth Circuit; formerly Chair, U.S. Sentencing Commission

Joseph E. Murphy
Director of Public Policy, Society of Corporate Compliance and Ethics; Of Counsel, Compliance Systems Legal Group.

Michael Oxley
Partner, Baker Hostetler; formerly Member of Congress (R-OH)

Susan Ponce
Senior Vice President, Special Assistant to the General Counsel, Halliburton Co.

Alexandra Rebay
Senior Vice President, Deputy General Counsel and Chief Compliance Officer, Verizon; formerly Assistant United States Attorney, Southern District of New York

Dan Roach
Vice President, Compliance and Audit, Dignity Health

Charles V. Senatore
Head of Corporate Compliance and Ethics, Fidelity Investments; formerly Director of the Securities and Exchange Commission's Southeast Region

Larry Thompson
John A. Sibley Chair in Corporate and Business Law, University of Georgia School of Law; formerly Deputy Attorney General of the United States and United States Attorney

Special Thanks
The Advisory Group wishes to thank the following staff members of the Ethics Resource Center for their support in the development of this report:

Paula Bongino
Nick Fetzer
Michael Gelb
# TABLE OF CONTENTS

**FOREWORD** ........................................................................................................................................... i

**ABBREVIATIONS USED FREQUENTLY IN THIS REPORT** ............................................................................. iii

**EXECUTIVE SUMMARY** .......................................................................................................................... 1

**SECTION I: Introduction** .......................................................................................................................... 15

**SECTION II: The Federal Sentencing Guidelines Model: Positive Impacts to Date** .................. 19
  - Federal Sentencing Guidelines for Organizations (FSGO) ................................................................. 20
  - 2010 Changes ...................................................................................................................................... 27
  - A Sea Change in Corporate Compliance and Ethics Management ................................................... 28

**SECTION III: Challenges That Persist** ..................................................................................................... 34
  - Challenge 1 .......................................................................................................................................... 36
  - Challenge 2 .......................................................................................................................................... 54
  - Challenge 3 .......................................................................................................................................... 65
  - Challenge 4 .......................................................................................................................................... 66

**SECTION IV: Recommendations** .......................................................................................................... 70
  - Recommendations to the U.S. Sentencing Commission ................................................................. 71
  - Recommendations to the U.S. Department of Justice ...................................................................... 84
  - Recommendation to the President of the United States .................................................................. 93
  - Recommendation to the President and Congress ........................................................................... 95
  - Recommendation to Congress ........................................................................................................... 96
  - Recommendation to the Courts .......................................................................................................... 97
  - Recommendations to the Private Sector .............................................................................................. 98

**SECTION V: Moving Forward** ................................................................................................................. 101

**APPENDICES**
  - Chapter Eight - Sentencing of Organizations .................................................................................... A-1
  - Information on the Role of Compliance/Ethics Programs in Enforcement Decisions ................... B-1
  - Communicated Expectations for Standards of Conduct .................................................................. C-1
FOREWORD

Just over two decades ago, in November 1991, the U.S. Sentencing Commission promulgated the Federal Sentencing Guidelines for Organizations (FSGO) in an attempt to bring greater consistency in sentencing when organizations, especially corporations, were convicted of violations of U.S. law. Previously, sentencing had been left largely to the discretion of federal judges and the result was a wide variation in punishment for the same violations. The range of outcomes not only offended basic fairness, but at times tended to minimize the incentives for good conduct.

Under U.S. law, corporations are responsible for the wrongdoing of their employees – even when those actions violate company policy. Before the FSGO, companies that worked hard to obey the law and ensure that employees did as well were often treated in the same way as organizations in which misconduct was not only tolerated, but even encouraged.

The FSGO sought to change all of that. By offering reduced sentences for corporate offenders that cooperated with investigators and/or established effective compliance and ethics programs to promote respect for the law, the Guidelines extended a metaphorical “carrot” to induce good corporate behavior. Bad actors, on the other hand, would receive stiffer sentences. Because of subsequent trends in law enforcement, including the preference for negotiated plea agreements instead of trial, the FSGO have turned out to have minimal impact on sentencing. But evidence shows that the Guidelines have achieved significant success in reducing workplace misconduct by nurturing a vast compliance and ethics movement and enlisting business organizations in a self-policing effort to deter law-breaking at every level of their business.

The success of the Guidelines hardly means they are perfect. Like any set of standards or rules, the Guidelines must continue to evolve based on real-life experience, including changes in the way companies themselves have adjusted their structures and the way they operate. Much as the FSGO charge companies with continuous evaluation of their compliance and ethics programs, the Guidelines – and especially their directives regarding compliance and ethics – also must be the focus of continuous improvement.
To that end, the Ethics Resource Center in 2011 initiated an independent assessment of the FSGO, the experience of the past 20 years, and the Guidelines’ effectiveness. ERC assembled a distinguished panel of former law enforcement officials, judges, prosecutors, academics, and compliance/ethics practitioners to review the Guidelines and offer suggestions for improvement. The group also solicited public input through the release of a discussion draft in November 2011. After adjustment for that feedback, the Advisory Group is now offering the attached Final Report to stimulate further discussion and spur necessary revisions to the FSGO.

We believe that the FSGO have helped inspire a major culture change among American businesses over the past two decades. To be sure, headline-grabbing instances of corporate fraud during that period have provided dramatic reminder that organizational misconduct has not been eliminated. However, we are convinced that for most companies, compliance with the law and the development of high integrity are some of management’s top priorities.

Simply put, workplaces with programs based on the FSGO are better places to work. Our economy and our society are better off when corporations and their employees obey the law and operate within ethical frameworks that direct them to “do the right thing.” The FSGO contribute mightily to this objective by establishing standards to guide company management in the development and implementation of effective compliance and ethics programs and ethical cultures. We believe that the findings in this Report can play a vital role in the continued development of high integrity in U.S. businesses.

In that spirit, we respectfully offer it for careful consideration by the U.S. Sentencing Commission, the U.S. Department of Justice, the Federal Judiciary, the Congress, and the President as well as corporate managers, boards of directors, and the compliance and ethics community.

Finally, we express our deepest appreciation and gratitude to the members of the Advisory Group for the time and energy they volunteered to this initiative and also to the ERC staff for its assistance to the panel.

Patricia J. Harned, Ph.D.
President, Ethics Resource Center
Advisory Group Co-Chair

Winthrop M. Swenson, Esq.
Partner, Compliance Systems Legal Group
Advisory Group Co-Chair
# ABBREVIATIONS USED FREQUENTLY IN THIS REPORT

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>CECO</td>
<td>Chief Ethics and Compliance Officer</td>
</tr>
<tr>
<td>DOJ</td>
<td>Department of Justice</td>
</tr>
<tr>
<td>DPA</td>
<td>Deferred Prosecution Agreement</td>
</tr>
<tr>
<td>ECEP</td>
<td>Effective Compliance and Ethics Program</td>
</tr>
<tr>
<td>ERC</td>
<td>Ethics Resource Center</td>
</tr>
<tr>
<td>FSGO</td>
<td>Federal Sentencing Guidelines for Organizations</td>
</tr>
<tr>
<td>GAO</td>
<td>Government Accountability Office</td>
</tr>
<tr>
<td>NPA</td>
<td>Non-Prosecution Agreement</td>
</tr>
<tr>
<td>USSC</td>
<td>U.S. Sentencing Commission</td>
</tr>
</tbody>
</table>
EXECUTIVE SUMMARY

Twenty years ago, on November 1, 1991, the U.S. Sentencing Commission (USCC) put into effect new guidelines to help federal judges impose fair and consistent sentences when corporations violated U.S. law. Formally known as the Federal Sentencing Guidelines for Organizations (FSGO), the new rules were mandated by Congress to address wide variation in sentences by federal judges who, at the time, were guided only by their own subjective thinking.

The FSGO established, for the first time, a uniform framework for punishing corporations that broke the law. But the FSGO did something else that was just as important: they created incentives for companies to self-police. Recognizing that under American law corporations “stand in the shoes” of their employees and, thus, are generally accountable for their acts – even when their actions violate the company’s stated rules – the FSGO sought to distinguish between companies that worked hard to prevent crime and those that turned a blind eye to misconduct or even created circumstances that encouraged it.

Believing the Guidelines could be a tool to encourage ethical business conduct, the Commission created a “carrot and stick” regime for assessing corporate culpability and giving credit, including sharp reductions in penalties, when an effective compliance and ethics program (ECEP) was in place “to prevent and detect violations of law.” On the other side of the coin, FSGO penalties would be severe for companies that “tolerated, encouraged or condoned” improper behavior.

This carrot-and-stick approach aimed to convert organizations from passive bystanders who hoped employees would behave well, into active advocates of an ethical culture in the workplace – in short, enlisting companies themselves in the fight against corporate crime. Given the potentially serious consequences of corporate misconduct and the limited ability of after-the-fact prosecutions to undo the damage or deter future law breaking, the Commission hoped that corporate self-policing through strong compliance and ethics programs could reduce the frequency and severity of misconduct.
Now, two decades later, the Ethics Resource Center (ERC) empanelled an Advisory Group of distinguished former law enforcement officials, federal judges, prosecutors, academics, and compliance/ethics experts to examine the FSGO, its successes and failures, and to identify possible areas of improvement. This Report is the product of that effort. It reflects the views and experience of Advisory Group members as well as public comment by enforcement officials, compliance practitioners, and members of the legal community in response to a draft released in November 2011.

Companies Have Widely Embraced Compliance/Ethics Programs

The FSGO have achieved significant successes, notably the vigorous efforts by many U.S. companies and other organizations to adopt comprehensive compliance/ethics programs. The new rules led to the creation of a new profession of compliance/ethics professionals, who now number in the thousands, to develop and implement the new corporate programs. In addition, as the FSGO have matured and their requirements been toughened by the Commission, boards of directors and senior corporate management in many companies have taken on leadership roles in promoting law-compliant and ethical cultures. Numerous books and articles have been written and conferences convened to help them know how to do that, and companies have identified best practices to help build compliance into everyday decision-making.

Survey data indicate that these efforts are producing tangible results. The ERC’s 2011 National Business Ethics Survey (NBES), for example, shows that employees in companies with effective, meaningful codes of conduct and programs based on the FSGO witness fewer incidents of misconduct, and are far more likely to report misconduct when observed. In part, this is because organizations with FSGO-based programs are more likely to have strong ethical cultures, and employees observe misconduct less often in organizations with stronger cultures than in those with weaker cultures.

The FSGO’s “seven-step” standards for compliance/ethics programs have become the de facto framework for U.S. corporations and also serve as a reference point for many U.S. regulatory and enforcement agencies.

Most significantly, with the exception of the Antitrust division, the U.S. Department of Justice now recognizes as a matter of policy that an ECEP should be a factor in deciding whether or not
DOJ will file criminal charges in cases of organizational misconduct. The DOJ view on compliance was first spelled out in 1999 by then Deputy Attorney General Eric H. Holder, Jr. in the so-called “Holder Memo” and later ratified in subsequent memoranda by two of Holder’s successors, Paul McNulty and Larry Thompson.

But Substantial Challenges Remain

Notwithstanding these successes, this Report identifies a number of developments and government policies that could erode the effectiveness of the FSGO and cause some businesses to reduce their commitment to ECEPs. The Report concludes that pro-compliance corporate practices and government policies created by the FSGO are not working together in the most effective and self-sustaining ways. It pinpoints four specific challenges:

Challenge 1: There are few FSGO cases involving large companies because criminal cases against bigger corporate defendants are largely being detoured around the judges for whom the Sentencing Guidelines were intended.

Corporate offenders are not receiving credit for ECEPs at sentencing because cases are being steered out of the traditional criminal justice process. Prosecutors are, instead, opting to resolve most cases involving large companies through Deferred Prosecution Agreements (“DPAs”), non-prosecution agreements (“NPAs”), or other administrative/civil settlement agreements – and, without convictions, there are no sentences to which the FSGO apply. For both parties, settlement has benefits. It eliminates the cost and risks of litigation. DPAs and NPAs also avoid the potentially devastating collateral damage, often to innocent parties, that can occur when a company is convicted of a crime.

DOJ policy directs prosecutors to consider the existence of an effective compliance program in deciding whether to prosecute, enter into a DPA or NPA, or take no action in cases of alleged misconduct. But there is little hard evidence that organizations are receiving the promised consideration for their compliance programs and prosecutors rarely point to compliance/ethics programs when publicly discussing case resolutions. A Conference Board study in 2009 found that after-the-offense compliance program requirements are often mandated in settlements, but it found very few cases where DOJ acknowledged granting credit for – or even carefully assessing – a pre-existing compliance/ethics program.
The failure to publicly recognize the role of ECEPs suggests that they do not matter to prosecutors, which creates the risk that corporations will scale back their commitment to compliance/ethics. As one corporate compliance/ethics officer explained in response to a 2010 ERC survey:

The current DOJ approach allows cynical executives to conclude that any violation justifies a DOJ conclusion that the compliance program was ineffective no matter how robust the program was in preventing other problems. As a result, additional resources are diverted elsewhere, an outcome potentially harmful to society at large and in opposition to what the DOJ probably intended.

Challenge 2: There is a lack of consistency in policies toward ECEPs across the various government agencies that play a role in corporate law enforcement and regulation because there is neither a requirement that these policies be aligned nor a mechanism available for doing so.

More than 20 federal agencies play a role in enforcing laws that govern corporate conduct, but each agency – and even divisions within agencies – has its own approach to corporate compliance/ethics programs. Businesses organizations are left to parse the differences. This lack of consistency is compounded by a lack of transparency.

It is often difficult to even discern an individual agency’s policies on ECEPs. Some agencies have an official policy embedded in regulation or statute. At others, one may be able to infer the agency’s policies by reviewing official remarks or comment letters or by examining particular cases. For still other agencies, it is hard to discern any particular policy, practice, or point of view at all. The Antitrust Division at the Justice Department (DOJ) even takes a position on compliance programs contradictory to the rest of DOJ.

It is often difficult to determine what elements agencies look for in evaluating compliance/ethics programs. While some agencies rely heavily on the FSGO framework, others do not. Nor is it always clear that an agency, in fact, grants credit for effective programs even when that agency has a policy that ostensibly supports their adoption.
Challenge 3: Many compliance/ethics programs fall short of their potential because portions of the FSGO remain underemphasized or unclear.

The ability of business managers to embrace and implement the ECEP criteria outlined in the FSGO is tied to their ability to understand the specific actions or decisions expected of them. On the one hand, FSGO criteria are principles-based, which provides organizations with valuable flexibility in tailoring an approach that best fits their circumstances and avoids a “one-size-fits-all” standard for compliance. This flexibility encourages innovation and discourages the “check the box” type of mentality that discourages critical judgment about how to instill effectiveness.

The benefits of flexibility and innovation notwithstanding, the principles-based nature of the FSGO criteria means that reasonable minds can disagree on what certain high-level principles mean. To address this issue, the FSGO would benefit from ongoing review and a greater use of “plain English.”

Challenge 4: Too many business executives take a “check the box” approach to their programs, rather than satisfying the full intent of the FSGO.

It is impossible to meet the FSGO standards with a mechanistic approach. The FSGO’s emphasis on diligence, actual effectiveness, and an inherent philosophy of structured flexibility are all intended to promote results-oriented innovation by individual companies within the Guidelines’ general framework. This intent needs to be better understood and applied. Moreover, priority needs to be given to two areas that are fundamental to compliance/ethics. First, the mission of for-profit companies needs to be seen as comprising both strong financial performance and a strong commitment to integrity. Second, the chief ethics and compliance officer must be properly positioned to ensure that he or she has the independence, access, authority, and empowerment necessary to effectively discharge these vital corporate responsibilities.

This Report focuses largely on the efforts needed by government to promote compliance/ethics programs, but the ultimate responsibility for corporate integrity rests with the private sector. While many business leaders are genuinely passionate about ethical performance and operate best-in-class compliance/ethics programs, many others ignore the level of diligence and
commitment needed to follow the FSGO. As a result, often times the individuals responsible for implementing effective compliance/ethics initiatives face more internal resistance than they should because they lack stature, access to key decision makers, and the necessary resources.

The FSGO contain language emphasizing that creditworthy compliance/ethics programs are not ones thoughtlessly built on a check-the-box framework. The FSGO make clear that the overarching goal of a creditworthy compliance program is that it will actually “be effective” in most circumstances, and they direct companies to exercise “due diligence” and “evaluate periodically” their programs to make sure this goal is met. Moreover, the FSGO are built around a philosophy of structured flexibility that is meant to encourage each company to find its own particular path to effectiveness within the FSGO’s general framework. This approach enables companies to take into account their own unique characteristics (e.g., nature of its business, history, risk profile, size, etc.) in developing compliance/ethics strategy.

Ultimately, when companies are truly committed, the board and management have defined the very mission of the company as fusing financial performance with an equally strong commitment to integrity. Moreover, committed companies ensure that the compliance and ethics program, including the person with day-to-day responsibility for the program, is fully empowered, autonomous, properly positioned, and resourced to help support this mission. Ideally, the chief ethics/compliance officer is a member of senior management and, at the very least, has meaningful and regular access to the company's board and senior management. Ideally, too, the board of directors has a member or committee with specific expertise in compliance and ethics.

The private sector must apply the types of effective management steps called for in the FSGO with the goal of achieving an ethical culture sustained by best-in-class programs. Merely “going through the motions” in implementing a compliance/ethics program will neither meet the intent of the FSGO standards nor result in the kind of ethical cultures in companies that society increasingly expects.
Recommendations

To address these challenges and to reinforce the carrot-and-stick framework that promotes ethical performance, this Report presents recommendations for the Sentencing Commission, the Department of Justice, the President, the Congress, the federal Courts, and the private sector:

Recommendations to the U.S. Sentencing Commission

Recommendation 1.1 - The Commission should renew – and regularly – focus on the FSGO with an eye toward continuous improvement to take account of changes in the business world.

Companies’ embrace of the FSGO as a guide for their compliance/ethics efforts creates a responsibility for the Sentencing Commission to monitor and update the FSGO, as necessary, on an ongoing basis. Over the last 20 years, the Commission has devoted most of its attention to its separate Guidelines for sentencing individuals who have violated federal law and struggled to maintain a significant focus on the FSGO. The Commission must do what the Guidelines ask of companies: continuously improve. To this end, the Commission might establish an advisory group of FSGO practitioners analogous to its Practitioners Advisory Group for the individual Guidelines.

Recommendation 1.2 - Clarify portions of the FSGO.

This Report identifies specific areas for improvement in the FSGO and also says the Commission should promote further study on the issue of evaluation of their compliance/ethics programs. The Report suggests that the FSGO should:

1) More strongly encourage companies to use incentives to promote their programs, including compliance/ethics as a key component of employee evaluations and reviews;

2) Emphasize and clarify commentary language pertaining to the role of managers and supervisors in promoting “an organizational culture that encourages ethical conduct and a commitment to compliance with the law;”
3) Give new emphasis to language relating to the compliance and ethics officer, including a strong relationship with the organization’s highest governing authority and providing sufficient autonomy, empowerment, and resources;

4) Encourage large organizations with more complex compliance/ethics management systems to ensure that at least one member of the governing authority possesses expertise on effective compliance/ethics management;

5) Encourage companies to increase compliance/ethics efforts at the local and regional level in order to better reflect the increased geographical dispersion of large corporations, especially multi-nationals;

6) Expand on current language by clarifying what it means to “take reasonable steps to respond appropriately” when criminal conduct has been detected by promoting the adoption of effective internal investigation protocols; and

7) Suggest some possible outcome metrics by which organizations can demonstrate the impact and effectiveness of their programs.

Recommendations to The U.S. Department of Justice

Noting the U.S. Department of Justice’s (DOJ’s) responsibility as the lead federal law enforcement agency, this Report directs five recommendations to the DOJ as the agency with the potentially decisive “vote” on whether the government will keep its oft stated promise to credit ECEPs.

Recommendation 2.1 - The DOJ should ensure that pre-existing compliance/ethics programs are a critical factor in the resolution of corporate misconduct cases.

Merely having a policy does not mean that it is communicated, understood, or followed. DOJ’s senior officials must make sure stated policies are effectively implemented. The Attorney General should direct all federal prosecutors to take proper account of ECEPs.
Recommendation 2.2 - The DOJ should establish standards, based on the FSGO, to govern how ECEPs will be judged as well as standards to guide how ECEPs should affect case outcomes.

The DOJ Principles of Prosecution should be revised to make clear that prosecutors should look to the FSGO compliance/ethics program standards when making assessments about ECEPs. Using other standards – or a “we know a good program when we see it” approach – prompts companies to ask why they have obediently followed the Guidelines for two decades.

DOJ “boiler plate” requirements for a company’s compliance/ethics program, often mandated in DPAs, consent decrees, and other forms of settlement should start with the FSGO criteria. DOJ may want to add other requirements on top of the Guidelines’ framework, but ignoring the framework invites confusion and inconsistency.

Separately, the Department should provide substantially more guidance to prosecutors on how a pre-existing ECEP – as well as the lack of one – should affect settlement terms, including the monetary penalty, the length of the DPA term, reporting requirements, whether a monitor will be required, and the scope of the monitor’s activities.

Recommendation 2.3 - The DOJ should move to require greater internal consistency among its own divisions in the treatment of ECEPs.

DOJ’s Antitrust Division has consistently insisted it will not take ECEPs into account in enforcing anti-trust law. While there is logic in the context of multi-party conspiracies for the Division’s policy of placing great weight on a voluntary disclosure by the first disclosing party, DOJ handles other kinds of corporate cases that involve conspiracies without applying the blanket “no credit for compliance programs” policy adopted by the Antitrust Division.

Recommendation 2.4 - The DOJ should adopt a credible process for evaluating ECEPs.

Directing U.S. attorneys to give due consideration to compliance/ethics programs requires the Department to provide the tools necessary for proper evaluation, which is not typically part of legal education or practice. The Department should provide training to key DOJ personnel on compliance/ethics program best practices. This training process might include dialogue with the private sector about emerging best practices.
When cases arise, companies should have the burden of demonstrating not only that they have designed their compliance/ethics program well, but also that they have evaluated it to make sure this is so. Importantly, if a company otherwise makes a case that it has diligently sought to institute an effective program meeting the FSGO standards, evidence from its program evaluation that the program is not “perfect” should not be used against its bid for credit. Penalizing an organization based on the findings of its own internal review is a recipe for half-hearted inquiries and could seriously erode support for self-policing.

Recommendation 2.5 - The DOJ must communicate what it is doing with respect to the treatment of ECEPs in cases.

The dearth of information about the impact of ECEPs in DOJ decision-making undermines the FSGO policy of incentivizing the development of best practice compliance/ethics programs. DOJ should provide a public accounting of the impact of ECEPs in DPAs and require that press releases and other statements regarding cases of corporate or other organizational misconduct explicitly discuss the role played by compliance/ethics. It also should collect and publish aggregate data on the role of ECEPs in such cases. This Report cites some recent and commendable examples of cases in which the Fraud Section of the Criminal Division has begun to include more communication about its treatment of ECEPs in its cases, and we hope these cases can help inform future DOJ’s policies and practices in this area.

Recommendation to the President of the United States Regarding All Other Executive Branch Agencies

Recommendation 3.1 - The President should use available authorities to direct all executive branch agencies to adopt, publicize, and apply clear written policies with respect to how they promote and consider ECEPs in enforcement and other relevant settings.

While DOJ is responsible for enforcement of criminal law – the only area to which the Guidelines legally apply – other government agencies also have embraced the concept of recognizing compliance/ethics. But government enforcement agencies have been too close-mouthed about the way they assess and account for compliance/ethics programs. The President should address this shortcoming by directing agencies to promote effective
compliance and ethics programs and instructing them to establish and publish clear policies to that effect.

Recommendation 3.2 - Each agency of the federal government should develop and implement their own compliance and ethics programs, applying the FSGOs standards. The President should use available authorities to direct all executive branch agencies to do so as well.

The FSGO standards apply to all organizations, including governments. Requiring federal agencies to adopt strong compliance and ethics programs would further promote the underlying policy of the FSGOs while also helping to ensure that the human beings staffing federal agencies understand and follow the laws and standards that apply to them. In addition, for government agencies, having their own internal compliance programs would help them to better understand such programs in the regulated community.

Recommendation to the President and Congress to Designate a Cross-Government Working Group

Recommendation 4.1 - Using available authorities, the President and Congress should establish a cross-government working group to create a Core Federal Model for corporate compliance/ethics programs.

Federal agencies deserve applause for supporting ECEPs, but the lack of cross-government coordination has resulted in a patchwork of inconsistent and duplicative demands. The President and Congress should direct federal agencies to work toward a more consistent government-wide approach that enables organizations to more effectively meet (or exceed) expectations for compliance/ethics and, in turn, reduce the frequency of misconduct by organizations and their employees. While some customization is appropriate to reflect the intricacies of specific risk areas, organizations deserve a single government-wide model, based on Sentencing Guidelines’ criteria for compliance/ethics programs.

Recommendations to Congress

Recommendation 5.1 - Congress should use its oversight authority to insist that federal regulatory and enforcement agencies establish, and demonstrate that they are
implementing policies for the promotion, evaluation, and consideration of compliance/ethics programs.

Congress can play an important role in encouraging organizational compliance/ethics efforts by insisting on transparent and consistent policy implementation by federal regulatory and enforcement agencies. Ideally, Congress and the Administration will agree on mutually-supporting actions to guide federal agencies and assure their full commitment to effective compliance/ethics programs, but Congress should exercise its oversight powers to enforce this commitment.

**Recommendation 5.2 - Congress should consider the impact on organizational compliance/ethics programs when it develops legislation related to law enforcement and regulatory oversight of organizations by the federal government.**

Congress should avoid legislation that unintentionally undermines the FSGO principles or organizational compliance efforts. It should consider the views of compliance and ethics experts when addressing issues of corporate crime and misconduct. For example, some believe that poorly drafted whistleblower provisions or other reward programs designed to encourage reporting of misconduct can erode compliance/ethics programs by encouraging reporting outside the company as a first resort.

To ensure that its actions are consistent with the FSGO’s approach to compliance and to organizational compliance/ethics efforts, Congress should consider the potential impact of legislation on the compliance/ethics function.

**Recommendation 5.3 - Congress should exercise its authority to ensure that at least one member of the U.S. Sentencing Commission has experience with the FSGO.**

Current law requires that at least three of the USSC’s voting members must be federal judges and also that no more than four members may belong to the same political party. To emphasize the importance of the FSGO, Congress should amend the law to require that at least one member of the Commission has substantial knowledge of and experience with the FSGO.
Recommendation to the Courts

Recommendation 6.1 - Judges should exercise judicial oversight of DPAs and other settlement agreements filed with the Courts to ensure that such agreements indicate on their face the consideration of the FSGO criteria for “an effective compliance and ethics program” and other FSGO factors in the development of the settlement’s terms.

Judges should assert their inherent authority to review settlement agreements that are filed with the court to confirm consideration of FSGO principles, especially the compliance/ethics program criteria, so that companies that have worked hard to ensure ethical performance and compliance receive proper credit. Judges would not supplant the prosecutor’s judgment with their own approach, but rather would verify the consideration of FSGO factors.

Judges will, of course, need to accept that additional requirements that supplement FSGO may be appropriate in individual cases, while ensuring that the FSGO should remain the foundation for evaluating ECEPs in enforcement and dispute resolution involving U.S. law.

Recommendations to the Private Sector

Recommendation 7.1 - While we have made recommendations to U.S. Sentencing Commission on how the FSGO criteria might be improved, we encourage the private sector to act now. Private sector organizations need to embrace the intent of the Guidelines’ diligence standards and implement compliance/ethics programs that are part and parcel of the business fabric and not the result of mere box-checking. This begins by defining the mission of a company as comprising both strong financial performance and a strong commitment to integrity. Proper positioning, empowerment, and autonomy of the chief ethics and compliance officer must also be a priority.

Boards of directors and senior executives should demand compliance/ethics programs that are effective in preventing and detecting misconduct and help build ethical and law-abiding cultures. Corporate leaders should require regular assessment of company compliance and ethics efforts including measures of the corporate culture and incorporate commitment to compliance and ethics as a key factor in all performance reviews and compensation systems, including those of senior officers. The board should ensure that the chief ethics and compliance officer is a senior corporate officer with sufficient empowerment, autonomy, resources, and access to senior
management and the board of directors to be effective. The compliance and ethics program should reach all parts of the business. Boards also should include at least one director with expertise on effective compliance/ethics management and familiarity with FSGO standards.

**Recommendation 7.2 - Invest in initiatives that raise the bar for “best practice.”**

Businesses should consider the full range of management tools in their compliance and ethics programs and never treat the FSGO as if they are a simple checklist. They should continue to search for the most effective ways to reach their employees and others who act for the company to ensure compliance with all applicable laws and ethical conduct. The FSGO are an excellent framework, but managers should apply their experience and imaginations to ensuring their employees always do the right things.
SECTION I

INTRODUCTION

In advocating for the Constitution, James Madison told us that angels do not govern men and that rules were required to temper human nature.\(^1\) Nor do angels run corporations or other large institutions. Most of us, including leaders, intend to behave well. But some individuals and some organizations act badly, break the law, and cause great damage to others in the process. We address that bad behavior with laws designed to punish the guilty and help society function smoothly by keeping the frequency of misconduct within tolerable limits.

Misconduct by organizations is a special concern because when it is severe enough it can harm thousands. History is replete with examples. Twenty-five years ago, the “Ill Wind” investigations revealed widespread fraud among defense contractors in their dealings with the U.S. government. A decade ago, fraud by senior officials at Enron, WorldCom, and other large corporations destroyed or diminished the companies and wreaked havoc on thousands of innocent individuals in the bargain. Among the collateral damage: hundreds of billions in shareholder value, tens of thousands of jobs, employee retirement funds eviscerated, and the erosion of public trust in big corporations and the financial markets that help sustain them.

More recently, questionable conduct at global financial institutions may have ignited and certainly exacerbated the financial meltdown and recession of 2008. While clear-cut law-breaking may have been less prevalent than at Enron and WorldCom, there is evidence that many individuals crossed the ethical lines by selling suspect securities and making risky loans that were unlikely to be repaid. The social cost has been extensive; in addition to direct harm to victims, there also had been an ongoing loss of public confidence in markets and business enterprises, which are increasingly important components of society.

Such misdeeds attest to the continuing need for tough law enforcement. But, meting out punishment only after the damage is an inherently limited approach with little benefit to victims –

the more so for behavior that skirts the law, but may not break it. This conundrum points to a need for strategies that prevent misconduct or at least minimize its prevalence. One way is a more positive approach of rules and incentives that encourage ethical conduct and stress compliance with the law as an essential obligation that society imposes on companies.

To that end, the United States Sentencing Commission (USSC) established sentencing guidelines for organizations, including corporations, in 1991 to establish a clear and uniform enforcement policy for misconduct by such organizations as businesses, unions, foundations, and other institutions. Known formally as the Federal Sentencing Guidelines for Organizations (FSGO), the USSC for the first time established a consistent framework for punishing corporations that broke the law. The FSGO included a new regime for assessing corporate culpability and giving credit, including a potential reduction in penalties, when an effective ethics and compliance program (ECEP) was in place. Penalties would be more severe in the absence of strong compliance efforts. It was thought that this carrot and stick approach might convert organizations from passive bystanders who hoped their employees would behave well to active advocates for ethical conduct on the job.

The Guidelines have had a substantial impact, yet challenges remain. Two decades after the establishment of the FSGO is an appropriate time to closely examine the means by which we are promoting compliance/ethics management by companies. To that end, in January 2011 the Ethics Resource Center (ERC) established an independent Advisory Group to consider the first 20 years of FSGO. Twenty-one individuals comprised the group, bringing voices of experience from the US Sentencing Commission; the US Department of Justice; the US Congress; the Federal Judiciary; academia; and corporations of various sizes and industries. Four members of the ERC Advisory Group also served on an Ad Hoc Advisory Group convened by the Sentencing Commission itself in 2003 to recommend changes to the FSGO compliance/ethics framework.

The ERC Advisory Group was tasked with considering the impact and challenges of the FSGO, as well as the possibilities for broader application of the FSGO in the enforcement community.

---
2 The Ethics Resource Center (ERC) is a nonprofit dedicated to independent research and the advancement of high ethical standards and practices in public and private institutions. For more information, visit www.ethics.org.
In framing the initiative and the development of this public Report, the Advisory Group was asked to consider the following questions:

- After 20 years of FSGO implementation, are we better off?
- What have been the successes of the FSGO? What challenges remain?
- In what ways can the model (which provides credit for ethics/compliance programs) of the FSGO be applied to other areas of enforcement?
- What recommendations would the Advisory Group make to the Sentencing Commission? To other agencies in the enforcement community? To the private sector?

While we recognize that the FSGO are applicable to organizations of all types, the private sector has led the way in establishing compliance/ethics programs in response to the FSGO. Additionally, the private sector has pressed the enforcement community for recognition of effective compliance/ethics programs in the form of reduced penalties and less burdensome settlements should wrongdoing occur. Therefore, in the language of this Report we focus on the private sector and enforcement of the law as it relates to corporations, in the hope that adoption of our recommendations will result in positive changes for other sectors as well.

Throughout 2011 and into 2012, the Advisory Group convened by conference call and in person to discuss the issues and recommendations discussed in the following Report. The panel solicited input from compliance/ethics professionals and the public at large in several ways:

- Presentation and discussion of the reporting outline with 500 compliance/ethics professionals attending a plenary session at an industry conference;  
- Two online surveys distributed to over 10,000 compliance/ethics professionals to gather input on the specific language of FSGO and areas that are in need of clarification;  
- A research study involving outreach to 25 federal agencies with enforcement responsibility, requesting interviews and policy statements regarding credit given for compliance/ethics programs;  
- Meetings with staff of Congressional Oversight Committees; and

3 September 21, 2011, Plenary session at the Best Practices Forum of the Ethics and Compliance Officer Association (ECOA).

- Solicitation of public comment on the initial draft of this Report before final adoption by the Advisory Group.

The goal of this Report is to celebrate the contributions of the FSGO and to leverage lessons learned to create a more effective approach to promoting and recognizing strong compliance/ethics management. History teaches that complacency about ethical behavior invites a slow slippage that can lead to catastrophic results. While we recognize that strong compliance programs will not prevent all bad behavior, we are certain that weak compliance programs will invite misconduct. Instead of picking up the pieces after the fact, it would be far wiser to reinvigorate the FSGO now as an incentive for good conduct and a bulwark against law breaking that hurts us all.

5 Held in November 2011 with majority and minority staff of the House Committee on Government Oversight and Reform.
THE FEDERAL SENTENCING GUIDELINES MODEL: POSITIVE IMPACTS OF THE FSGO TO DATE

Motivated by growing concern that there was too much disparity in sentencing for federal crimes, and potentially too much leniency, Congress enacted the Sentencing Reform Act of 1984, establishing the U.S. Sentencing Commission (USSC) with a mandate to develop essentially binding standards to guide the sentencing decisions of federal judges. The idea was to replace the prevailing system of “indeterminate sentencing,” which allowed judges to use their personal, subjective views on the relevance of such factors as the seriousness of the offense and a defendant’s character and background when setting a sentence. The Guidelines would constrain sentences to increase the likelihood of similar sentences for defendants convicted of similar crimes.

The new law also contained provisions intended to protect against “a sentencing guidelines system that will simply shift discretion from sentencing judges to prosecutors. The concern was that the prosecutor could use the plea bargaining process to circumvent the guidelines recommendation if he or she didn’t agree with the guidelines recommendation.”

In May 1987, the Commission sent Congress a set of Federal Sentencing Guidelines for the sentencing of individual offenders. These Guidelines, which took effect on November 1, 1987, divide federal crimes into 43 “offense levels” and assign offenders to six “criminal history categories” on the basis of previous misconduct. The intersection of the two categories provides the judge with a recommended sentencing range so that offenders guilty of the same

8 Senate Report at 6.
crime and with a similar record would receive similar treatment. The Guidelines allow the judge to “depart” from the suggested sentencing range if the court identifies aggravating or mitigating circumstances to justify a lighter or harsher sentence.⁹

The Sentencing Guidelines for individuals were almost immediately challenged in Mistretta v. United States, 488 U.S. 361 (1989), on grounds that Congress had unconstitutionally delegated power.¹⁰ The United States Supreme Court rejected this challenge, but subsequent rulings, notably United States v. Booker, 543 U.S. 220 (2005), have largely converted the Guidelines from mandatory to advisory. While judges continue to apply sentences within Guideline ranges for a majority of the 83,000 federal offenders sentenced every year, the percentage of departures has risen steadily since the Booker ruling.¹¹

Federal Sentencing Guidelines for Organizations (FSGO)

Following completion of the Guidelines for individual offenders, the USSC turned its attention to sentencing for criminal violations by organizations and, after several years of study and debate, promulgated a new Chapter Eight of the Federal Sentencing Guidelines Manual. The FSGO took effect on November 1, 1991, and apply to corporations, partnerships, labor unions, pension funds, trusts, non-profit entities, and governmental units. Recognizing the distinct features of organizations, they are different in structure and approach from the individual Guidelines.

The Organizational Guidelines were designed to address several realities. First, as with individuals, the Commission found that judicial discretion had led to significant disparities in penalties. In studying past organizational sentencing cases, the Commission found that sentences ranged from imposing forms of “corporate penance,” such as requiring a company to donate executives’ time to charity, to wholly novel punishments, such as sentencing a


corporation to a term of “imprisonment.” While some fines appeared to be less than the cost of complying with the law that was violated, others were quite steep.\(^\text{12}\) Thus, fairness alone demanded a more structured and philosophically coherent approach to sentencing of organizational offenders.

The philosophical approach the Commission settled on began with recognition of the sweeping nature of the U.S. legal doctrine of “vicarious corporate liability.” Under this doctrine, organizations are deemed criminally liable for the actions of an employee who breaks the law during the course of employment as long as the employee’s motivation was at least partly to benefit the organization.\(^\text{13}\) Since even the act of a single employee – out of what might be hundreds or even hundreds of thousands of law-compliant employees within a single organization – could render an organization criminally liable, the Commission recognized that very different kinds of organizations might be convicted of a crime. Both an organization in which the management had diligently tried to prevent misconduct, but nevertheless had an employee deliberately break the rules, and an organization in which the management was directly complicit in the offense could be convicted of precisely the same crime. Initially, for reasons simply of fairness, the Commission wanted the FSGO to draw distinctions among quite different organizational defendants.\(^\text{14}\)

The Commission also was concerned, however, about deterrence and believed that traditional, after-the-fact enforcement efforts were not sufficiently effective in deterring organizational crime. Likened by some to enforcing speeding laws through random arrests, these efforts catch a limited number of offenders. But there is considerable doubt that the low incidence of such \textit{ex post} enforcement broadly deters other misconduct; it seemed to the Commission that many offenses were uncovered only after substantial harm had occurred or escaped detection


\(^{13}\) See, e.g., Department of Justice, United States Attorneys’ Manual, § 9-28.200 “General Considerations of Corporate Liability” (discussing relevant court holdings).

altogether. The Commission believed that to better promote prevention and deterrence, companies themselves should be “conscripted” into the fight against corporate crime.\textsuperscript{15}

To address these various concerns – unwarranted disparity, fairness, and prevention/deterrence – the Commission settled on a “carrot and stick” approach that would create incentives for organizations to actively police themselves. The model drew on the experience of the defense industry, which had recently adopted a similar self-policing model in response to widespread fraud by defense contractors in the so-called “Ill Wind” procurement scandals of the 1980s. The idea was simple – better to encourage organizational cultures that promoted ethical performance than to wait to nab violators only after the damage had occurred.

With that in mind, the FSGO provided for reduced penalties for companies with an “effective program to prevent and detect violations of law,” while imposing high fines and other sanctions (e.g., court monitored “probation”) on companies that “tolerated, encouraged or condoned” improper behavior. A company with an effective compliance program that met specified Guidelines criteria, cooperated with government investigations, and accepted responsibility for its actions could receive a reduction of up to 95 percent of its “base fine.” Companies in which senior personnel played a role in the offense (including deliberately looking the other way), that did not cooperate, and lacked a creditworthy compliance program faced a fine as much as 80 times higher.\textsuperscript{16}

Some have questioned the approach, asking how a compliance and ethics program could be rated “effective” in the face of a violation serious enough to merit prosecution. But the Commission concluded that requiring “perfection” conflicts with human experience and also would undermine the FSGO’s carrot and stick approach of incentivizing self-policing. What should matter, the Commission concluded in essence, was whether an organization could demonstrate that it had diligently sought to prevent, detect, and appropriately respond to violations.\textsuperscript{17}

\textsuperscript{16} See USSG §8C2.6-8C2.7.
\textsuperscript{17} See USSG §8C2.1, comment. (Background).
On the other hand, the Commission's approach took a harsh view of instances when an organization's senior personnel had played a role in the offense – including having “condoned” or been “willfully ignorant” of it – and concluded that a finding to this effect mandated a per se rejection of credit for the organization’s compliance program.\textsuperscript{18} In addition to the seriousness of the offense and the level and pervasiveness of involvement by senior personnel, other factors that can significantly influence a sentence include whether the organization voluntarily disclosed the offense to authorities (a mitigating factor), and the organization’s past history of violations (a potentially aggravating factor).

To receive credit for its compliance program, the FSGO provided that the program be “designed, implemented and enforced so that it generally will be effective” and that “the organization must have taken [seven] types of steps.”\textsuperscript{19} Recognizing that the precise design of an effective program could appropriately vary among the thousands of organizations across the United States, the seven required steps are more categories of compliance initiatives than prescriptive rules. Allowing organizations to test different approaches opens the door for continuous improvement based on real-world experience, rather than a static one-size-fits-all set of rules that assume that the Commission’s experts would always know best.

In the original formulation of the Guidelines (now slightly modified as described here), the seven required types of steps were:

1. The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.

2. Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.

3. The organization must have used due care not to delegate substantial discretionary

\textsuperscript{\textnormal{18} Formerly found at USSG §8C2.5(f) – now at §8C2.5(f)(3)(A).

\textsuperscript{19} See USSG §8B2.1.}
authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.

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

5. The organization must have taken reasonable steps to achieve compliance with its standards, e.g., by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.

6. The standards must have been consistently enforced through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case-specific.

7. After an offense has been detected, the organization must have taken all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law.20

By the Commission’s own admission, the FSGO strategy of challenging companies to take up the fight against corporate crime by instituting effective compliance/ethics programs was something of an experiment. The Commission’s Chairman at the time, William W. Wilkins, Jr., explained it this way:

[T]he ‘carrot and stick’ approach of the guidelines for organizations, with its heavy reliance on a belief in encouraging strong compliance programs,

20 USSG §8A1.2. (1991); now found at USSG §8B2.1. For the current FSGO framework, see Appendix A.
must still be viewed as developmental. If organizations ignore this exploratory invitation to shield against potential liability with well-designed and rigorously implemented compliance systems, it is doubtful this new approach will endure.\textsuperscript{21}

The Commission also hoped that, over time, companies would develop successful practices that could be widely shared and copied to create a virtuous cycle in which advances in compliance would build on themselves to continually reduce the instances of organizational misconduct. The Commission, too, would learn from the experience in order to fine tune the guidelines and fix flaws or loopholes to improve the effectiveness of compliance programs.\textsuperscript{22}

**Ad Hoc Advisory Group – 2001 - 2003**

In late 2001, recognizing the tenth anniversary of the FSGO, the Commission decided to establish an “Ad Hoc Advisory Committee” to review the FSGO and suggest possible improvements. The 15-member Advisory Group selected by the Commission in early 2002 was a diverse group of practitioners and academics that included, among other notable members, the present Attorney General of the United States, Eric H. Holder, Jr.

While observing that the FSGO had been a success, USSC Chair, Judge Diana Murphy, also noted at the time: “Like any body of law, however, the organizational guidelines may need to be modified as circumstances change. In this tenth anniversary year for these guidelines, practitioners and industry representatives are encouraged to share their thinking about the organizational guidelines and their effect.”\textsuperscript{23}

In recommendations released in October 2003, on the heels of corporate scandals involving senior executives at Enron, WorldCom, and other corporations, the Advisory Group concluded that the Guidelines should be modified to “better address the role of organizational leadership in


\textsuperscript{22} Ibid.

ensuring that compliance programs are valued, supported, periodically re-evaluated, and
operate for their intended purpose.” Accordingly, the Group proposed adjustments in the
seven-step framework in order to explicitly assign senior management and the board of
directors with new compliance responsibilities and to generally help ensure that
compliance/ethics would be woven into the fabric of each organization.

The Advisory Group also elevated the visibility of the FSGO credit for compliance/ethics
programs by drafting a separate new Guideline to define an “effective program.” In the initial
Guidelines, by comparison, the definition of an effective program had been relegated to
“commentary.” The proposed amendments were ultimately adopted by the Commission with
only minor changes and took effect on November 1, 2004.

The initial Guidelines were essentially silent on the board’s role. Under the revised Guidelines,
the board was charged with being knowledgeable about the organization’s compliance/ethics
program and exercising “reasonable oversight” of the compliance program’s effectiveness. The
board also was to receive direct reports from the individual(s) with “day-to-day operational
responsibility” for the compliance program, although this was to occur “as appropriate,” signaling
some discretion.  

Senior management, too, was assigned new responsibilities. Most importantly, management was now expected to actively “promote an organizational culture that
encourages ethical conduct and a commitment to compliance with the law.”

The proposed new language highlighted for the first time the importance of building an
organizational “culture” of ethics and compliance; stressed the need for committing adequate
resources and providing sufficient authority to the individuals responsible for compliance;
suggested new training, monitoring, and program evaluation requirements; and said
organizations should establish a mechanism for anonymous reporting of misconduct that “may

26 USSG §8B2.1, comment. (n. 3).
27 USSG §8B2.1(a)(2).
29 See USSG §8B2.1(b)(4),(5).
include mechanisms that allow for anonymity or confidentiality.” It also proposed a significant new section that required ongoing risk assessment that, in the words of one commentator: “makes it clear that risk assessment is the foundation for the entire [compliance] program and that risk assessment is not a one-time endeavor – rather it is ongoing.” The revisions also recognized the essential role of incentives in creating an effective compliance and ethics program.

2010 Changes

Changes to the FSGO have been minor and technical since the Advisory Group completed its work, but one recent adjustment merits mention. A new rule adopted in 2010 made it somewhat easier for organizations to receive compliance credit despite misconduct by managers. After years of debate, this change addressed so-called “credit blocker” language in the Guidelines. Designed to ensure sufficient penalties when senior officials engaged in misconduct, some commentators thought the absolute credit blocker when “high-level personnel” are involved and the “rebuttable presumption” against credit when “substantial authority personnel” are involved were too sweeping. The presumption against program credit when “substantial authority” personnel are involved meant that acts by relatively low level employees, such as a local sales director based far from a company’s headquarters, might bar credit for an organization with an otherwise strong compliance program and a generally exemplary record. In a large corporation there could be hundreds or even thousands of such persons situated throughout the world.

The 2010 amendments eased the rule by allowing credit despite misconduct by more senior employees if the company meets four conditions. Three of these pre-conditions are: 1) the company must have detected the offense itself, 2) it must have promptly reported the offense to governmental authorities, and 3) no “individual with operational responsibility for the compliance and ethics program” could have been involved in the offense.

30 See USSG § 8B2.1(5)(C).
32 See USSG § 8C2.5(3).
The fourth pre-condition for credit despite involvement of more senior personnel sought to strengthen the hand of those with “operational responsibility for the compliance and ethics program.” Bolstering less ironclad requirements for board reporting under the Guidelines’ earlier definition of a creditworthy compliance program, the USSC established as the fourth condition that the personnel with day-to-day responsibility for compliance must have had “express authority to communicate personally to the governing authority [e.g., board of directors] or appropriate subgroup thereof (A) promptly on any matter involving criminal conduct or potential criminal conduct, and (B) no less than annually on the implementation and effectiveness of the compliance and ethics program.”

The change seems designed to enable reporting to the board by the individual closest to the compliance program rather than a more senior employee, such as the General Counsel, who may have flow-chart responsibility for compliance, but delegates day-to-day leadership. When such a delegated arrangement exists, the new language helps ensure that a compliance/ethics officer confronted with an instance of potential criminal conduct has the authority to take the initiative for reaching out to the board without waiting for an OK from higher-ups, a summons from the board, or a pre-scheduled session with the board.

The result of the 2010 and other modifications is the updated Guidelines framework for an effective program. The current framework is attached to this Report as Appendix A.

**A Sea Change in Corporate Compliance and Ethics Management**

The specifics of the Guidelines aside, the most important story that emerges from the FSGO’s 20 year history is that the USSC’s carrot and stick approach has catalyzed vigorous efforts by companies to promote ethical performance and reduce organizational misconduct. At the time the FSGO were promulgated, compliance program efforts were mostly confined to specific risk areas. There were programs that addressed such risks as antitrust, EEO, environmental

---

33 See USSG §8C2.5(3), and comment. (n 11).
34 USSG §8B2.1.
compliance, workplace safety, and FCPA. Although there were companies with broader codes of conduct, probably the closest to a companywide, formal compliance/ethics management system were those of a few large companies in the defense industry. These companies, motivated to recover from scandal and to respond to recommendations from the 1986 Interim Report of the Packard Commission, voluntarily drafted principles for business conduct and started a process of creating and sharing best practices. By 1990 more than 32 major defense contractors had pledged to adopt the core principles, but these more broadly-based practices had not spread outside the narrow community of large defense contractors.

In response to the FSGO’s promulgation in 1991, the development of comprehensive ethics and compliance management practices has mushroomed. The Ethics and Compliance Officer Association, which was created in 1992 in direct response to the FSGO with 19 members, now counts more than 1,200 members exclusively comprised of in-house compliance/ethics professionals – a job category that practically did not exist in 1991. The Society of Corporate Compliance and Ethics, a nine-year old group that certifies compliance/ethics professionals, has more than 2,800 members comprised of both in-house and outside compliance/ethics practitioners, including service providers and advisers.

__________________________


37 In response to the “Ill Wind” scandals, major defense contractors established the Defense Industry Initiative on Business Conduct (DII) which promoted the development of compliance/ethics programs and continues today. See www.dii.org.

38 For more information, visit the Defense Industry Initiative website (www.dii.org).

39 Source: Ed Petry, formerly Executive Director, Ethics and Compliance Officer Association.


42 See www.corporatecompliance.org.
Indeed, the birth of an entire industry of service providers specializing in corporate compliance/ethics training, helpline and related case management, and a host of other compliance/ethics management services and products, appears traceable to the promulgation of the FSGO. At the same time, the number of in-house compliance/ethics practitioners, both full and part time, has ballooned. Experts also are now writing about the importance of ensuring that corporate officers such as general counsel and chief financial officers play a leadership role in the promotion of a company’s compliance/ethics initiatives – an essentially unexplored topic 20 years ago. The compliance and ethics profession has developed its own codes of professional ethics, a sign of the commitment practitioners have to this field. Regional and industry-based groups that share ethics and compliance best practices also have emerged, and broader based business and legal organizations such as the Conference Board and the Practising Law Institute devote significant attention to corporate compliance/ethics management issues. The model first established by the defense industry to commit to a set of industry core principles and to share best practices has now been replicated in the construction industry and among healthcare group purchasing organizations.

The Guidelines not only catalyzed development of a corporate compliance/ethics field, the FSGO’s “seven-step” standards for compliance/ethics programs also have become the de facto framework used to design such programs in the United States – and to some extent around the world. In other words, most companies today with serious compliance/ethics programs carefully calibrate their programs to the Guidelines’ compliance/ethics program criteria. Boards of

45 To date there are at least 20 such regional groups including the Greater Houston Business Ethics Roundtable, New England Ethics Forum, Bay Area Ethics and Compliance Association, and Northwest Ethics Network. There are numerous industry groups ranging from Energy to Retail and Consumer Products. See http://www.theecoa.org/imis15/ECOAPublic/ABOUT_THE_ECOA/ECOAPublic/AboutContent/ABOUT_THE_ECOA.aspx?
hkey=e446751b-96ae-49ae-8b9d-aa387ef8a83b.
directors receive regular reports from management on how their respective companies’ programs conform to these standards, and outside firms evaluate compliance/ethics programs against the FSGO model.

The Guidelines’ compliance/ethics program framework also has served as a reference point for compliance/ethics program models used by a variety of regulatory and enforcement agencies. Executive agencies in the United States, including the Environmental Protection Agency, the Department of Health and Human Services, and the multiple agencies that collaboratively produce the Federal Acquisition Regulations have closely followed the FSGO model for their own specialized programs, albeit with idiosyncratic deviations discussed in the next section of this Report.

Even outside the United States, the FSGO model appears to have been influential. Most recently, the Organisation for Economic Co-Operation and Development’s (OECD) Working Group on Bribery in International Business Transactions issued “Good Practice Guidance” on compliance expectations for anti-bribery compliance programs that overlaps with the FSGO standards. The King II Corporate Governance Principles of South Africa were even more closely modeled on the FSGO framework.

__________________________

48 The Department of Health and Human Services, Office of Inspector General, has issued “model plans” for compliance programs in various healthcare sub-industries. For an overview, see Kaplan & Murphy Compliance Programs and the Corporate Sentencing Guidelines – Preventing Criminal And Civil Liability”, §§24:6-24:9 (West; 2011-2012 Ed.).
50 For example, the Federal Acquisition Regulation model omits the FSGO requirement that the compliance/ethics program be supported internally within the organization with “appropriate incentives to perform in accordance with the compliance and ethics program,” and the Environmental Protection Agency model omits the FSGO requirement that an organization “use reasonable efforts not to include within the substantial authority personnel … any individual …[who] has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.”
More generally, while not necessarily tracking the specifics of the FSGO model, a number of policy-making bodies have incorporated compliance/ethics program expectations within broader corporate standards. For example, the Sarbanes-Oxley Act, the New York Stock Exchange, and the NASDAQ listing requirements followed the USSC’s example in developing compliance program requirements for businesses.  

Most significantly for purposes of this Report, the U.S. Department of Justice also now recognizes as a matter of policy that a company’s rigorous compliance program should be a factor in deciding whether or not DOJ will file criminal charges in cases of organizational misconduct. The DOJ view on compliance was first enunciated in 1999 by then Deputy Attorney General Eric H. Holder, Jr. in the so-called “Holder Memo” and later ratified in subsequent memoranda by two of Holder’s successors, Paul McNulty and Larry Thompson. All three recognized how management can shape a company’s culture, either positively or negatively, and incorporated that into DOJ’s decisions about whether to bring criminal charges against a company:

> While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation’s employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is

---


enforcing the program or is tacitly encouraging or pressuring employees
to engage in misconduct to achieve business objectives.  

This policy has since been codified in the United States Attorneys' Manual.  

For their part, companies and other organizations have identified best practices to build compliance into everyday decision-making and embed it at the core of the business. They have learned the value of internal reporting mechanisms that protect employees' anonymity, embraced a number of user-friendly practices to promote ethical performance, and in some instances use compliance and ethical performance in their employee evaluation programs. And, as previously mentioned in this Report, survey data indicates that these efforts by companies yield positive results.


Since their promulgation 20 years ago, it is clear that the Federal Sentencing Guidelines for Organizations have set in motion a cascade of pro-compliance corporate practices and, to a notable degree, government policies. These developments not only reflect a shared recognition of the serious social harm that corporate crime can cause, but also of the importance of enlisting the business community in the effort to combat it.

However, an important question remains: Does the overall policy environment optimize the business community’s participation in the fight against corporate crime? In other words, do public policies as a whole align to create sufficient incentives for companies, which face strong shareholder pressures to compress costs, to wholeheartedly commit both scarce resources and best practices in this fight?

This question does not arise because businesses are indifferent to law abidance; indeed, virtually all companies would say that they support good corporate citizenship and the rule of law. But, just as the Commission understood with the original carrot and stick formula of the Guidelines, the incentives can affect behavior. Twenty years of history have demonstrated that organizations do respond to policy incentives. But because the Guidelines do not exist in a policy vacuum, the remaining question is whether the governmental policies and practices that surround the Guidelines are helping or hindering.

To begin to understand the types of conditions under which the business community is being asked by government to become a full partner in the effort to combat corporate crime, the following questions need exploration:

- In using deferred prosecution agreements to “detour” corporate cases out of the sentencing process where the FSGO incentives would apply, are prosecutors actually keeping the promise to reduce penalties for companies that undertake rigorous
compliance efforts – and has the government created enough transparency so that the public can see if those promises are being kept?

- In communicating with companies about what is expected of them in terms of compliance/ethics, is government speaking with a consistent voice, or is it offering a patchwork that may confuse rather than enlighten?

- In weighing whether a particular company’s compliance efforts should be judged worthy of “credit,” do those doing the judging have sufficient knowledge, information, and resources to do so credibly?

- And, what more can corporate America do voluntarily to embed the principles of FSGO, even beyond the motivation provided by “the carrot” or “the stick” from government?

Considering these and other questions like them, we find that challenges persist, with the result that the cascade of pro-compliance corporate practices and government policies that have been created by the FSGO are not coming together in the most effective and self-sustaining ways. Of the challenges that persist, four are pivotal:

1. There are few FSGO cases involving large companies because criminal cases against large corporate defendants (and many smaller ones) are regularly being resolved before they reach the judges for whom the Sentencing Guidelines were intended. For businesses that put genuine effort into developing effective compliance and ethics programs that track the FSGO standards, this means the decision to reward such efforts is being diverted into a largely non-transparent realm of prosecutorial discretion. Although this “diversion” means an alternative to criminal convictions that has benefits for both the government and companies, it also reintroduces into the process some of the very problems that the Sentencing Reform Act sought to address.

2. There is a lack of consistency in policies toward ECEPs across the various government agencies that play a role in corporate law enforcement and regulation because there is neither a requirement that these policies be aligned nor a mechanism available for doing so. This variation is not only burdensome for business as it tries to harmonize siloed
frameworks and expectations relating to ECEPs, it is arguably inefficient for each
government agency to reinvent the wheel when establishing such frameworks.

3. Many compliance/ethics programs fall short of their potential. While many companies
today believe they are following the FSGO’s standards for ECEPs, portions of these
standards are unclear and other portions may under-emphasize key points and
emerging best practices.

4. Too many business executives take a check-the-box approach to the FSGO, rather than
focusing on the FSGO requirements that companies apply “due diligence” in
establishing the compliance/ethics program and ensure that “the program …be
reasonably designed, implemented and enforced so that the program is generally
effective.” The FSGO framework is a set of standards meant to subsume the best
practices that have developed under them throughout industry. Companies need to
identify, continue to develop, and ultimately apply these best practices in order to meet
the Guidelines’ standards. Put another way, businesses need to apply the full range of
effective governance and management techniques in the effort to mitigate corporate
crime and unethical conduct. In this context, proper positioning, empowerment, and
autonomy of the chief ethics and compliance officer should be a priority for companies.

We explore these challenges in turn below, and provide recommendations for addressing them
in the section that follows.

**Challenge 1:**

*There are few FSGO cases involving large companies because criminal cases against
bigger corporate defendants are largely being detoured around the judges for whom the
Sentencing Guidelines were intended.*

---

56 USSG §8B2.1(a)(2)
An assumption underlying the willingness of companies to adopt compliance/ethics programs meeting the FSGO standards is that, in the event that an employee does violate the law, the company’s prior compliance/ethics efforts will be assessed, and the company will receive credit, based on those same FSGO standards if in fact those prior efforts were creditworthy. Unfortunately, data collected by the Sentencing Commission (USSC) do not provide support for this key assumption.

The USSC reports that in the 20 years since the FSGO were promulgated in 1991, 3,433 organizations have been sentenced – and only five received credit for a compliance/ethics program.\(^{57}\) Regrettably, the Commission has no publicly available data on the nature of these organizations that received ECEP credit.\(^{58}\) However, close observers of corporate criminal cases believe it likely that the companies receiving credit were relatively small corporations that did not have the kind of comprehensive programs being implemented by large, sophisticated companies. In short, few, if any, large companies have received credit for an ECEP under the FSGO’s standards.

News stories make clear that is not because there are no cases involving large companies. The FSGO are not being applied to large companies because most cases involving large companies today are being resolved without criminal charges, which in turn means no conviction and, therefore, no judicial application of the Guidelines.

What is happening instead is that cases involving large companies are commonly being resolved through the use of Deferred Prosecution Agreements (DPAs), non-prosecution


agreements (NPAs), or other administrative/civil settlement agreements. The rationales for the use of these types of extra-criminal process agreements are sensible: 1) such agreements allow corporate misconduct to be remedied in a way that avoids the potentially devastating collateral damage, often to innocent parties, that can ensue when a company is convicted of a crime,\(^{59}\) and 2) these agreements ensure that the government avoids expending scarce resources litigating a criminal case. The Department of Justice first began using Deferred and Non-Prosecution Agreements in 1993,\(^{60}\) but their use became frequent only in the latter part of this past decade, as shown in the table below:

<table>
<thead>
<tr>
<th>Year</th>
<th># of Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>5</td>
</tr>
<tr>
<td>2005</td>
<td>20</td>
</tr>
<tr>
<td>2006</td>
<td>24</td>
</tr>
<tr>
<td>2007</td>
<td>41</td>
</tr>
<tr>
<td>2008</td>
<td>25</td>
</tr>
<tr>
<td>2009</td>
<td>23</td>
</tr>
<tr>
<td>2010</td>
<td>32</td>
</tr>
<tr>
<td>2011</td>
<td>29</td>
</tr>
</tbody>
</table>

---

\(^{59}\) In a 2011 DPA with Johnson & Johnson, for example, the Department of Justice noted, “Were the Department to initiate a prosecution of J&J or one of its operating companies and obtain a conviction, instead of entering into this Agreement to defer prosecution, J&J could be subject to exclusion from participation in federal health care programs….” [http://www.justice.gov/criminal/fraud/fcpa/cases/depuy-inc/04-08-11depuy-dpa.pdf](http://www.justice.gov/criminal/fraud/fcpa/cases/depuy-inc/04-08-11depuy-dpa.pdf). Commentators have criticized the use of criminal prosecution because of the collateral consequences that may ensue, as with the prosecution of Arthur Andersen, one of the country’s largest public accounting firms, which was widely seen as the proximate cause for Andersen going out of business. See, e.g., Ainslie, Elizabeth K., “Essay: Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution,” 43 Am. Crim. L. Rev. 107 (Winter, 2006).


DOJ Policy: ECEPs to Be Considered in Corporate Cases

In principle, decisions by prosecutors on what action to take with respect to a corporation suspected of criminal conduct – i.e., declining to prosecute, entering into a DPA or NPA, or pursuing a criminal conviction – are not unregulated. Rather, according to DOJ policy, they are to be guided by DOJ’s Principles of Federal Prosecution of Business Organizations, now embedded within the U.S. Attorneys’ Manual (“DOJ Prosecution Principles”).

Moreover, the DOJ Prosecution Principles instruct prosecutors to consider nine factors most of which also appear in the FSGO, suggesting that there should be symmetry in cases regardless of whether they are “sentenced” under the FSGO, on the one hand, or diverted away from the criminal justice process and “settled” under a DPA or NPA, on the other. The nine factors, and a representation of how they are to influence prosecutorial decisions, are summarized in the illustration below.

---


63 These include the seriousness of the offense, USSC §8C2.4. (Base Fine), whether the organization voluntarily disclosed the offense, whether the organization cooperated with the government, the organization’s past history of wrongdoing, the pervasiveness of the wrongdoing in the instant case, whether the organization obstructed the investigation, and the effectiveness of the organization’s compliance and ethics program. USSC §8C2.5 (Culpability Score). “Remedial efforts” are considered under the definition of a creditworthy compliance program, see USSC §8B2.1 (Effective Compliance and Ethics Program), and collateral consequences are referenced in USSC §8C2.8(a)(3) (Determining the Fine Within the Range) (Policy Statement). The only DOJ factor not accounted for in the FSGO is whether individuals are being held accountable for the offense.
The factor circled in the chart – “Pre-existing compliance program” – is, of course, the point in the decision process where prosecutors are supposed to provide recognition and credit for an ECEP. And, given the paucity of large corporate cases that follow the traditional criminal justice path into the federal courts for sentencing and application of the FSGO’s ECEP criteria, it is where the business community looks to see whether the federal government is delivering on its promise to recognize genuine compliance efforts.

---

64 US GAO. (2009). CORPORATE CRIME: DOJ Has Taken Steps to Better Track Its Use of Deferred and Non-Prosecution Agreements, but Should Evaluate Effectiveness (Rep.).
Little Publicly Available Evidence that DOJ Considers ECEPs

Unfortunately, the record on this promise is, at best, murky. While senior Department of Justice personnel have long extolled the importance of having an ECEP and indicated DOJ cares about them, prosecutors have rarely pointed to any evidence that an ECEP actually played a role in the outcome of a real case. That is true whether one looks at press releases, case statistics, opinion memos, or the like.

This is not due to a policy within the Department of Justice against publicly discussing in concrete terms how the nine DOJ Principles of Prosecution can affect a case. For example, the head of the Criminal Division in a 2010 speech cited cases where “cooperation” – one of the nine factors in the DOJ Principles of Prosecution – had led to reduced penalties, including one case where he said the reduction could be calculated at “67 to 84 percent.” Although the audience for the speech was, as he acknowledged, the in-house “stewards” of corporate compliance, and while he also said that a “robust, state-of-the-art compliance program and a true culture of corporate compliance” have “never before… been as important” and warned companies against adopting “paper” programs, he offered no examples of where an ECEP influenced the outcome of a case, even generally.

The lack of information on whether and how DOJ takes ECEPs into account in real cases was documented in a 2009 study, “Ethics and Compliance Enforcement Decisions – the Information Gap,” by the Conference Board. The study found that while “there are many publicly available

65 For example, in 1995, Deputy Assistant Attorney General, Criminal Division, Robert S. Litt said, “In recent years, the Department of Justice has come to focus more and more on the importance of prevention and compliance, as opposed to enforcement and punishment, as a means of effective law enforcement. If you want to police an …industry…you have to enlist the industry itself in helping you. And so we are looking for ways to encourage corporate self-policing.” U.S. Sentencing Commission, Symposium Proceedings: “Corporate Crime in America: Strengthening the ‘Good Citizen’ Corporation,” p.303 (1995).


67 Executive Action Series, No. 310. (June 2009).
examples” of cases where after-the-offense compliance program requirements have been included in a DPA or other government agreement, “there have been very few publicized cases of companies that have received credit under …DOJ … policies for having effective preexisting (i.e., in existence at the time of the offense) compliance and ethics programs.”68

The study’s working group used a variety of techniques to look for examples of “pre-offense” ECEPs receiving credit, including reaching out directly to DOJ for any information it might be able to provide. The Fraud Section of the Criminal Division cited one case (a 2007 FCPA settlement with Textron) where it said that the Department had publicly acknowledged – in a press release – the impact of an ECEP. However, what this press release actually said was:

-The Department has agreed not to file criminal charges against the company or its subsidiaries in recognition of Textron’s early discovery and reporting of the improper payments; Textron’s thorough review of those payments as well as its discovery and review of improper payments made in other countries, including India, Egypt, and the United Arab Emirates; and the company’s implementation of enhanced compliance policies and procedures [emphasis added].69

Thus, in even this example of DOJ publicly acknowledging the mitigating effect of an ECEP, the press release appears to credit 1) voluntary disclosure as the primary reason for the favorable treatment, and 2) “enhanced” – apparently post-offense – implementation of compliance upgrades.

The Lack of DOJ Cases Considering ECEPs – The Effect on Businesses

Noting the dearth of evidence that pre-offense ECEPs actually influence DOJ settlements, the Conference Board study saw the implications this way:

From an ethics and compliance incentives perspective, publicly recognizing settlement-based programs (but not preexisting ones) in

68 Ibid. at p. 2-3.
enforcement decisions is hardly optimal. In essence, it sends a message that the companies need not be concerned with compliance/ethics programs until after a violation, and thereby undercuts the important law enforcement policy of deterrence.\textsuperscript{70}

In late 2010, the Ethics Resource Center (ERC) with participation from the two largest corporate compliance/ethics professional associations – the Society of Corporate Compliance and Ethics (SCCE) and the Ethics and Compliance Officer Association (ECOA) – surveyed in-house compliance/ethics professionals to help further gauge how DOJ cases are perceived. The study,\textsuperscript{71} released in early 2011, further underscored what the Conference Board had found. Overwhelming majorities of respondents said they believed their companies’ in-house compliance/ethics programs could be strengthened if DOJ made the following kinds of information more readily available:

- General statistics about the consideration of compliance/ethics programs in enforcement decisions (93 percent said Very Helpful/Helpful).

- Descriptions (without identifying information) of individual cases in which an organization’s compliance/ethics program played a favorable role in an enforcement decision (97 percent said Very Helpful/Helpful).

- Information about whether specific aspects of a program (e.g., sufficiency of compliance/ethics training, appropriate position of the compliance/ethics officer) played a role in enforcement (96 percent said Very Helpful/Helpful).

- In addition to cases where an organization’s compliance/ethics program contributed to the organization’s avoiding prosecution entirely, information about cases where a program contributed to the organization’s receiving some other enforcement-related benefit, such as avoiding having to engage a monitor (97 percent said Very Helpful/Helpful).

\textsuperscript{70} Ibid. at 67. p.3.
\textsuperscript{71} Ibid. at 4.
Respondents also overwhelmingly said that case information should distinguish between credit for ECEPs that were established pre- vs. post-offense (93 percent) and should help the public be able to disentangle the influence of ECEPs from the influence of voluntary disclosure/cooperation in case outcomes (87 percent).

The respondents made clear that if government wants to optimize the participation of companies in the fight against corporate misconduct through more and better ECEPs, this kind of information is vital for very practical reasons. The following comments from the study’s respondents are illustrative:72

- “The current DOJ approach allows cynical executives to conclude that any violation justifies a DOJ conclusion that the compliance program was ineffective no matter how robust the program was in preventing other problems. As a result, additional resources are diverted elsewhere, an outcome potentially harmful to society at large and in opposition to what the DOJ probably intended.”

- “Particularly in times of shrinking budgets and restricted resources it would be very helpful to have some evidence to demonstrate why a solid compliance program is needed – and why a better program is worth the effort versus a bare bones minimum.”

- “Without specific information from the Department that shows compliance programs really matter, it is difficult to convince companies that the government actually cares. Everyone already knows the government wants you to turn yourself in and cooperate, but that seems to be the only thing that matters. We hear about that all the time; more cases about disclosure and cooperation will not help convince management, but compliance cases will.”

- “We need to know that the Department cares enough to distinguish real cases from paper ones. We need the Department to make clear, for example, that programs where

the chief compliance officer has no power, no protection, and no access to the board will be treated as shams, but programs where the compliance people are empowered will be given credit. Until the government makes this clear, programs are going to remain underpowered and not live up to their potential.”

Recent Positive Movement from the Criminal Division’s Fraud Section

In recent years, the Fraud Section of DOJ’s Criminal Division has greatly increased the amount of information it has made available to the public. It is now regularly posting on the DOJ website indictments, settlements, press releases, opinions, and other information related to cases pursued under the U.S. Foreign Corrupt Practices Act.73 This effort is very welcome.

It is also true that the Fraud Section, relative to prosecutors in other parts of DOJ, has moved closer to acknowledging the relevance of ECEPs in reaching settlements. However, a review of case materials made available by the Fraud Section (DPAs, NPAs, and press releases) since the Conference Board’s study shows that, in most cases where a company receives a “break” and ECEPs are discussed, the following also are true:

- The predominant factor driving the outcome of the case appears to be voluntary disclosure/cooperation;

- Consideration of a company’s ECEP efforts typically appears in the settlement at the end of a sometimes substantial list of other factors affecting the outcome, implying that ECEPs are a secondary consideration;

- While the impact on monetary penalties due to such FSGO factors as voluntary disclosure/cooperation and pervasiveness of the misconduct among senior personnel

73 See http://www.justice.gov/criminal/fraud/fcpa/cases/a.html. Finding this site is not especially easy for the uninitiated and seems to require knowledge of the organizational structure of DOJ (one can find the site by going to the DOJ site and searching “Fraud Section”), or that the kind of corporate cases receiving this higher degree of prosecutorial description are FCPA cases (one can find the site by searching “FCPA”).
are plainly laid out, no cases have been posted in which a company plainly received credit for its pre-existing ECEP;\textsuperscript{74}

- Discussion of ECEPs in settlements typically pertains to after-the-fact compliance improvements, not to a pre-existing ECEP.\textsuperscript{75}

One recent exception to the last bullet is the Fraud Section’s settlement with Johnson & Johnson filed in April 2011. The settlement agreement explicitly cites J&J’s “effective” “pre-existing” ECEP as a “relevant consideration” in the outcome of the case:

\emph{J&J had a pre-existing compliance and ethics program that was effective and the majority of problematic operations globally resulted from insufficient implementation of the J&J compliance and ethics program in acquired companies.}\textsuperscript{76}

However, while the agreement says the pre-existing ECEP was “relevant,” it does not say how the pre-existing ECEP affected the settlement’s terms – in contrast to, for example, the company’s voluntary disclosure/cooperation which is explicitly accounted for, and in precise dollar terms, to lower the settlement’s monetary penalty. Moreover, the company’s pre-existing ECEP was one of 15 “Relevant Considerations” listed in the settlement, and it appears in the

\textsuperscript{74} Commendably, the Fraud section has been outlining in settlements how it believes the FSGO would apply to the facts of these cases, but in no cases have DOJ’s FSGO calculations indicated that credit is being awarded.

\textsuperscript{75} See, e.g., Press Release on Comverse Technology Inc., April 7, 2011. (“The agreement recognizes the company’s thorough self-investigation and the results of its investigation, voluntary disclosure of the underlying conduct, and full cooperation with the department. CTI has undertaken extensive remedial efforts and overhauled its overall compliance culture, including through the implementation of mandatory training programs focused on anti-corruption and the use of third-party agents, and intermediaries, as well as more rigorous accounting controls for the approval of third-party payments). For other cases, see the Fraud Section FCPA case docket on its website.


©2012 Ethics Resource Center
settlement as number 15 – i.e., the last one – on this list. This prioritization has the feeling of damning with faint praise even if that was not the intent.

If the Fraud Section felt that the ECEP was “relevant” to the terms of the settlement, but did not want to give it full FSGO fine-mitigation credit for the reason cited in the excerpt quoted above, it had options. These include:

- Specifying that, while not warranting full credit, the ECEP nevertheless warranted a monetary penalty below the otherwise applicable FSGO fine – in fact, the settlement did provide for “a 25 percent reduction off the bottom of the [FSGO] fine range”, but did not say what factors influenced this.

- Specifying that the ECEP played a role in other aspects of the settlement, such as the decision not to require a corporate monitor as DOJ has required in other settlements.

On April 25, 2012 (days before the issuance of this Report), the Department of Justice issued a press release announcing a guilty plea by a former managing director for Morgan Stanley who was charged with conspiring to evade internal controls to enrich himself and a Chinese government official. The press release indicated that “after considering all the available facts and circumstances, including that Morgan Stanley constructed and maintained a system of internal controls, which provided reasonable assurances that its employees were not bribing government officials, the Department of Justice declined to bring any enforcement action against Morgan Stanley related to [the Managing Director’s] conduct.” In addition to citing Morgan Stanley’s voluntary disclosure and cooperation, the press release cited specific examples of compliance measures that Morgan Stanley had undertaken:

According to court documents, Morgan Stanley maintained a system of internal controls meant to ensure accountability for its assets and to prevent employees from offering, promising or paying anything of value.

to foreign government officials. Morgan Stanley’s internal policies, which were updated regularly to reflect regulatory developments and specific risks, prohibited bribery and addressed corruption risks associated with the giving of gifts, business entertainment, travel, lodging, meals, charitable contributions and employment. Morgan Stanley frequently trained its employees on its internal policies, the FCPA and other anti-corruption laws. Between 2002 and 2008, Morgan Stanley trained various groups of Asia-based personnel on anti-corruption policies 54 times. During the same period, Morgan Stanley trained [the Managing Director] on the FCPA seven times and reminded him to comply with the FCPA at least 35 times. Morgan Stanley’s compliance personnel regularly monitored transactions, randomly audited particular employees, transactions and business units, and tested to identify illicit payments. Moreover, Morgan Stanley conducted extensive due diligence on all new business partners and imposed stringent controls on payments made to business partners.78

The Morgan Stanley case is a commendable and welcome example of compliance efforts receiving visible and meaningful credit in a decision on whether to prosecute a corporation for the wrongdoing committed by an employee. It is still not clear from the disclosed facts whether the FSGO were applied in determining whether Morgan Stanley’s compliance efforts were deemed creditworthy, which leaves open for question the standard by which the company’s compliance efforts were measured (indeed, the language in the press release characterized these measures as “internal accounting controls” rather than elements of an effective compliance and ethics program as reflected in the FSGO criteria). Nevertheless, this represents the type of decision-making and transparency that individuals in the compliance and ethics field have been advocating for, and we hope it reflects an ongoing evolution of the DOJ’s policies and practices in this area.

While the Fraud Section has made strides in providing greater transparency to the public, it is also true that the Fraud Section is just one section within the vast constellation of personnel and departments that make up Department of Justice. The Criminal Division, within which the Fraud Section resides, gets involved in corporate cases not handled by the Fraud Section, the

78 Ibid at 76.
Criminal Division is not the only DOJ Division that engages in enforcement of corporate cases, and there are 93 United States Attorneys' Offices spread across the United States and its territories, each with the ability to prosecute corporate cases with relative independence. The Conference Board study found a similar lack of publicly available information – e.g., settlements, press releases – that ECEPs are being considered by these other groups of prosecutors as well.

Moreover, as explained in more detail below, even within DOJ there are major policy differences toward ECEPs. Most strikingly, DOJ's Antitrust Division takes the approach that it is not bound by the U.S. Attorneys' Manual on this point and will give no credit to a company's ECEP, even a truly exemplary one. All that matters is whether a company was “the first in the door” to make a voluntary disclosure.

Practitioners who have been involved in the resolution of corporate cases with DOJ know from experience that ECEPs do factor into settlement negotiations. Thus, we are not contending that ECEPs are not being considered by prosecutors. What is clear is that there is little publicly available evidence of it – and that undermines sound public policy.

The Lack of a Credible Review Process

While the record of ECEPs getting consideration in the settlement of cases is thin, the standards and processes by which compliance and ethics programs are measured for effectiveness are thinner. Consider, for example:

- Who should be performing the assessment? Government provides little “schooling,” if any, to prosecutors on what criteria and industry best practices to look for in assessing the design, implementation, or operating effectiveness of a compliance and ethics program. The issues involved in managing ECEPs in large companies are multifaceted, and so, too, are the facts that must be weighed when assessing the effectiveness of those efforts. This raises the question of whether the right competencies exist within government to perform these types of assessments credibly and whether government is

---


prepared to commit the resources necessary to develop and sustain those competencies. The rise in the use of DPAs has brought with it an increased use of third-party monitors to do the type of substantive and ongoing assessment work necessary to monitor compliance with the DPA -- but the use of third-party experts in this context is most often after-the-fact, i.e., after the “punishment” has already been decided and the compliance program’s day in court has passed.

- What common set of criteria, assessment framework, methodology, or work steps are available to prosecutors to measure the effectiveness of compliance and ethics programs? What basis is there to believe that two different prosecutors confronting similarly-situated compliance programs will arrive at similar conclusions in assessing those programs? How in the Johnson & Johnson case cited above did the Fraud Section determine that J&J’s compliance/ethics program was “effective”?

- While the DOJ Prosecution Principles provide some high-level considerations for prosecutors to weigh – e.g., “Prosecutors should therefore attempt to determine whether a corporation’s compliance program is merely a ‘paper program’ or whether it was designed, implemented, reviewed, and revised, as appropriate, in an effective manner”\(^{81}\) – there is little substantive guidance that informs prosecutors about what steps they should follow to ensure they arrive at the most complete and accurate answers. This leaves government officials in the position of simply asserting, as they often do, that they “know good programs when we see them.” This may or may not be true, and either way, we believe government can do better -- and we believe companies that make meaningful investments in compliance deserve better.

- Assuming an assessment of a compliance program is performed, how do the results of such an assessment inform, tangibly and specifically, the outcome of a matter? The DOJ Prosecution Principles provide little real guidance on how findings relating to a company’s pre-existing compliance/ethics program (e.g., meeting all the FSGO criteria and evaluated by the company for effectiveness; meeting all criteria and evaluated for effectiveness but with modest shortcomings; reasonably designed but not tested for

effectiveness; clearly substandard) can be tied to different aspects of a settlement (e.g.,
the size of the monetary penalty, the length of the DPA term; the requirements for
reporting back to DOJ post-settlement; whether a monitor will be required; the scope of
the monitor’s activities). Altogether, the lack of assessment standards and guidance on
how the quality of a compliance/ethics program should influence the outcome of a matter
create the impression, validated by the ERC and Conference Board studies cited above,
that too many judgments are being made inside a black box.

In 1995, the late Senator Edward M. Kennedy, one of the original sponsors of the Sentencing
Reform Act contemplated the future of the still new Federal Sentencing Guidelines for
Organizations and saw these same concerns on the horizon:

If companies are going to do their part and commit to more than window
dressing compliance, those who are responsible for enforcing the law
must be able to tell the difference between sincere and cosmetic
compliance efforts. Unless prosecutors, debarment officials, judges, and
others have the expertise to assess compliance program effectiveness,
there is a risk that companies without substantial compliance programs
will get a free ride, and those with strong programs will not receive the
credit that they deserve. Either outcome is a threat to the new corporate
crime policy.\textsuperscript{82}

\textit{A Role for the Courts?}

Because most companies are eager to avoid the stigma (and potentially the significant collateral
consequences) of a criminal conviction, prosecutors have tremendous leverage in negotiating
the terms of DPAs. It is also true that guarding against undue prosecutorial discretion was a
concern of Congress when it enacted the Sentencing Reform Act that created the sentencing
guidelines system. As the Senate Report to the legislation explained:

Proceedings: “Corporate Crime in America: Strengthening the ‘Good Citizen’ Corporation,” p.120.
Some critics [of the legislation] expressed concern that a sentencing guidelines system will simply shift discretion from sentencing judges to prosecutors. The concern is that the prosecutor will use the plea bargaining process to circumvent the guidelines recommendation if he doesn’t agree with the guidelines recommendation.

The bill contains a provision designed to … assure that judges can examine plea agreements to make certain that prosecutors have not used plea bargaining to undermine the sentencing guidelines.\(^\text{83}\)

What Congress did not consider was that a previously unknown avenue for resolving organizational cases – DPAs – would develop in which judges would play no role, thus at least raising the question of whether prosecutorial discretion in these cases is undermining the “transparency, consistency, and fairness” that the Guidelines were intended to achieve.\(^\text{84}\) This question leads to another: Should the judiciary have a role in overseeing such agreements?

The Government Accountability Office (GAO) considered this question as part of an examination of DOJ’s use of DPAs and uncovered differing points of view among the numerous judges, prosecutors, monitors and company officials included in its study.\(^\text{85}\) The advantages and disadvantages of greater court involvement cited in the GAO study are highlighted in the table below:

\(^{83}\) Senate Report at 6.


### Greater Court Involvement in DPAs

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The court could act as an independent arbiter of disputes that companies and DOJ identify, or to handle significant events in the DPA process, such as the determination of a breach.</td>
<td>• The lack of time and resources available to judges to become more involved in the DPA process or their willingness to do so.</td>
</tr>
<tr>
<td>• The court’s involvement in the monitor process could decrease the appearance of favoritism and add to the perception of fairness in a monitor’s selection.</td>
<td>• Potential concerns related to the separation of powers under the Constitution. For example, some participants in the GAO study observed that:</td>
</tr>
<tr>
<td>• The court could increase transparency in the DPA process by, for example, making monitor reports filed in the case publicly available.</td>
<td>o Judges are prohibited under the rules of criminal procedure from participating in plea bargaining between two parties in a case, and negotiations over DPAs are similar to plea bargaining.</td>
</tr>
<tr>
<td></td>
<td>o Decisions in the DPA process -- such as whether to enter into a DPA instead of prosecute, set the terms of the agreement, or determine whether a company has complied with or breached an agreement -- are functions of the executive rather than the judicial branch.</td>
</tr>
<tr>
<td></td>
<td>o If a judge disagreed with the prosecutor’s determination that a company had complied with or breached an agreement, the judge’s authority to refuse the prosecutor’s request to dismiss the indictment and proceed with prosecution is unclear.</td>
</tr>
</tbody>
</table>

|                                                                            |                                                                                         |
|                                                                            | Additional time and processes associated with court involvement, such as hearing, may slow down the DPA process. |
|                                                                            | Judges’ lack of knowledge and expertise about the case or its subject matters, such as the operation of an environmental system at a wastewater treatment plant, which prosecutors in the case may have spent years developing. |

The GAO study reported that the “DOJ did not have a position on whether greater judicial involvement in the DPA process creates separation of powers issues; however, DOJ believes that judicial involvement in the NPA process would create concerns related to the separation of powers.

---

86 US GAO. (2009). CORPORATE CRIME: DOJ Has Taken Steps to Better Track Its Use of Deferred and Non-Prosecution Agreements, but Should Evaluate Effectiveness (Rep.).
powers because no judicial review is required for NPAs, as they typically do not involve court filings.  

One approach not considered by the GAO is whether courts might play a limited role quite consistent with their traditional role in the Guidelines system – to review DPAs filed with the court to ensure that in arriving at their terms DOJ considered all FSGO factors and that this consideration is explicit in the agreement. This kind of “process check” would help ensure that ECEPs are considered and that the public would see their impact. Appropriately, it would not supplant DOJ’s judgment on how to weigh the FSGO factor with the judge’s own opinion.

The challenges relating to DOJ’s crediting ECEPs exist elsewhere; indeed, they exist across most, if not all, federal enforcement agencies that interface with the business community. We explore the challenges across other federal enforcement agencies immediately below.

**Challenge 2:**

There is a lack of consistency in policies toward ECEPs across the various government agencies that play a role in corporate law enforcement and regulation because there is neither a requirement that these policies be aligned nor a mechanism available for doing so.

Many federal agencies (see table below) play a role in enforcing the laws that govern corporate conduct, and often even more specialized divisions and departments do so within those agencies. What sorts of policies and practices have these agencies and divisions adopted toward compliance and ethics programs, and do these policies and practices facilitate or frustrate efforts by the business community to adopt them?

Rather than look at this question in the abstract, it may be helpful to consider what the answer might look like from the point of view of a single management team at a single company –

---

specifically, what types of practical questions might a well-intentioned management team itself ask when trying to figure what is meant by government’s call to be a more self-policing, self-governing, good corporate citizen?

### Illustrative Federal Agencies Involved in Regulating and Enforcing Corporate Conduct

<table>
<thead>
<tr>
<th>Department of Agriculture</th>
<th>Federal Communications Commission</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Commerce</td>
<td>Federal Deposit Insurance Corporation</td>
</tr>
<tr>
<td>Department of Defense</td>
<td>Federal Energy Regulatory Commission</td>
</tr>
<tr>
<td>Department of Energy</td>
<td>Federal Reserve Board of Governors</td>
</tr>
<tr>
<td>Department of Health and Human Services</td>
<td>Federal Trade Commission</td>
</tr>
<tr>
<td>Department of Justice</td>
<td>Food and Drug Administration</td>
</tr>
<tr>
<td>Department of Labor</td>
<td>General Services Administration</td>
</tr>
<tr>
<td>Department of the Treasury</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>Environmental Protection Agency</td>
<td>National Labor Relations Board</td>
</tr>
<tr>
<td>Equal Employment Opportunity Commission</td>
<td>Nuclear Regulatory Commission</td>
</tr>
<tr>
<td>Federal Aviation Administration</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td></td>
<td>U.S. Agency for International Development</td>
</tr>
<tr>
<td></td>
<td>U.S. Postal Service</td>
</tr>
</tbody>
</table>

Q. What policies do the regulatory and enforcement agencies that interface with our business have toward compliance/ethics programs, and where can we find them?

Surprisingly, the simple act of discerning what an individual agency’s policies are toward ECEPs can be challenging. Some agencies have an official policy that derives from regulation or statute. For others, one may be able to infer what the agency’s policies are by reviewing official remarks by agency personnel or comment letters, or by examining particular cases or decisions in an attempt to identify precedents and trends. And for some, one may be hard pressed to discern any particular policy, practice, or point of view at all.

If our sample management team happened to be in the healthcare business, its path to understanding the healthcare regulator’s position – at least its officially stated position – towards compliance programs would be relatively straightforward. It would find a website organized by the Office of Inspector General for Health and Human Services (HHS/OIG) that sets forth a series of guidance documents directed at various segments of the health care industry (e.g., hospitals, nursing homes, third-party billers, and durable medical equipment suppliers), that
outline specific expectations for ECEPs within those industry segments.\textsuperscript{88} Our sample management team also would discover that the guidance documents contain familiar principles for designing ECEPs because they substantially overlap with the FSGO model of an “effective compliance and ethics program.” Importantly, the management team also would learn that HHS/OIG officially states that it will consider the existence of an effective compliance program that pre-dated any governmental investigation when addressing the appropriateness of administrative sanctions.\textsuperscript{89}

If our sample management team went to the Federal Trade Commission to learn what its official policy was toward compliance programs in the context of its enforcement of civil antitrust laws, it would find no formal policy.\textsuperscript{90} However, the team could perhaps gain some insight from official remarks, such as these provided by an Assistant Director of the Competition Bureau: “The more a company can tell the FTC about its efforts to keep its nose clean, the more likely the Commission is to see its action as being in good faith and the more willing it is to permit mitigation, including mitigation down to zero penalties.”\textsuperscript{91}

If our sample managers went to the Equal Employment Opportunity Commission to learn what its policies were toward compliance programs in the enforcement of anti-discrimination laws, they might be even more hard pressed to find clear answers. While the EEOC website contains a plethora of interpretations of various statutes, guidance specifically related to EEO compliance programs is fairly sparse and hard to find.

Q. \textit{Are we required to establish a compliance program, or is our decision to do so voluntary?}

As described earlier in this Report, history has demonstrated that companies widely see the carrot and stick model of the FSGO as providing a strong incentive to adopt an ECEP, but quite often the decision to do so is, in fact, voluntary. For some companies, however, adopting a

\textsuperscript{88}\textit{See, e.g.,} \url{http://oig.hhs.gov/compliance/compliance-guidance/index.asp}.
\textsuperscript{89}\textit{See, e.g.,} Federal Register / Vol. 63, No. 35 / Monday, February 23, 1998.
\textsuperscript{90} See “Compliance Programs and the Corporate Sentencing Guidelines – Preventing Criminal And Civil Liability”, §24:10 (Kaplan & Murphy eds.) (West; 2011-2012 Ed.).
\textsuperscript{91} Murphy J., An FTC View of Compliance Programs: Compliance Efforts Can Mean No Penalties, 4 Corp. Conduct Q., No. 4 (1996) (telephone interview with Daniel Ducore).
compliance program may be more than just a good idea. For example, if our sample management team ran an investment company, they would find that the Securities and Exchange Commission requires registered investment companies and advisers to adopt compliance programs to prevent and detect violations of federal securities laws.\textsuperscript{92} Likewise, if our sample management team had a major division that derived over $5 million from government contracts, it typically would be required to adopt a compliance program to prevent and detect violations of government contracting laws.\textsuperscript{93}

More broadly, if our sample management team ran a publicly-held company in any industry, it would likely find itself subject to the Sarbanes-Oxley Act of 2002. Section 404 of that Act requires management and the external auditor to report on the adequacy of a company’s internal control over financial reporting, as defined under an internal control framework such as The Committee of Sponsoring Organizations of the Treadway Commission (COSO). The COSO framework, in return, calls for numerous entity-level controls (e.g., codes of conduct, training, whistleblower hotlines, disciplinary mechanisms) that are similar to, although different from, the ECEP definitions and criteria established under the FSGO. These definitions may prompt our sample management team to pose the next question.

\textbf{Q. What elements should our compliance program have?}

Here too the answer will vary, which is frustrating for any management team looking for clear and straightforward guidance on what it is supposed to do. Let us assume our sample management team runs a fairly large, publicly-traded manufacturing and services company. The company sells its widgets and associated services to both commercial and government customers, and an increasing percentage of their products are both produced and sold overseas. As the team wades into the question of what the compliance/ethics program should look like, it will have to untangle and reconcile a patchwork of inconsistent and overlapping guidance and criteria reflected from the following types of sources:

\textsuperscript{92} See Final Rule: Compliance Programs of Investment Companies and Investment Advisers. (n.d.). \textit{Final Rule: Compliance Programs of Investment Companies and Investment Advisers; Rel. Nos. IA-2204; IC-26299; File No. S7-03-03}. Retrieved from \url{http://www.sec.gov/rules/final/ia-2204.htm}

• Federal Sentencing Guidelines criteria;
• NYSE and/or NASDAQ listing standard requirements;
• Sarbanes-Oxley Act requirements (including COSO Internal Control Framework);
• FCPA compliance program requirements imposed by DOJ in recent DPAs;
• Federal Acquisition Regulation contractor requirements to establish business ethics awareness and compliance program and internal control system;
• Bureau of Information and Security of the Department of Commerce Export Management and Compliance Program Guidelines;
• EPA Incentives for Self-Policing Policy; and
• OSHA’s Voluntary Safety and Health Program Management Guidelines.

This list would be considerably longer if our sample company were not a generic widget manufacturer, but in a more substantially regulated industry such as financial services, healthcare, pharmaceuticals, energy, or aviation. In addition, all of this would be prior to turning to what compliance program criteria may be issued by a state government (e.g., under California law, pharmaceutical companies that produce or prepare drugs or engage in marketing in that state are required to adopt comprehensive compliance programs,94 companies of 50 or more employees must provide two hours of sexual harassment prevention training to their managers every two years95), or by international standard-setters (e.g., OECD Working Group on Bribery in International Business Transactions Good Practice Guidance, UK Bribery Act, and other guidance issued by countries such as Australia, Italy, and South Africa).96

_____________________

94 See “Compliance Programs and the Corporate Sentencing Guidelines – Preventing Criminal And Civil Liability”, §24:29 (Kaplan & Murphy eds.) (2010).
95 California Government Code section 12950.1.
Staying with the federal agencies in our example, it is true that several agencies have published compliance program standards that draw heavily on the FSGO framework, and this provides some symmetry in potentially applicable requirements. But even among these agencies’ standards, there are unexplained inconsistencies. For example, the Federal Acquisition Regulation model omits the FSGO requirement that the compliance/ethics program be supported internally within the organization with “appropriate incentives to perform in accordance with the compliance and ethics program.” The Environmental Protection Agency model omits the FSGO requirement that an organization “use reasonable efforts not to include within the substantial authority personnel … any individual …[who] has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.”

Many more agencies have promulgated standards that show no conscious effort to align with the FSGO. Let us examine what our sample management team might experience in reconciling the requirements of those. Consider, for example: In how many different ways is our sample management team being instructed to establish just one element of its compliance program – a code of conduct? See Appendix C of this Report for a small sample of what our management team must untangle and reconcile.

This kind of unevenness in standards for codes of conduct also exists with other ECEP elements, such as the role and positioning of the compliance function; whistleblower

98 USSG §8B2.1(b)(3).
mechanisms and protections;\textsuperscript{100} and the use of appropriate discipline and incentives to support the ECEP.\textsuperscript{101} For example, on the topic of discipline/incentives, the FSGO and FAR criteria call for the consideration of discipline for managers who fail to take reasonable steps to prevent or detect improper conduct, whereas the Department of Commerce BIS guidelines only address disciplinary action against individual wrongdoers. Conversely, both the FSGO and BIS indicate that compliance be promoted through the corporate incentive structure, whereas the FAR criteria are silent on whether incentives are a relevant factor in promoting compliance. This variation is not only burdensome for business as it tries to decipher siloed frameworks and expectations relating to ECEPs, it is arguably inefficient for each government agency to reinvent the wheel when establishing such frameworks. Of course, different enforcement agencies have legitimate differences in their approaches, and each risk area may call for more emphasis on specific compliance elements and less on others. Thus, if EPA sees no need for diligence in determining who to hire or promote, it should at least explain the rationale for the change. Agencies and enforcers should not be restricted in their ability to test out new approaches, but this should be transparent and explained, with the touchstone being the common FSGO standards and the promotion of effective compliance techniques.

\textsuperscript{100} For example, compare §301(4)(B) of the Sarbanes-Oxley Act (an audit committee “shall establish procedures … for the confidential, anonymous submission by employees of … concerns regarding” fraud) with USSG §8B2.1(b)(5)(B) (an organization shall take reasonable steps to have and publicize a system, which \textit{may} include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding … criminal conduct without fear of retaliation”) [emphasis added].

Q. If we establish an ECEP, does the regulator or enforcement agency have a clear policy indicating that the ECEP will be considered if we experience instances of wrongdoing by employees?

Merely because an agency has standards for compliance/ethics programs does not mean that it actually takes them into account. Government officials have been exclaiming the importance of ECEPs in much the same way that parents urge kids to eat vegetables – “they are good for you.” This does not mean that the agencies for which these officials work are necessarily following the second part of the typical parental message; the part that offers an incentive – “and if you do, you will get dessert.”

Do government agencies actually provide enforcement-related benefits for companies that take compliance/ethics management seriously? As discussed earlier with respect to DOJ’s Prosecution Principles, merely having a policy does not mean that the policy is being followed. Nevertheless, the existence of such a policy is a logical starting point. Examples of agencies that have policies indicating that compliance efforts will be considered in making enforcement decisions include those highlighted in the table below.

<table>
<thead>
<tr>
<th>Consideration of Compliance Programs in Charging Decisions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Source</strong></td>
</tr>
<tr>
<td>Department of Health and Human Services Office of Inspector General&lt;sup&gt;102&lt;/sup&gt;</td>
</tr>
<tr>
<td>Environmental Protection Agency&lt;sup&gt;103&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

---


Before arriving at any debarment decision, the debarring official should consider factors such as the following: Whether the contractor had effective standards of conduct and internal control systems in place at the time of the activity which constitutes cause for debarment or had adopted such procedures prior to any Government investigation of the activity cited as a cause for debarment…

How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?

Q. *If we establish an ECEP, will this influence the fine or penalty decisions by a regulator or enforcement agency if we experience instances of wrongdoing by employees?*

This is the second part of the previous question – do agencies actually give enforcement-related benefits for ECEPs. The answers are often opaque. We observed earlier, for instance, that while the DOJ principles factor in ECEPs in determining whether to prosecute, there is no standard disclosure that provides an accounting of how ECEPs are incorporated into fine calculations of pre-trial agreements such as DPAs.\(^\text{106}\)

Similarly, HHS/OIG also stops well short of articulating the ECEP’s impact on penalties. Its self-disclosure protocol states, on the one hand, “The OIG believes it must continue encouraging the health care industry to conduct voluntary self-evaluations and providing viable opportunities for self disclosure,” but goes on to say:

*The OIG … is not obligated to resolve the matter in any particular manner*  
*and that, “If the OIG consents, the disclosing provider will be required to agree in writing that the acceptance of the payment does not constitute the*


\(^{106}\) In addition there is a carve-out for the Antitrust Division, which does not consider compliance programs.
The EPA’s policies, on the other hand, are more specific in terms of how ECEPs are weighed in fine calculations. Under its Audit Policy, EPA states that it “will not seek gravity-based penalties for disclosing entities that meet all nine Policy conditions, including systematic discovery [defined as the detection of a potential violation through an environmental audit or a compliance management system that reflects the entity’s due diligence in preventing, detecting and correcting violations].” Moreover, the policy provides that “Gravity-based penalties will be reduced by 75 percent where the disclosing entity does not detect the violation through systematic discovery but otherwise meets all other Policy conditions. The Policy appropriately limits the complete waiver of gravity-based civil penalties to companies that conduct environmental auditing or have in place a compliance management system. However, to encourage disclosure and correction of violations even in the absence of systematic discovery, EPA will reduce gravity-based penalties by 75 percent for entities that meet [certain conditions] of the Policy.” It goes on to observe that, “EPA expects that a disclosure under this provision will encourage the entity to work with the Agency to resolve environmental problems and begin to develop an effective auditing program or compliance management system.”

Q. Are there any other tangible benefits or incentives (aside from potential leniency in charging and penalty decisions) offered by regulators or enforcement agencies to companies that invest in compliance?

This is an area where there may be room for some creative thinking by enforcement agencies. OSHA, through its Voluntary Protection Programs (VPP), offers an intriguing

\[\text{Full citation and footnote details...}\]
example of how such incentives might be explored. According to OSHA, the legislative underpinning for VPP is rooted in the Occupational Safety and Health Act of 1970, which expresses Congress’s intent:

> to assure so far as possible every working man and woman in the Nation safe and healthful working conditions and to preserve our human resources - (1) by **encouraging employers and employees** in their efforts to reduce the number of occupational safety and health hazards at their places of employment, and to **stimulate employers and employees to institute new and to perfect existing programs** for providing safe and healthful working conditions" [emphasis added].  

VPP is designed to encourage management, labor, and OSHA to work cooperatively and proactively to prevent workplace fatalities, injuries, and illnesses. To participate, employers must undergo a rigorous onsite compliance evaluation by a team of safety and health professionals and maintain low injury rates. Once admitted, VPP participants are exempt from OSHA programmed inspections while they maintain their VPP status. As of 2011, there were 1,727 participant worksites in the federal VPP program (compared to 83 participant sites twenty years ago), and the average VPP worksite had a Days Away Restricted or Transferred (DART) case rate of 52 percent below the average for its industry.

One of the more novel features of VPP is the Special Government Employee program, which enables the numerous site inspections that must be performed to be staffed, in part, by volunteers from VPP member companies. According to OSHA, this innovative program not only

---


benefits OSHA by supplementing its on-site evaluation teams, but also gives industry participants the opportunity to exchange ideas, gain new perspectives, and grow professionally while serving as full-fledged team members on OSHA’s VPP onsite evaluations.  

In the final tally, OSHA sees itself as gaining “a corps of ambassadors enthusiastically spreading the message of safety and health system management [who] also provide OSHA with valuable input and augment its limited resources.”  

**Challenge 3:**

Many compliance/ethics programs fall short of their potential because portions of the FSGO remain underemphasized or unclear.

The ability of business managers to embrace and implement the ECEP criteria outlined in the FSGO is tied to their ability to understand what specific actions or decisions they should consider in applying those criteria in practice. We note that the FSGO criteria are principles-based, which offers at least two important advantages: i) it provides organizations with the **flexibility** in tailoring an approach that best fits their circumstances, without being overly prescriptive or insisting on a “one size fits all” approach to compliance; and ii) it encourages **innovation** by establishing an overarching requirement that compliance and ethics programs be **effective**, thereby discouraging a “check the box” mentality that is over-reliant on checklists, and under-reliant on critical questions such as whether effective results have been achieved. For example, the FSGO requires programs to reflect “due diligence” and to be improved with modifications when violations occur.

The benefits of flexibility and innovation notwithstanding, the principles-based nature of the FSGO criteria means that reasonable minds can disagree on, or simply misjudge, what certain high-level principles mean. As part of this initiative, ERC facilitated outreach efforts to members of the compliance and ethics community to invite their views on whether there were


115 Ibid at 112.
opportunities to clarify or, in light of the ongoing development of best practices, strengthen elements of the FSGO.

Based on this feedback, the development of relevant literature and the experience of ERC Advisory Group members, we believe that the FSGO would benefit from a considered review, with an eye toward amendments in several areas described in the next section of this Report. We believe the FSGO are well-drafted and cover important points, but can be improved based on twenty years of experience.

**Challenge 4:**

**Too many business executives take a “check the box” approach to their programs, rather than satisfying the full intent of the FSGO.**

It is impossible to meet the FSGO standards with a mechanistic approach. The FSGO’s emphasis on diligence, actual effectiveness and an inherent philosophy of structured flexibility are all intended to promote results-oriented innovation by individual companies within the Guidelines’ general framework. This intent needs to be better understood and applied. Moreover, priority needs to be given to two areas that are fundamental to compliance/ethics. First, the mission of for-profit companies needs to be seen as comprising both strong financial performance and a strong commitment to integrity. Second, the chief ethics and compliance officer must be properly positioned to ensure that he or she has the independence, access, authority, and empowerment necessary to effectively discharge these vital corporate responsibilities.

The majority of this Report focuses on the efforts needed by government officials to promote compliance/ethics programs, as enforcement efforts and judicial decisions do impact business practice. But it is equally important to acknowledge that it is not the responsibility of government to set the bar for the highest standard of corporate integrity. That is the responsibility of the private business sector.

Best-in-class compliance/ethics programs set and achieve goals that go beyond the literal words of the FSGO. In fact, business leaders in these organizations are often quick to say that, while they monitor enforcement actions and respond to changes in regulation, their primary
focus when it comes to compliance/ethics is weaving integrity into the DNA of a company, encouraging ethical decision-making at all levels, setting a tone from the top, and otherwise ensuring that their employees know they can and should raise concerns when they have them. In these organizations, aspiring to be in full compliance with the law is a given.\textsuperscript{116}

Unfortunately, the practices of these best-in-class organizations have not been adopted by many companies where there is still an overwhelming emphasis on government enforcement to “make the case” for compliance/ethics efforts. In a recent survey of compliance/ethics professionals, the majority of respondents indicated that one of the most important reasons they desired more information from the DOJ was that they needed help in reminding company leaders about the value of the investment in their compliance/ethics programs.\textsuperscript{117}

Compliance/ethics professionals should not have to fight for resources to build good programs, or rely on “worst case scenario” arguments to build corporate commitment to compliance and ethics. Most business executives already believe that ethics is good business, and they personally feel they are leading by example when it comes to ethical conduct.\textsuperscript{118} Yet few corporate personnel with the title of compliance/ethics “officer” actually are officers in their companies, and a regular discussion among compliance/ethics practitioners is that they feel they do not have “a seat at the table” to make compliance/ethics relevant to their businesses. On top of this, employees consistently say that compliance/ethics is not a priority at the highest levels of their organizations.\textsuperscript{119}

In short, the managements of too many companies aim for what they perceive as minimally required when it comes to compliance/ethics – in essence, they aim for the bottom. A major flaw in this thinking is that – quite apart from the question of what good corporate citizens should be doing on their own without the threat of enforcement – the fact is that minimalistic, check-the-box compliance/ethics programs do not even satisfy the intent of the Guidelines. For example,

\textsuperscript{117} Ibid. at 69.
the FSGO explicitly provide that the overarching goal of a creditworthy compliance program is that it will “generally be effective,” and companies are directed to exercise “due diligence” and “evaluate periodically” their programs to make sure this goal is met. Moreover, the FSGO are drafted with a philosophy that has been aptly called “structured flexibility” – that is, the Guidelines seek to encourage each company to find its own particular path to effectiveness within the FSGO’s general framework, taking into account the company’s unique characteristics (such as its history, risk profile, and industry). The Sentencing Commission used the language and drafting approach it did because it wanted to promote results-oriented innovation by companies to pursue the development of compliance/ethics programs that actually work.

When companies have successfully integrated compliance/ethics into the company’s DNA, it is in great part because the board and management have defined the mission of the company as comprising both financial performance and an equally strong commitment to acting with integrity. Doing this is more than merely adopting the right words in a values or mission statement. As analyzed in a Policy Brief for the Committee for Economic Development, it means that the board has selected the CEO and top leaders, in part, for their demonstrated commitment to integrity. It also means that the board assesses, with real metrics that affect compensation, the performance of the company’s leaders in meeting their integrity-related goals. As the Policy Brief notes, this is no easy task given the counter-currents of Wall Street’s “short-termism” and the willingness of some companies “to use large amounts of cash and options, with fewer payout requirements … to attract top leaders … in a very competitive labor market.” But incorporating commitment to compliance with law and ethical conduct into compensation and performance systems is necessary to hardwire “tone at the top” – to transform it from mere cliché into a reality that can drive compliance/ethics throughout the company.

Moreover, the goal of a company whose mission includes integrity should be to follow not just the letter of the law but also its spirit and, indeed, to go beyond legal requirements to behave

120 See USSG §8B2.1
121 See Swenson, W. M., “An Effective Compliance and Ethics Programs,” § 4:6 (Structured Flexibility) and §4:7 (Focus on Result-Oriented Efforts) in Compliance Programs and the Corporate Sentencing Guidelines – Preventing Criminal and Civil Liability” (Kaplan & Murphy eds.) (West; 2011-2012 ed ).
ethically in dealings with the company’s various stakeholders. This means establishing a corporate culture in which values such as honesty and trustworthiness are actively promoted and enforced throughout the organization.

Finally, committed companies ensure that the person with day-to-day responsibility for the program is fully empowered, autonomous, properly positioned, and resourced to help support this mission.

Best practice needs to be redefined by the private sector so that the literal interpretation of the FSGO elements is truly a place of beginning, as opposed to the maximum they can and should aim to achieve. This is the expectation of the Guidelines themselves, and it is what that society is increasingly demanding to restore and maintain trust in private sector institutions.
SECTION IV

RECOMMENDATIONS

The Advisory Group’s review of the Guidelines’ 20-year history identified substantial areas of success. In particular, we are firmly convinced that the FSGO has been a major catalyst in the development of a vibrant compliance/ethics community. Despite some damaging, high-profile instances of corporate fraud, we also believe that the USSC has successfully driven changes in organizational thinking so that the promotion of ethical behavior and the reduction of misconduct have become a core responsibility of businesses’ senior leadership.

However, we also identified areas for improvement, especially in the way enforcement agencies have addressed the organizational compliance/ethics programs sparked by the Guidelines. Not surprisingly, the FSGO’s 20-year experience includes some unanticipated developments, including a tendency for prosecutors to adopt an *ad hoc* approach to compliance/ethics rather than use the Guidelines’ criteria for assessing whether a compliance program is creditworthy.

As noted elsewhere in this Report, federal prosecutors as well as alleged offenders have generally preferred to avoid trial by agreeing to alternative resolutions such as DPAs and NPAs. This is especially true for misconduct involving large companies, which are almost never resolved at trial. As a result, the incentive of reduced penalties – the carrot of USSC’s carrot and stick approach to organizational misconduct – is rarely implemented. In the absence of trials there are no sentences to be reduced.

Further, enforcement agencies provide little transparency into their decision-making process. Little public information is provided about the impact of compliance/ethics programs on decisions about prosecuting organizations or the terms of DPAs and NPAs. There is almost no guidance in the cases on what aspects of programs were considered effective and which elements were found lacking. Moreover, settlement terms frequently ignore the FSGO criteria for compliance/ethics programs, undermining the Guidelines’ stature and potentially sowing confusion about what standards organizations should follow. Prosecutors’ unexplained deviations from Guideline criteria raise the possibility that compliance/ethics programs based on
the Guidelines – and that is almost all of them – may prove irrelevant to government agencies in cases of misconduct.

A lack of consistency across the government is another concern that sends confusing signals about the expectations for organizational compliance/ethics programs. It is not fully clear how various federal agencies evaluate the effectiveness of compliance/ethics programs, but it appears that the evaluation process and outcomes vary from agency to agency and, in some cases, within agencies.

To address these concerns and to reinforce the carrot and stick framework that promotes ethical performance and respect for law within organizations, we offer the following recommendations.

**Recommendations to the U.S. Sentencing Commission**

**Recommendation 1.1 – The Commission should renew – and regularly – focus on the FSGO with an eye toward continuous improvement to take account of changes in the business world.**

As discussed in Section II of this Report, the FSGO have had an enormous impact. Most notably, the Guidelines’ standards have become the primary reference point for the business community in designing corporate compliance/ethics programs. Today, in-house professionals, corporate managers, and boards of directors widely look to the Guidelines in assessing their respective companies’ programs, as well as in assessing the adequacy of their own roles in supporting compliance/ethics. Although the Guidelines’ carrot and stick approach was intended to incentivize corporate action, the degree to which the Guidelines framework has taken hold in Corporate America in terms of both the number and rigor of compliance/ethics programs probably far exceeds what most observers expected 20 years ago. 123

The success that the FSGO have achieved in spurring companies to follow the Guidelines’ compliance/ethics standards creates, we believe, a responsibility for the U.S. Sentencing

Commission. The Guidelines' compliance/ethics standards have held up remarkably well over time – they have provided a realistic, sensible, and sufficiently flexible model to accommodate the development of effective programs in a wide variety of corporate and organizational settings. Over the last 20 years, the Commission also has made two sets of substantive changes to the FSGO – one relatively significant in 2004 with the assistance of an advisory group, and a second, more limited set in 2010.

However, in 20 years since the FSGO were promulgated, the business world has changed substantially, and it continues to change. Twenty years ago, for example, the number of non-U.S. employees working for global companies subject to U.S. laws was a fraction of what it is today. It is now highly common for companies to be globally dispersed to a degree that was relatively unusual two decades ago – with many thousands of a company’s employees operating thousands of miles from the senior management team in headquarters. These kinds of changes also mean that companies have been continuously working to find effective ways to train, listen to, and generally absorb into a common corporate culture of ethics/compliance employees from highly diverse backgrounds and experiences. The business environment, in short, is dynamic and the development of compliance/ethics best practices has, therefore, not stood still. It, too, has evolved.

Despite the fact that the Guidelines have become the de facto standard for compliance/ethics programs for the business community – therefore affecting the lives of millions of employees on a daily basis – and despite the evolution of best practices in compliance/ethics programs, the Commission has struggled to maintain a consistent focus on the FSGO.

124 See, e.g., Remarks of David Cote, CEO of Honeywell, at the October 11, 2011, Bloomberg News/Washington Post Republican Debate at Dartmouth College. Mr. Cote estimated, “Twenty years ago there were a billion people actively participating in the global economy. Today there are more than 4 billion active participants in the global economy.”

125 See, e.g., Heineman, B. W. (2008). *High performance with high integrity* (pp. 83-84). Boston, MA: Harvard Business Press. (discussing how global compliance/ethics communications today “must identify and candidly address local cultural practices that are (or appear to be) at sharp variance with the corporation’s norms”).

©2012 Ethics Resource Center
We do not believe this is the Commission’s fault. As Commission Chair, Judge Patti B. Saris, persuasively laid out at a recent Congressional hearing, “The Commission has been extraordinarily busy” responding to mandates from Congress and significant Supreme Court rulings affecting the Guidelines for individuals. It also is true that from one vantage point – the number of organizational vs. individual defendants annually sentenced – the organizational Guidelines should take a back seat to the individual Guidelines. But Judge Saris’ recent testimony is revealing about the concern: in 89 pages of testimony and exhibits discussing the “state of federal sentencing” since 2005 on the topics of primary interest to Congress, only a single footnote mentioned the Organizational Guidelines.

We believe it is time for the Sentencing Commission to adopt an ongoing process of monitoring and, as necessary, making amendments to the FSGO in light of experience – to do what the Guidelines, in essence, ask companies to do with respect to compliance/ethics programs: continuously improve. Unlike the environment in 1991, there are now many sources of valuable input for the Commission, including the development of best practices in industry, approaches to compliance reflected in other agencies’ standards, and the development of program standards around the world.

A logical way of doing this would be to establish, as the Commission did in 2003, an advisory group of FSGO practitioners. The Commission has a standing Practitioners Advisory Group (“PAG”) focused on the individual Guidelines. Just as the Commission has recognized with the PAG and the individual Guidelines, we believe that an FSGO-focused Advisory Group would

127 Somewhat more than 83,000 federal felony and Class A misdemeanor cases are sentenced annually. Ibid., p. 1. The Commission reported that there were 149 cases in which an organization was sentenced in FY 2010. Ibid., footnote 119.
128 Ibid., footnote 119 (noting the number of organizations sentenced in the preceding year).
129 See USSG §8B2.1(b)(7) (indicating that effective programs undertake continuous improvement in light of experience).
help the Commission meet its statutory mandate to “periodically review and revise [the organizational Guidelines], in consideration of comments and data coming to its attention….“\textsuperscript{131}

We recognize that the Commission can only do what it has budget and resources to do, and while forming an FSGO Advisory Group would presumably require minimal additional budget, we have therefore made a parallel recommendation to the President and Congress (see Recommendation 4.1).

If our recommendation to form a working group across government enforcement agencies to create a uniform federal model for corporate compliance and ethics programs (see Recommendation 4.1) is adopted, a separate Sentencing Commission FSGO Advisory Group might become unnecessary, although it would then become essential that the inter-agency group have regular input from private sector compliance and ethics practitioners.

**Recommendation 1.2 — Clarify portions of the FSGO.**

Our recommendation for a renewed focus on the FSGO by the Sentencing Commission is not driven by abstract concern; we believe there are areas where the Guidelines could benefit from more emphasis or clarity. We highlight several such areas where we believe the Commission might consider specific revisions, briefly note several others, and finally suggest an overarching revision that might be considered.

a. **“Incentives”**

At the recommendation of the 2003 Ad Hoc Advisory Group, the section of the FSGO standards for compliance/ethics programs that already required “adequate discipline” for violations of company standards was amended to add: “The organization’s compliance and ethics program shall be promoted and enforced consistently throughout the organization through … appropriate incentives to perform in accordance with the compliance and ethics program.”\textsuperscript{132}

This provision relates to a topic that many practitioners have come to believe is one of the most vital to transforming compliance/ethics inside an organization from mere “words” to “reality” —

\textsuperscript{131} 28 U.S.C. § 994(o).
\textsuperscript{132} USSG §8B2.1(b)(6)(A).
that is, an employee’s commitment to compliance/ethics ought to matter to his/her advancement and compensation within the organization. As explained in a recent, widely cited book on corporate integrity:

*The challenge for companies is not just to reward financial performance. The ultimate goal must be a compensation system that pays for performance with integrity. Of course, most companies claim that they build integrity issues into their compensation and performance decisions. But how many companies use meaningful evaluation tools so that real accountability for integrity takes root?*

....

*Personalized goals and objectives plus explicit integrity compensation guidelines – which affect a component of pay and are factors in promotions – provide the essential, real-world incentives that can have a significant role in creating the high-performance-with-high-integrity culture. They can turn a corporate cliché – integrity is considered in compensation decisions – into a core corporate principle.*

Unfortunately the FSGO provision that was added to address these kinds of considerations is, we believe, one of the most misunderstood and least frequently applied. As noted in a white paper on this topic, “Although incentives are an essential element of compliance and ethics programs, surprisingly little attention has been paid to this topic, as compared to other elements such as codes of conduct, helplines, training and risk assessment.”


134 At the annual Ethics and Compliance Officer Association Conference held in September 2011, a plenary session identified this provision in the Guidelines as the one most needing clarification. See note 3.

135 Murphy, J. E., (November 2011); Using Incentives in Your Compliance and Ethics Program [http://www.corporatecompliance.org/AM/Template.cfm?Section=Surveys&Template=/surveyform.cfm&survey=Incentives](http://www.corporatecompliance.org/AM/Template.cfm?Section=Surveys&Template=/surveyform.cfm&survey=Incentives); Compensation, Performance, Compliance and Ethics, A survey by the Health Care Compliance Association and the Society of Corporate Compliance and Ethics 1 (May 2009) [http://www.corporatecompliance.org/staticcontent/09IncentivesSurvey_report.pdf](http://www.corporatecompliance.org/staticcontent/09IncentivesSurvey_report.pdf) (“when it comes to compliance and ethics metrics, very little has been done to incent ethical behavior”).
The concept of tying corporate incentives to compliance/ethics is so lightly emphasized in the Guidelines that many companies seem to ignore it altogether. Others seem comfortable believing that it can be met by vague language in a performance evaluation form about being “ethical” – the kind of criterion that is quickly passed over before the evaluation process turns to the “real” criteria such as whether the employee has met his/her financial goals. Others have interpreted the provision as contemplating only that a company give an occasional “award” for ethics. It is clear that these kinds of practices fall short of what is needed, and we therefore believe that the current Guideline language warrants clarification and emphasis.

One aspect of this topic where the Sentencing Commission may particularly want to add specificity to the Guidelines is the board of directors’ responsibility for connecting the compensation of the company’s top leaders, starting with the CEO, with the demonstrated attainment of integrity-related goals. “Tone at the top” is far more likely to have culturally transformative meaning if a company’s management knows that ethical and law-compliant performance within the company will affect their own assessment, compensation and career progression. When that connection is made at the top, compliance/ethics can be expected to be given greater priority throughout the company.

b. The role of managers in promoting “an organizational culture that encourages ethical conduct and a commitment to compliance with the law”

A related FSGO concept that we believe needs elucidation is a provision found in the Guidelines commentary that provides:

High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law [emphasis added].

§8B2.1, comment. (n. 3)
We believe that the intent of this language – especially the highlighted part – was to ensure that both senior and mid-level managers would proactively support compliance/ethics inside the organization, and not merely be bystanders. As with the “incentives” language, we think that this concept has come to be recognized as critical. While top-level commitment is always vitally important, employees look most of all to their own immediate manager for cues on ethics/compliance. Even in reporting misconduct, employees are far more likely to go to their immediate supervisors than they are to a whistleblower hotline. Supervisors are one of the largest influences on employees’ perceptions about the ethical culture in which they work.\footnote{Ethics Resource Center. (2010). \textit{Blowing the Whistle on Workplace Misconduct}. \url{www.ethics.org}.}

We also believe that because the language is buried in Guideline commentary – it is not in the Guideline itself – and is vaguely written, the intent of this language is frequently missed.\footnote{At the 2011 Ethics and Compliance Officer Association Conference, a plenary session identified this provision as the one second most in need of emphasis/clarification.} This means that in-house practitioners who must persuade their companies to have managers play an active role in compliance/ethics have an unnecessarily weak peg to hang their hat on. For these reasons, we believe that the current language warrants clarification and emphasis.

c. Reporting Relationship of the Chief Ethics and Compliance Officer (CECO)

While the Commission deserves great credit for amending the FSGO in 2010 to emphasize the role of those responsible for the day to day operation of the compliance and ethics program, the positioning, empowerment, and autonomy of the chief ethics and compliance officer (CECO) remains an area where the FSGO needs additional attention. In the drafting of this report, more public comments were received on this issue than any other.\footnote{Ethics Resource Center. \textit{Comments from the Public}. (n.d.). Retrieved from \url{http://fsgo.ethics.org/Comments from the Public}.}

As an industry report observed, because of inadequate positioning it often appears that company compliance and ethics personnel are set up for failure.\footnote{Ethics Resource Center et. al., \textit{Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer} (August 2007) \url{http://ethics.org/resource/ceco}.} Sadly it remains the case

\begin{footnotes}
\footnote{Ethics Resource Center. (2010). \textit{Blowing the Whistle on Workplace Misconduct}. \url{www.ethics.org}. }
\footnote{At the 2011 Ethics and Compliance Officer Association Conference, a plenary session identified this provision as the one second most in need of emphasis/clarification.}
\footnote{Ethics Resource Center. \textit{Comments from the Public}. (n.d.). Retrieved from \url{http://fsgo.ethics.org/Comments from the Public}.}
\footnote{Ethics Resource Center et. al., \textit{Leading Corporate Integrity: Defining the Role of the Chief Ethics and Compliance Officer} (August 2007) \url{http://ethics.org/resource/ceco}.}
\end{footnotes}
that egregious corporate crime and misconduct often takes place at the top of the business. Those responsible for the ethics and compliance program need to be positioned at the executive level to support, and where necessary, intervene with other executives and the board of directors.\textsuperscript{141} Yet today many compliance/ethics “officers” are not actually corporate officers, and many more lack the opportunity for direct personal (and unfiltered) contact with the board or an independent committee of the board.\textsuperscript{142} If the compliance and ethics officer is not positioned properly, the foundation of the program may be in jeopardy.

The placement of the CECO within an organization remains a subject of considerable discussion, and practices vary based on such factors as company size, culture, complexity, and industry. Nonetheless there is widespread agreement that the individual who is tasked with day-to-day responsibility of the program should be positioned in such a way that he or she has sufficient authority, independence, and empowerment to be taken seriously at all levels within the organization.\textsuperscript{143}

We are not in this Report recommending that the Commission adopt a particular practice, as there is significant need for further study on the issue. Instead, we urge the Commission (or its Advisory Group, if established) to seek further input from CECOs, business leaders, and other experts. We urge that Commission add more clarity on this matter in the Guidelines, particularly with regard to the ways large companies can ensure that their CECOs have the levels of autonomy and empowerment needed in order to encourage greater influence of the ethics and

\begin{footnotes}
\footnotetext[141]{The point is covered in the OECD Good Practice Guidance, item 4, by providing that oversight of the program, “including the authority to report matters directly to independent monitoring bodies such as internal audit committees of boards of directors or of supervisory boards, is the duty of one or more senior corporate officers, with an adequate level of autonomy from management, resources, and authority.” The terms “senior corporate officers” would appear to preclude anyone other than a direct report to the CEO.}

\footnotetext[142]{Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds (RAND 2009) \url{http://www.rand.org/pubs/conf_proceedings/CF258/}.}

\footnotetext[143]{Ideally, the chief ethics/compliance officer is a member of senior management and, at the very least, has meaningful and regular access to the company’s board and senior management. Ideally, too, the board of directors has a member or committee with specific expertise in compliance and ethics.}
\end{footnotes}
compliance function. There are various options that could be considered for achieving this. For example, one option may be to specify a preferred reporting relationship of the CECO. Another example of an option may be to promote additional safeguards for the CECO, such as requiring prior approval from the governing authority on decisions related to the appointment or removal of the CECO, as well as the terms and conditions of his or her employment. We believe further study is warranted so that potential advantages and disadvantages associated with these and other possible governance and reporting options can be more fully identified and explored.

d. Compliance/ethics expertise on the governing authority

As noted earlier, one of the outcomes of the 2004 amendments to the FSGO was a more explicit standard related to the oversight role for the board of directors. The FSGO currently state that “the organization’s governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.”

While this added language has been a positive addition, it is now time to consider whether an organization’s governing body would be better positioned to discharge these responsibilities if it included among its membership at least one individual with expertise on compliance/ethics management. Such a requirement may not be necessary for small or medium-sized enterprises, but could be appropriate for large organizations with more complex compliance/ethics risks and systems. Just as boards of public companies today often ensure that their audit committees include individuals with financial expertise, we believe the presence of compliance/ethics expertise on the board is worthy of consideration.

e. Effective internal investigations

The FSGO currently state that “after criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization’s

144 USSG §8B.2.1(B)(2)(A).
compliance and ethics program." The FSGO are silent on the role an effective internal investigation may have in this regard, and such silence may invite design flaws in compliance/ethics programs. We believe this could be remedied by being more explicit about the need for organizations to adopt protocols for the conduct of effective internal investigations into alleged or suspected instances of wrongdoing.

f. Compliance/ethics infrastructure

As companies subject to U.S. law have become more geographically dispersed and often find themselves operating in ethically and legally challenging environments, many have opted to expand their compliance/ethics presence and establish regional or locally-based compliance/ethics personnel to ensure that 1) the compliance/ethics message is understood, 2) local issues are spotted, and 3) locally-based employees have a comfortable place where they can go with sensitive issues. We are not in this Report recommending that the Commission adopt a particular structure in the Guidelines that it would expect all companies, or even all large companies, to implement. However, we believe that there is significant variation in how effectively large companies integrate compliance/ethics into their global operations and that this kind of broad-based compliance/ethics infrastructure is one way to potentially make a difference.

This is also an area where there are lessons to be learned from some of the specific compliance areas where local presence has been the norm, such as environmental compliance and workplace safety. The Commission might elect to address this issue simply by expanding existing language on ensuring “adequate resources” and require that these resources be consistent with the organization’s size and geographic complexity.

g. Outcome metrics for periodic evaluation

Following the 2004 revisions to the Guidelines, companies were called upon to “evaluate periodically the effectiveness of the organization’s compliance and ethics program.” Some organizations have undertaken their own reviews; others have brought in third parties to

145 USSG §8B.2.1(B)(7).
146 See USSG §8B.2.1(B)(2)(C).
147 USSG §8B.2.1(B)(5)(B).
examine their efforts. More recently, a practice of third party ranking or grading of companies has emerged as an evaluative effort. While the area of compliance/ethics program measurement is still fairly new and can vary significantly among the different compliance risk areas, research is emerging that identifies some of the outcomes of an effective program. As already mentioned in this Report, studies have shown that an ECEP reduces misconduct, increases employee reporting, and reduces the likelihood of retaliation against whistleblowers.

In making the case that they have established an ECEP, companies with best practice programs can provide evidence that they have consistently implemented the elements of a program as defined in the FSGO. They also are able to show data that employee perceptions and conduct, in those areas subject to quantitative measurement, have improved over time. Even further, industry groups are beginning to measure themselves by common metrics, creating benchmarks by which they can compare their program performance to peer organizations.

Nevertheless, the means by which organizations measure the effectiveness of their programs still vary, and in some cases organizations can be lulled into a false sense of security by evaluations or public rankings that may not be empirically based or reliable. We are not recommending that the Commission determine the methods by which organizations should evaluate their compliance/ethics programs, as program evaluation literature suggests that an evaluation design should reflect the goals and structure of an organization and the types of risk it faces. However, we do encourage the Commission to open further discussion and analysis in this area, including consideration of possible outcome measures by which organizations could demonstrate the impact of their programs (e.g., observed misconduct, frequency and nature of reporting, fear of retaliation, direct measurement in risk areas where this is possible). Doing so could encourage companies to undertake high quality evaluative efforts, and prompt boards of directors to review and reflect on the results of such efforts.

148 Recognizing, however, that measuring implementation is different from the more difficult task of measuring effectiveness.
Beyond these highlighted areas where clarity/emphasis may be beneficial, practitioners and members of the public also have raised others, including:

- The Guidelines should explicitly recognize that an ombuds function may be an appropriate means of meeting the requirement “to have and publicize a system ... whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.”

- The Guidelines should make mandatory the currently discretionary decision of whether an organization’s internal reporting mechanisms will “allow for anonymity or confidentiality,” at least for larger companies.

- Element One of the Guidelines calls for standards and procedures, and the commentary states that this includes internal controls. But the item is typically read and applied as if it said “standards and standards.” The need for internal controls should be clarified.

- The Guidelines say very little about third parties (in references to “agents”), but this is an area of substantial concern to companies. There have been significant developments in some of the specific compliance risk areas, especially FCPA and overseas bribery. The OECD Good Practice Guidance provides a useful model of what could be considered. In its item 6, the Guidance provides:

  6. ethics and compliance programmes or measures designed to prevent and detect foreign bribery applicable, where appropriate and subject to contractual arrangements, to third parties such as agents and other intermediaries, consultants, representatives, distributors, contractors and

---


151 USSG §8B.2.1(B)(5)(C). Compared to the Sarbanes-Oxley Act, which requires a listed company’s audit committee to establish procedures for “the confidential, anonymous submission by employees … of concerns regarding questionable accounting or auditing matters.” Sarbanes-Oxley Act, §301(4)(B).
suppliers, consortia, and joint venture partners (hereinafter “business partners”), including, inter alia, the following essential elements:

I. properly documented risk-based due diligence pertaining to the hiring, as well as the appropriate and regular oversight of business partners;

II. informing business partners of the company’s commitment to abiding by laws on the prohibitions against foreign bribery, and of the company’s ethics and compliance programme or measures for preventing and detecting such bribery; and

III. seeking a reciprocal commitment from business partners.

This is not to say that the Commission should necessarily adopt the model of the Guidance, but only that it is an important factor for further consideration.

- Small and medium-sized enterprises:

One of the enduring challenges in law enforcement, and thus in compliance and ethics, is how to reach the small and medium-sized enterprises (SMEs). The 2004 revisions to the FSGO made an attempt at this, urging:

As appropriate, a large organization should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs.\(^ {152} \)

While larger companies have imposed compliance-related restrictions on third parties, there does not appear to be any significant outreach by large companies intended to help smaller companies in actually establishing their own programs. One issue for the Commission and a practitioners advisory group is whether this precatory language should be made more compelling, so that companies have a reason to accept the invitation to help in reaching SMEs. This is also an issue the Commission would be well positioned to address across a range of enforcement and regulatory agencies.

\(^ {152} \) USSG §8B2.1 (Comment) 2(C)(ii).
We are not taking a position on these other areas for possible revision, but cite them to note that issues are being raised that warrant ongoing consideration.

i. **Enhancing overall clarity**

Finally, we note that especially in light of recent case law that has rendered the Guidelines more advisory, there may be an opportunity to rework the overall Guidelines definition of “an effective compliance and ethics program” to make the definition less legalistic and, thereby, more understandable. We think that some of the confusion that has arisen over the meaning of individual FSGO sections is due to the use of a structure and terminology intended to create legal exactitude in a Guideline system where the question of whether a sentence is “within the Guideline range” has historically generated – at least with respect to individual sentencing – much litigation. With the Guidelines being recast as more advisory, we think the Commission has an opportunity to rethink this approach. More “plain English,” more narrative, and potentially more use of illustrative examples, might enhance the clarity of the FSGO standards for compliance/ethics programs and, therefore, render them more effective in achieving their intended results.

We note, however, that the FSGO have stood up well over time so on balance we do not support wholesale redrafting the FSGO or much tinkering with a very successful formula. Rather, some degree of clarification combined with a stronger commitment from the enforcement and regulatory community can help ensure the message is clearer for all stakeholders.

**Recommendations to the Department of Justice**

With lead responsibility for federal law enforcement and as the agency with the broadest authority for enforcing federal law, the Department of Justice holds a potentially decisive “vote” on the future effectiveness of the Guidelines’ approach of incentivizing companies to fight aggressively against corporate crime. Overall, what is needed is a new commitment to ECEPs, not merely rhetorically by prosecutors at conferences, but in how cases are actually handled and publicly described.
We offer five recommendations to DOJ that we believe can significantly contribute to this goal.

**Recommendation 2.1 – The DOJ should ensure that pre-existing compliance/ethics programs are a critical factor in the resolution of corporate misconduct cases.**

Companies with best practice compliance/ethics programs recognize that merely having a policy does not necessarily mean that it is being communicated, understood, or followed. Indeed, DOJ’s Principles of Federal Prosecution of Business Organizations (“DOJ Prosecution Principles”) indicate that a company that failed to follow through and make sure its policies had taken hold would be viewed as having a “paper program.” We think DOJ needs to take a page from the DOJ Prosecution Principles and apply the lesson that companies have learned.

The DOJ Prosecution Principles state that prosecutors should consider ECEPs in organizational cases, but the lack of concrete evidence that this is happening – coupled with a lack of standards, process, and training, discussed below – suggest that the problem is more than a flaw in communication. We believe it reflects a lack of seriousness that needs to be confronted. This is not meant in any way as a slight against federal prosecutors, whom we believe comprise some of the brightest, most hard-working public servants in government. But it is meant to say that it is time for follow-through on this particular policy.

We believe the tone must be set at the top and that the Attorney General should communicate to all prosecutors – whether they be in a division at main Justice, or in one of the 93 U.S. Attorneys’ Offices – that ECEPs must be considered, and then to back up this directive with the further steps outlined below. We recognize that the degree of autonomy that prosecutorial groups within the Department of Justice (such as the individual U.S. Attorneys’ Offices) have historically enjoyed makes this a challenging task. But it is not essentially different from the challenge faced by large complex business organizations in ensuring that their diverse and geographically-dispersed employees adhere to company compliance/ethics standards.

**Recommendation 2.2 – The DOJ should establish standards, based on the FSGO, to govern how ECEPs will be judged as well as standards to guide how ECEPs should affect case outcomes.**

The DOJ Prosecution Principles contain the following language on ECEPs:
The critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. **The Department has no formulaic requirements regarding corporate compliance programs.** The fundamental questions any prosecutor should ask are: Is the corporation’s compliance program well designed? Is the program being applied earnestly and in good faith? Does the corporation’s compliance program work? In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal misconduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program, and revisions to corporate compliance programs in light of lessons learned [emphasis added].

While it is difficult to fault the sentiments expressed in this language, as guidance it is highly general. For example, it is exactly right that a prosecutor should want to know whether the program is “well designed,” whether it was “being applied earnestly and in good faith,” and whether the “compliance program work[s].” Indeed, these are the critical questions. But how is a prosecutor supposed to make these assessments? This general kind of guidance was welcome and even groundbreaking when it was written. But best practices for compliance/ethics programs have since emerged. Under today’s best practice standards, surely the test needs to be more than gauging whether errant employees in the past were disciplined (few companies fail to do this) and the other criteria mentioned.

The statement that the “Department has no formulaic requirements regarding corporate compliance programs,” is a positive if it is meant to signify that prosecutors should not blindly insist on one-size-fits-all, but the choice should not be between only very aspirational standards and no standards at all. Therefore, the DOJ Principles of Prosecution should be revised to make it clear that *prosecutors should look to the FSGO standards* in making assessments about ECEPs. They are the standards used by most companies because they are built into federal
law. Because they have been applied for twenty years, they have become associated with an array of best practices, which means prosecutors can easily reject the companies who come forward with insincere check-the-box programs. Using other standards – or a “we know a good program when we see it” approach – legitimately allows companies to ask, “Why have we obediently followed the Guidelines for all these years?” It is true that the DOJ Principles of Prosecution state in a footnote that the FSGO exist, but prosecutors are not instructed to use them.¹⁵³

Relatedly, when DOJ inserts in DPAs, consent decrees, and other settlement agreements “boiler plate” requirements for a company’s compliance/ethics program, that boiler plate should start with the FSGO criteria. DOJ may want to add risk-specific requirements on top of the Guidelines framework (e.g., the OECD Good Practice Guidance in FCPA cases), but ignoring the FSGO framework exemplifies the confusion and inconsistency described earlier in this Report. This is particularly unnecessary because the FSGO’s principles-based approach leaves a great deal of room for DOJ to customize it for specific legal risk areas. For example, the OECD standards can readily be built on a FSGO foundation.

Separately, the Department needs to provide substantially more guidance to prosecutors on how a pre-existing ECEP – as well as the lack of one – should affect settlements. This includes such terms as the monetary penalty, the length of the DPA term, the requirements for reporting back to DOJ post-settlement, whether a monitor will be required, the scope of the monitor’s activities, and other terms of the settlement, including what ECEP enhancements will be required.

To be clear, we believe that the conceptual model for decision-making in corporate cases reflected in the table below devised by the Government Accountability Office is correct in these key respects:

- ECEPs should not be the only relevant factor in the disposition of such cases, but they should be a real and meaningful factor.

¹⁵³ Note 7 of §9-28.000 of the DOJ Principles of Prosecution merely says, “For a detailed review of these and other factors concerning corporate compliance programs, see USSG §8B2.1.”
• Prosecutors should have flexibility in the amount of credit given to a factor – including an ECEP. Thus, credit for a compliance/ethics program need not be a binary “yes” or “no” as it is under the FSGO. Rather, an exemplary program might warrant treatment different from a merely acceptable one.

Ultimately, while prosecutorial discretion, i.e., the use of sound judgment on a case-by-case basis, is appropriate, standards and/or principles of the kind described above are critical to ensure that fair and reasonably consistent results also emerge.

Recommendation 2.3 – The DOJ should move to require greater internal consistency among its own divisions in the treatment of ECEPs.
For as long as federal policies have existed recognizing the importance of rigorous corporate compliance/ethics programs, the Antitrust Division has insisted it will not take them into account.  We recognize the logic of placing great weight on a voluntary disclosure by the first disclosing party in the context of multi-party conspiracies, but DOJ handles other kinds of corporate cases that involve conspiracies without applying the blanket “no credit for compliance programs under any circumstances” policy adopted by the Antitrust Division.

As a senior Antitrust Division official remarked in 1995:

\[M\]y remarks will make absolutely clear, the manner in which federal prosecutors take compliance programs, self-reporting, and cooperation into account at the various stages of investigation and prosecution can vary significantly from one component of the Department of Justice to another….  

We believe it is time for the Department to greatly reduce these inconsistencies.

**Recommendation 2.4 – The DOJ should adopt a credible process for evaluating ECEPs.**

We have indicated that we think prosecutors need standards against which to evaluate ECEPs (i.e., they should be required to use or at least start with the FSGO standards) in order to separate the sham programs from those with meaning. They also would benefit from standards for determining how ECEPs should affect case outcomes (including the terms of settlement agreements). In addition, we also need to ensure that prosecutors have the know-how and tools to competently evaluate corporate ECEPs. Otherwise, weak programs may be awarded a passing grade, while good programs will not earn the credit they deserve.

---

154 See discussion at pp. 52, supra. For a relatively early statement on this point, See Remarks of Gary Spratling, Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, “The Experience and Views of the Enforcement Community,” in U.S. Sentencing Commission, Symposium Proceedings: “Corporate Crime in America: Strengthening the ‘Good Citizen’ Corporation,” p.120 (1995) (“This is the bad news for corporations. The existence of a compliance program … can do little, if anything, at the Antitrust Division….”).

155 Ibid. at p. 304.
We think that DOJ can help ensure competency in this critically important area by using a mix of these methods:

\subsection*{a. Training and Outreach}

The Department should provide training to key DOJ personnel on compliance/ethics program best practices. Because organizational cases can arise anywhere in the country, it may be that, as part of an overall training strategy, the Department can designate these key personnel as internal consultants to provide guidance to line prosecutors in resolving “true” corporate cases – i.e., cases where the “corporate” target is, for example, more than simply the alter ego of a sole proprietor and an ECEP is essentially irrelevant. Sessions on corporate compliance/ethics were held some years ago at DOJ’s training facility, the National Advocacy Center, but the prosecutors who attended the sessions were not necessarily the “key” personnel most likely to deal with corporate cases. More recently, the SEC included a limited amount of training on compliance programs in its introductory “boot camp” for its new FCPA task force; personnel from DOJ and the FBI also attended. Part of this training process might be to engage in dialogue with the private sector about best practices through informational meetings.

\subsection*{b. Burden on the Company to Show Basis for Asserting Comprehensiveness and Effectiveness}

It is common for companies in negotiating the resolution of cases with DOJ to make a submission on the company’s compliance/ethics program. We think this practice should be formalized within the DOJ Prosecution Principles with these understandings:

\begin{itemize}
  \item The burden is entirely on the company to demonstrate the bona fides of its program.
  \item The company should indicate that the design and operation of its ECEP meets the FSGO criteria (and any other applicable industry-specific or risk-specific applicable standards). It should be noted that meeting the FSGO criteria also means, per se, that the program has been “customized” by the company in light of such things as its compliance risks, size, and history.\footnote{USSG §8B2.1, comment. (n. 2, 7).}
\end{itemize}
The company should demonstrate that it has evaluated its ECEP and, in light of what is learned through its evaluative activities, is on a path of continuous improvement. The key here is that the company is legitimately making the effort to assess program effectiveness. Evaluation is an FSGO requirement for ECEPs, and what DOJ must require is that its prosecutors see evidence that it is going on in a meaningful way. Companies use such techniques as compliance audits, process/control walk-throughs, employee surveys, on site focus groups, and assessments by qualified third-parties to conduct evaluations. It should be left to the company to make the case that it has chosen an appropriate set of evaluation methods.

Importantly, if a company otherwise makes a case that it has diligently sought to institute an effective program meeting the FSGO standards, evidence from its program evaluation that the program is not “perfect” should not be used against its bid for credit. Rigorous evaluation, especially in large organizations, inevitably unearths opportunities for improvement – indeed, that is the point of the evaluation. Thus a policy that such revelations will not be used against the company as long as the company is working to address its weaknesses is essential to incentivize honest evaluation. In fact, a rigorous evaluation should have particular weight in securing favorable treatment. Conversely, penalizing an organization based on the findings of its own internal review is a recipe for half-hearted inquiries and could seriously erode support for self-policing. Beyond that, perfection is not a realistic goal for most human enterprises – especially ones with thousands of employees scattered across the globe and contending with a plethora of laws.

Note: There has been a growth in corporate ethics “awards.” Some of these awards use unproven or even suspect methodologies. Generally, we do not believe such awards represent a reliable proxy for ECEP evaluation. Superficial indicators such as awards or rankings are not

---

a substitute for rigorous and continuous monitoring, testing, and review of a compliance/ethics program designed according to FSGO criteria.

c. Post Offense / Pre-Settlement Third Party Review

In certain circumstances, DOJ might also consider a technique used by the U.S. Attorney for the Western District of Pennsylvania in a case involving Mellon Bank. DOJ and the company agreed to have a pre-settlement evaluation of the compliance/ethics program by a third-party agreeable to both sides. The third-party review was paid for by the company, but the results were reported confidentially to the U.S. Attorney.

Recommendation 2.5 – The DOJ must communicate what it is doing with respect to the treatment of ECEPs in cases.

A principal finding of this Report is that the dearth of information on how ECEPs come into play in DOJ decisions is undermining the FSGO policy of incentivizing the development of best practice compliance/ethics programs. DOJ should invest in a communications and training effort across all departments and offices to:

1) Ensure that the role ECEPs played in the disposition of organizational cases is fully communicated in all press releases and settlement; and

2) Generally collect and publish information on the role of ECEPs in such cases.

Types of information that should be communicated (because they are viewed as especially helpful to in-house practitioners in securing resources ¹⁵⁸) include:

- Aggregate or general statistics about the consideration of compliance/ethics programs in enforcement decisions.

- Descriptions (without identifying information) of cases in which an organization’s compliance/ethics program played a favorable role in securing a non-prosecution decision.

¹⁵⁸ According to the ERC/SCCE/ECOA study discussed, note 4, in this Report.
• Information about whether specific aspects of a program (e.g., sufficiency of compliance/ethics training, appropriate position of the compliance/ethics officer) played a role in enforcement.

• In addition to cases where an organization’s compliance/ethics program contributed to the organization’s avoiding prosecution entirely, information about cases where a program contributed to the organization’s receiving some other enforcement-related benefit, such as avoiding having to engage a monitor.

This Report cites some recent and commendable examples of cases in which the Fraud Section of the Criminal Division has begun to include more communication about its treatment of ECEPs in its cases, and we hope these cases can help inform future DOJ’s policies and practices in this area. A more detailed breakdown of the kinds of information that would be helpful if DOJ communicated is set out at Appendix B of this Report.

**Recommendations to the President of the United States Regarding All Other Executive Branch Agencies**

**Recommendation 3.1 – The President should use available authorities to direct all executive branch agencies to adopt, publicize, and apply clear written policies with respect to how they promote and consider ECEPs in enforcement and other relevant settings.**

While DOJ is responsible for enforcement of criminal law – the only area that the Guidelines legally apply to – other government agencies also have, at least rhetorically, embraced the concept of providing recognition for compliance/ethics. However, the benefits of this generalized support for ECEPs are at least partly offset by a lack of transparency. Government enforcement agencies have been too close-mouthed about the way they assess and account for compliance/ethics programs, including the applicability of the FSGO criteria.

---

159 Ibid. at 75
160 For example, during the development of this Report we contacted 25 federal agencies to request copies of policies indicating that consideration is given to compliance and ethics programs as a part of an enforcement decision. Of the 25 agencies, only 3 agreed to interviews with our staff to provide additional information. None of the agencies forwarded a written policy.
Using available authorities (some agencies are quasi-independent which limits presidential authority) the President should direct all executive branch agencies to:

1) Establish, if they have not already, a policy to promote ECEPs and the role that ECEPs play in their treatment of organizations; and

2) Publish information on how this policy is being implemented.

The clarity and increased transparency that would flow from this directive would not only strengthen the efficiency and effectiveness of the incentives for companies to invest in best-in-class compliance, it also would lay the groundwork for a more consistent government-wide approach to compliance/ethics as discussed immediately below.

Recommendation 3.2 – Each agency of the federal government should develop and implement their own compliance and ethics programs, applying the FSGOs standards. The President should use available authorities to direct all executive branch agencies to do so as well.

The FSGO standards apply to all organizations, including governments. Requiring federal agencies to adopt strong compliance and ethics programs would further promote the underlying policy of the FSGOs while also helping to ensure that the human beings staffing federal agencies understand and follow the laws and standards that apply to them. In addition, for government agencies, having their own internal compliance programs would help them to better understand such programs in the regulated community.¹⁶¹

¹⁶¹ See The Rutgers Center for Government Compliance and Ethics, http://rcgce.camlaw.rutgers.edu/, for background and guidance on government agency compliance and ethics programs; and the Department of Justice Inspector General’s report on its review of the FBI’s Integrity and Compliance program, observing: “We believe that the concept of the FBI’s OIC program has been beneficial to its efforts to monitor and enhance compliance with legal requirements, and that other agencies may wish to consider implementing a similar kind of program.” (http://www.justice.gov/oig/reports/2011/e1201.pdf).
Recommendation to the President and Congress to Designate a Cross-Government Working Group

Recommendation 4.1 – Using available authorities, the President and Congress should establish a cross-government working group to create a Core Federal Model for corporate compliance/ethics programs.

While the U.S. Sentencing Commission has developed the principal model for ECEPs in use in the U.S. today, the relevance of ECEPs is not limited to federal sentencing, and many agencies have recognized this by creating their own ECEP models that may, or may not, draw on the FSGO framework. The result is a patchwork of inconsistent and redundant demands that businesses must bear the burden of deciphering.

What is now needed is a more uniform set of standards to enable organizations to more effectively meet (or exceed) expectations for compliance/ethics efforts and, in turn, reduce the frequency of misconduct by organizations and their employees. It also would allow businesses to organize more efficiently in meeting government’s expectations.

We therefore urge the immediate establishment of a government working group to review existing approaches to compliance/ethics and develop a Core Federal Model. The idea is that – just as the FSGO already apply across industries – it should not be difficult to create a widely applicable core model. Some customization would be required to reflect the intricacies of specific risk areas. The SEC and DOJ, for example, would not be precluded from developing more specific guidance on vetting commercial agents in connection with the Foreign Corrupt Practices Act. Also, each agency would have its own policy on how to respond to a company with a qualifying program (for example, DOJ’s policy would relate the ECEP to a decision to enter an NPA or decline prosecution; or the Defense Department/Air Force Office of Inspector General could opt not to suspend a company from contracting; and OSHA might relax its audit frequencies of companies with good programs).

We believe that the FSGO framework for compliance/ethics programs, because it is a cross-industry model, is already the basis of certain other agencies’ models, and has achieved substantial success over 20 years would provide the presumptive foundation for the Core
Federal Model. The Sentencing Commission already has authority in its enabling statute that might allow it to play a facilitating role, but it is possible that with the participation of a judicial branch agency (the Sentencing Commission), quasi-independent agencies, and executive branch agencies, that Congress and the President would both need to play a role to make this happen. Fundamentally, we believe that organizations deserve a single framework, based on FSGO criteria for compliance/ethics programs, that they can apply against their own business realities and risk profile.

**Recommendations to Congress**

Recommendation 5.1 – Congress should use its oversight authority to insist that federal regulatory and enforcement agencies establish, and demonstrate that they are implementing policies for the promotion, evaluation, and consideration of compliance/ethics programs.

Congress can play an important role in encouraging organizational compliance/ethics efforts by insisting on transparent and consistent policy implementation by federal regulatory and enforcement agencies. Ideally, Congress and the administration can agree on mutually-supporting actions to guide federal agencies and assure their full commitment to effective compliance/ethics programs, but a predicate to this type of mutually reinforcing action is for Congress to use its oversight powers to monitor agency progress.

Recommendation 5.2 – Congress should consider the impact on organizational compliance/ethics programs when it develops legislation related to law enforcement and regulatory oversight of organizations by the federal government.

Beyond exercising oversight authority of federal agencies, Congress also must avoid legislation that unintentionally undermines the FSGO principles or organizational compliance efforts. For example, some believe that poorly-drafted whistleblower provisions or other reward programs designed to encourage reporting of misconduct can erode compliance/ethics programs by encouraging reporting outside the company as a first resort.

To ensure that its actions are consistent with the FSGO’s approach to compliance and to organizational compliance/ethics efforts, Congress should assess the potential impact of legislation on the compliance/ethics function, including inviting comment from compliance and ethics experts. Such a process would enable lawmakers to make fully-informed decisions about pending legislation.

Recommendation 5.3 – Congress should exercise its authority to ensure that at least one member of the U.S. Sentencing Commission has experience with the FSGO.

The Sentencing Reform Act of 1984 stipulates that at least three of the seven voting members of the U.S. Sentencing Commission must be federal judges, and no more than four members may belong to the same political party. We recommend that Congress amend the Act to require that at least one member of the Commission also have demonstrated knowledge and experience with the application of the FSGO. Recognizing that few judicial cases have actually involved the Guidelines, 163 this experience will likely involve prosecution or defense of corporate crime in cases where compliance and ethics programs were at issue, experience with the development or implementation of compliance/ethics programs based on the FSGO, or counsel to corporations regarding compliance with the organizational Guidelines.

Recommendations to the Courts

Recommendation 6.1 – Judges should exercise judicial oversight of DPAs and other settlement agreements filed with the Courts to ensure that such agreements indicate on their face the consideration of the FSGO criteria for “an effective compliance and ethics program” and other FSGO factors in the development of the settlement’s terms.

We believe that judges should assert their inherent authority to review settlement agreements filed with the court to confirm consideration of the FSGO principles, especially the compliance/ethics program criteria, so that companies that have worked hard to ensure ethical performance and compliance receive proper credit. We understand, as the GAO study

163 Although courts have had some experience with compliance programs in the area of discrimination and harassment under federal law, following Farragher v. Boca Raton, 524 U.S. 775 (1998); Burlington Indus., Inc. v. Ellerth, 524 U.S. 742 (1998); Kolstad v. American Dental Ass’n, 527 US 526 (1999).
discussed earlier in the Report found, that a lack of time and resources available to judges to become more involved in the DPA may hinder their willingness to do so. We do not envision judges supplanting the prosecutor’s judgment with their own de novo approach; rather, we envision the courts verifying that consideration of the FSGO factors took place. We think this is an appropriate practice, particularly now, when consideration of these factors in the ever-burgeoning number of DPAs is less than clear.

Judges will, of course, need to accept that additional requirements that supplement FSGO may be appropriate in individual cases, while ensuring that the FSGO should remain the foundation for evaluating ECEPs in enforcement and dispute resolution involving U.S. law.

Further, judges can ensure that settlements drive organizational commitment to compliance/ethics and other FSGO factors by seeking settlement terms that require necessary fixes in existing practice and/or the establishment of effective compliance/ethics programs where they do not currently exist.

These changes will likely require the assistance of the Judicial Conference in helping to ensure that judges understand this somewhat new role reviewing corporate cases.

**Recommendations to the Private Sector**

Recommendation 7.1 – While we have made recommendations to U.S. Sentencing Commission on how the FSGO criteria might be improved, we encourage the private sector to act now. Private sector organizations need to embrace the intent of the Guidelines’ diligence standards and implement compliance/ethics programs that are part and parcel of the business fabric and not the result of mere box-checking. This begins by defining the mission of a company as comprising both strong financial performance and a strong commitment to integrity. Proper positioning, empowerment, and autonomy of the chief ethics and compliance officer must also be a priority.

Boards of directors and senior executives should not be satisfied with a compliance/ethics program that is a mere formality and does not meet the rigor contemplated by the FSGO. A company that merely checks the box when it comes to implementing programs relies on false
hope. Prosecutors assert that they are only “impressed by …living, breathing, practical programs,” and research affirms that companies that have taken the message of the FSGOs to heart and have focused on core values and building strong cultures are the ones with “living, breathing, practical programs.” Even further, corporate executives who fail to push for stronger compliance/ethics programs may fall behind in their own markets. Consumers are increasingly taking account of which companies have high ethical standards and those that do not, and market research shows that customers are willing to pay more for a brand that they associate with integrity. Similarly, investors are more willing to put their money in companies they trust. High ethical standards can be a competitive advantage.

Just as “tone at the top” is essential to many business initiatives, so too it is central that the commitment to compliance and ethics is a part of the company’s daily life and not simply something that underlings are left to handle. We urge business leaders to take compliance/ethics very seriously by embracing integrity as part of the corporate mission – not by subordinating the pursuit of strong financial results, but in tandem with it. Executives should ask for regular assessment of corporate cultures, and establish performance standards so that senior leaders – including the CEO – are evaluated on their abilities to promote an effective compliance and ethics program. They should aspire to meet not just the letter of the law, but its spirit as well. And they also should aspire to create cultures of honesty and trustworthiness where employees are prompted to go beyond legal requirements and to make decisions that also achieve high ethical standards as well. They should assure that the person with day-to-day responsibility for the compliance and ethics program – the chief ethics and compliance officer – is fully empowered, properly positioned, sufficiently autonomous, and provided enough resources to enable full implementation of the FSGOs elements. Compliance and ethics professionals should be appropriately positioned and encouraged to seek ways to integrate compliance/ethics into regular business discussions. Finally, large organizations with a need for more complex compliance/ethics management systems should appoint at least one board member who possesses expertise on effective compliance/ethics management.

Recommendation 7.2 – Invest in initiatives that raise the bar for “best practice.”

In the initial discussions of our Advisory Group, the question was raised, “What does a good compliance/ethics program really look like? What difference does it make?” While we have cited several emerging insights from research about the outcomes of an effective program in this Report, there is still much to be learned. Business leaders rightly call upon compliance/ethics professionals to tell them how their investment in an ECEP will help profitability. We do not yet have a conclusive answer to that question. Even academic literature does not provide much detail about the specific program practices that yield the greatest effects when it comes to compliance and ethics.

Businesses should not rely on government to tell them what effective compliance/ethics programs look like; they also must work to identify the right programs for themselves. We believe that it is useful when the compliance/ethics profession can, in fact, identify the impact of ECEPs, not only in terms of the prevention and detection of wrongdoing, but also in terms of corporate profitability and contribution to the larger social good. Understanding what works best will require investment of time and resources into research as well as the development of metrics and the robust exchange of ideas within and across industry groups. Businesses should work together with industry associations, academics, nonprofit organizations, and other experts to undertake this important task. Best practices forums should not only focus on “how we do things now,” but also on “What should we be doing next?” in the spirit that “a rising tide raises all boats.”¹⁶⁶ If the private sector will accept responsibility for defining effective program practices and best practice, all of us will benefit.

While this Report has identified a number of challenges and required areas of improvement, we strongly believe that the FSGO have been a major positive factor in spreading corporate commitment to building ethical cultures in the workplace. In our view, the experience of the past 20 years has more than borne out the wisdom of the U.S. Sentencing Commission’s decision to view business organizations as potential partners in the fight to reduce workplace misconduct and to build respect for the law from mailroom to C-suite.

With the FSGO providing the road map, the vast majority of American business corporations have built an ethos of compliance and ethical conduct. Both anecdotal evidence and empirical data show that misconduct goes down and compliance goes up when business leaders truly commit to the development of ethical cultures and provide the needed resources and support for compliance and ethics programs. But we also know that corporate decision-makers value the bottom line, and compliance and ethics programs are often vulnerable.

The recommendations in this Report are designed to address some of these vulnerabilities by strengthening the commitment of government – from prosecutors to the President – to the consistent application of FSGO and the compliance regime it has helped create. We also believe that, in some areas, FSGO could be better focused and clearer about what companies are expected to do.

The FSGO are and always will be a work in progress. The pressures on corporations and their workers will always change as times goes on. We believe that the recommendations outlined in this Report will raise the odds that even stronger ethical cultures and increasingly effective compliance and ethics programs will be part of the inevitable changes that always lie ahead.
2011 FEDERAL SENTENCING GUIDELINES MANUAL
CHAPTER EIGHT – SENTENCING OF ORGANIZATIONS

2. EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673).

§8B2.1. Effective Compliance and Ethics Program

(a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (b)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

(1) exercise due diligence to prevent and detect criminal conduct; and

(2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

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

(1) The organization shall establish standards and procedures to prevent and detect criminal conduct.

(2) (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.

(B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.
(C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate resources, appropriate authority, and direct access 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 individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.

(4) (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subparagraph (B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals’ respective roles and responsibilities.

(B) The individuals referred to in subparagraph (A) are the members of the governing authority, high-level personnel, substantial authority personnel, 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 compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;

(B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and

(C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.

(6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.

(7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.
(c) In implementing subsection (b), the organization shall periodically assess the risk of
criminal conduct and shall take appropriate steps to design, implement, or modify each
requirement set forth in subsection (b) to reduce the risk of criminal conduct identified through
this process.

Commentary

Application Notes:

1. Definitions.—For purposes of this guideline:

"Compliance and ethics program" means a program designed to prevent and detect criminal
conduct.

"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.

"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).

"Standards and procedures" means standards of conduct and internal controls that are
reasonably capable of reducing the likelihood of criminal conduct.

2. Factors to Consider in Meeting Requirements of this Guideline.—

(A) In General.—Each of the requirements set forth in this guideline shall be met by an
organization; however, in determining what specific actions are necessary to meet those
requirements, factors that shall be considered include: (i) applicable industry practice or
the standards called for by any applicable governmental regulation; (ii) the size of the
organization; and (iii) similar misconduct.

(B) Applicable Governmental Regulation and Industry Practice.—An organization's
failure to incorporate and follow applicable industry practice or the standards called for by
any applicable governmental regulation weighs against a finding of an effective
compliance and ethics program.

(C) The Size of the Organization.—

(i) In General.—The formality and scope of actions that an organization
shall take to meet the requirements of this guideline, including the necessary
features of the organization's standards and procedures, depend on the size
of the organization.

(ii) Large Organizations.—A large organization generally shall devote more
formal operations and greater resources in meeting the requirements of this
(iii) **Small Organizations.**—In meeting the requirements of this guideline, small organizations shall demonstrate the same degree of commitment to ethical conduct and compliance with the law as large organizations. However, a small organization may meet the requirements of this guideline with less formality and fewer resources than would be expected of large organizations. In appropriate circumstances, reliance on existing resources and simple systems can demonstrate a degree of commitment that, for a large organization, would only be demonstrated through more formally planned and implemented systems.

Examples of the informality and use of fewer resources with which a small organization may meet the requirements of this guideline include the following: (I) the governing authority’s discharge of its responsibility for oversight of the compliance and ethics program by directly managing the organization’s compliance and ethics efforts; (II) training employees through informal staff meetings, and monitoring through regular “walk-arounds” or continuous observation while managing the organization; (III) using available personnel, rather than employing separate staff, to carry out the compliance and ethics program; and (IV) modeling its own compliance and ethics program on existing, well-regarded compliance and ethics programs and best practices of other similar organizations.

(D) **Recurrence of Similar Misconduct.**—Recurrence of similar misconduct creates doubt regarding whether the organization took reasonable steps to meet the requirements of this guideline. For purposes of this subparagraph, “similar misconduct” has the meaning given that term in the Commentary to §8A1.2 (Application Instructions - Organizations).

3. **Application of Subsection (b)(2).**—High-level personnel and substantial authority personnel of the organization shall be knowledgeable about the content and operation of the compliance and ethics program, shall perform their assigned duties consistent with the exercise of due diligence, and shall promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

If the specific individual(s) assigned overall responsibility for the compliance and ethics program does not have day-to-day operational responsibility for the program, then the individual(s) with day-to-day operational responsibility for the program typically should, no less than annually, give the governing authority or an appropriate subgroup thereof information on the implementation and effectiveness of the compliance and ethics program.
4. **Application of Subsection (b)(3).**—

(A) **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.

(B) **Implementation.**—In implementing subsection (b)(3), the organization shall hire and promote individuals so as to ensure that all individuals within the high-level personnel and substantial authority personnel of the organization will perform their assigned duties in a manner consistent with the exercise of due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law under subsection (a). With respect to the hiring or promotion of such individuals, an organization shall consider the relatedness of the individual's illegal activities and other misconduct (i.e., other conduct inconsistent with an effective compliance and ethics program) to the specific responsibilities the individual is anticipated to be assigned and other factors such as: (i) the recency of the individual's illegal activities and other misconduct; and (ii) whether the individual has engaged in other such illegal activities and other such misconduct.

5. **Application of Subsection (b)(6).**—Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however, the form of discipline that will be appropriate will be case specific.

6. **Application of Subsection (b)(7).**—Subsection (b)(7) has two aspects.

First, the organization should respond appropriately to the criminal conduct. The organization should take reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct. These steps may include, where appropriate, providing restitution to identifiable victims, as well as other forms of remediation. Other reasonable steps to respond appropriately to the criminal conduct may include self-reporting and cooperation with authorities.

Second, the organization should act appropriately to prevent further similar criminal conduct, including assessing the compliance and ethics program and making modifications necessary to ensure the program is effective. The steps taken should be consistent with subsections (b)(5) and (c) and may include the use of an outside professional advisor to ensure adequate assessment and implementation of any modifications.

7. **Application of Subsection (c).**—To meet the requirements of subsection (c), an organization shall:

(A) Assess periodically the risk that criminal conduct will occur, including assessing the following:

(i) The nature and seriousness of such criminal conduct.

(ii) The likelihood that certain criminal conduct 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 criminal
conduct may occur, the organization shall take reasonable steps to prevent and detect that type of criminal conduct. For example, an organization that, due to the nature of its business, employs sales personnel who have flexibility to set prices shall establish 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 standards and procedures designed to prevent and detect fraud.

(iii) The prior history of the organization. The prior history of an organization may indicate types of criminal conduct that it shall take actions to prevent and detect.

(B) Prioritize periodically, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b), in order to focus on preventing and detecting the criminal conduct identified under subparagraph (A) of this note as most serious, and most likely, to occur.

(C) Modify, as appropriate, the actions taken pursuant to any requirement set forth in subsection (b) to reduce the risk of criminal conduct identified under subparagraph (A) of this note as most serious, and most likely, to occur.

Background: This section sets forth the requirements for an effective compliance and ethics program. 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 criminal conduct for which the organization would be vicariously liable. The prior diligence of an organization in seeking to prevent and detect criminal conduct has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offense.

Historical Note: Effective November 1, 2004 (see Appendix C, amendment 673). amended effective November 1, 2010 (see Appendix C, amendment 744); November 1, 2011 (see Appendix C, amendment 758).
APPENDIX B

INFORMATION ON THE ROLE OF COMPLIANCE/ETHICS PROGRAMS IN ENFORCEMENT DECISIONS

The preceding Report concludes that information on whether and how the DOJ gives credit to organizations for ethics and compliance programs will strengthen the quality of these internal efforts. The following illustrate the kinds of useful information pertaining to the role compliance/ethics programs played in enforcement decisions that DOJ (and other agencies involved in enforcement) might include in:

- A general release of statistics.
- Descriptions contained in press releases and settlement agreements in individual cases.

1. **Benefits given to companies with effective programs.**

The Department of Justice and other enforcement agencies could identify the decisions in which it opted for any of the following in whole or in part because an effective compliance/ethics program was present.

a. Organization was permitted to conduct initial investigation
b. The DOJ declined to prosecute criminally; handled civilly
c. The DOJ declined to take any action at all
d. Deferred prosecution subject to settlement agreement
e. Non-prosecution subject to settlement agreement
f. Settlement agreement; no compliance/ethics program imposed because of existing program
g. Settlement agreement; compliance/ethics program mandated, but essentially continuation of existing program
h. Settlement agreement; compliance/ethics program imposed but more lenient because of existing program; some enhancements required
i. No monitor imposed in settlement
j. No fine imposed
k. Reduced fine because of program
l. Civil penalty; no criminal fine because of program
m. Subsidiary, not parent, subject to enforcement action because of program

2. **List of reasons for rejection of or reduction in credit for a compliance/ethics program.** In cases where the department did not give credit to an organization for its ethics and compliance program, the department could identify key features that were lacking.

Examples include:

a. No “procedures” of internal controls to prevent violations
b. Management structure for compliance/ethics program (e.g., Compliance/Ethics Officer (CECO)) not empowered or not reporting to board
c. The organization had not provided training to those who were involved in the misconduct
d. No meaningful mechanism in place for anonymous or confidential reporting (helpline/reporting system)
e. Retaliation toward the whistleblower occurred
f. No Compliance/Ethics audits were undertaken or audits were infrequent
g. No evaluations of the effectiveness of the compliance/ethics program took place or evaluations were insufficiently frequent
h. The organization’s performance management system and other incentives did not meaningfully consider commitment to the compliance/ethics program
i. Inadequate disciplinary system/no discipline for failure to take reasonable steps to prevent/detect violations
j. Allegations not effectively investigated

3. **Extent to which a compliance/ethics program factored into monetary penalties.**

For example:

- This could be demonstrated in a FSGO calculation set forth in a settlement agreement, as the Fraud Section has been doing, an indication of how it affected the monetary
penalty within the range if an FSGO calculation is made, a reduction below the range, or otherwise.

- Estimated reduction in financial penalty to company from the Compliance/Ethics program.

4. **Case Descriptions:**

The DOJ could provide information on the consideration given compliance/ethics efforts in case descriptions of enforcement decisions. The following are recent Justice Department and SEC acknowledgments of company ethics and compliance programs and the role they played which provide a good starting point, but could be substantially augmented in future cases.

Example from the SEC:

**U.S. SECURITIES AND EXCHANGE COMMISSION**

Litigation Release No. 21222 / September 24, 2009

Securities and Exchange Commission v. Christopher A. Black, Case No. 09-CV-0128 (S.D. Ind., September 24, 2009)

SEC FILES SETTLED REGULATION FD CHARGES AGAINST FORMER CHIEF FINANCIAL OFFICER

... 

"In determining not to bring an enforcement action against ACL, the Commission considered several factors. Prior to the June 16, 2007 disclosure by Black, ACL cultivated an environment of compliance by providing training regarding the requirements of Regulation FD and by adopting policies that implemented controls to prevent violations. Further, Black alone was responsible for the violation and he acted outside the control systems established by ACL to prevent improper disclosures."

...

Examples from the DOJ:

**UNITED STATES OF AMERICA v. UNIVERSAL LEAF TABACOS LTDA., E.D. Va. Aug. 6, 2010**
p. 4, fn. 2

“2. Pursuant to Universal's internal compliance program, Universal maintained on its website an employee "hotline" that allowed current and former employees to report improper conduct. It is because of this useful compliance initiative that the improper conduct came to light. The agreed upon disposition partly reflects credit given for Universal's pre-existing compliance program.”

Noble Corporation Non Prosecution Agreement (Nov. 4, 2010)

“The Department enters into this Non-Prosecution Agreement based, in part, on the following factors: . . . (e) the existence of Noble's pre-existing compliance program and steps taken by Noble's Audit Committee to detect and prevent improper conduct from occurring;”

Of these three, the most helpful is the SEC's because the company, in fact, faced no punitive action from the government and the program played a role in this disposition. While the Noble case is helpful because it mentions the compliance program, the disposition of the case seems to be exactly what would have happened in any voluntary disclosure, with or without a compliance program. The statement also gives no indication what, if any, parts of the program merited credit. In this respect the Black case and the Universal Leaf case are helpful because they indicate some aspects of the programs that merited praise.
## COMMUNICATED EXPECTATIONS FOR STANDARDS OF CONDUCT

### Communicated Expectations for Standards of Conduct

<table>
<thead>
<tr>
<th>Source</th>
<th>Excerpt Language on Guidance/Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Sentencing Commission(^1)</td>
<td>The organization shall establish standards of conduct(^2) to prevent and detect criminal conduct for all members of the governing authority, high-level personnel, substantial authority personnel, employees, and as appropriate, agents.</td>
</tr>
<tr>
<td>Sarbanes Oxley Act Section 404 - COSO Internal Control Framework Criteria(^3)</td>
<td>Requires management and the external auditor to assess:</td>
</tr>
<tr>
<td></td>
<td>• Existence of codes of conduct and other policies regarding acceptable business practices.</td>
</tr>
<tr>
<td></td>
<td>• Establishment of the “tone at the top” by management – including explicit moral guidance about what is right and wrong – and extent of communications throughout the organization.</td>
</tr>
<tr>
<td>Sarbanes Oxley Act Section 406 - SEC Implementation Rules(^4)</td>
<td>A company must disclose whether it has adopted a code of ethics that applies to the registrant’s principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. If the company has not adopted such a code of ethics, it must explain why it has not done so. Defines the term &quot;code of ethics&quot; as written standards that are reasonably designed to deter wrongdoing and to promote:</td>
</tr>
<tr>
<td></td>
<td>• Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;</td>
</tr>
</tbody>
</table>

---

1. The FSGO make clear the applicability of the standards of conduct by explaining to whom they must be communicated; i.e., “to all employees, and, as appropriate, the organization’s agents.” USSG §8B2.1(b)(4)(B).
2. USSG §8B2.1, comment. (n. 1) (“Standards” means standards of conduct that are reasonably capable of reducing the likelihood of criminal conduct).
<table>
<thead>
<tr>
<th>Department of Justice Sample Language Used in FCPA DPAs and Opinion Releases</th>
<th>A clearly-articulated corporate policy against violations of the FCPA and other anti-corruption laws to be followed by all directors, officers, employees, and all business partners, including, but not limited to, agents, consultants, representatives and joint venture partners and teaming partners, involved in business transactions, representation, or business development or retention in a foreign jurisdiction, that are reasonably capable of reducing the prospect that anti-corruption laws will be violated.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Acquisition Regulation (FAR)(^5)</td>
<td>Within 30 days after contract award, unless the Contracting Officer establishes a longer time period, the Contractor shall have a written code of business ethics and conduct and make a copy of the code available to each employee engaged in performance of the [federal government] contract.</td>
</tr>
<tr>
<td>Bureau of Information and Security of the Department of Commerce Export Management and Compliance Program Guidelines (BIS)(^6)</td>
<td>Effective export management and compliance program Manuals document export control and compliance policies and procedures for standards of conduct and ethics. It is recommended that a company distribute its Manual widely, especially to those employees who have export management and compliance functions and responsibilities.</td>
</tr>
<tr>
<td>EPA Incentives for Self-Policing(^7)</td>
<td>Compliance policies, standards and procedures that identify how employees and agents are to meet the requirements of laws, regulations, permits, enforceable agreements and other sources of authority for environmental requirements.</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>OSHA Voluntary Safety and Health Program Management Guidelines</th>
<th>A clearly-stated worksite policy on safe and healthful work and working conditions so that all personnel at the site or working for the site understand the priority of safety and health protection.</th>
</tr>
</thead>
</table>
| NYSE Listing Standards (The NYSE is a Self-Regulatory Organization) | Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers.  
Commentary: No code of business conduct and ethics can replace the thoughtful behavior of an ethical director, officer or employee. However, such a code can focus the board and management on areas of ethical risk, provide guidance to personnel to help them recognize and deal with ethical issues, provide mechanisms to report unethical conduct, and help to foster a culture of honesty and accountability.  
Each code of business conduct and ethics must require that any waiver of the code for executive officers or directors may be made only by the board or a board committee and must be promptly disclosed to shareholders. This disclosure requirement should inhibit casual and perhaps questionable waivers, and should help assure that, when warranted, a waiver is accompanied by appropriate controls designed to protect the company. It will also give shareholders the opportunity to evaluate the board’s performance in granting waivers.  
Each code of business conduct and ethics must also contain compliance standards and procedures that will facilitate the effective operation of the code. These standards should ensure the prompt and consistent action against violations of the code. Each listed company’s website must include its code of business conduct and ethics. Each company’s annual report on Form 10-K filed with the SEC must state that the foregoing information is available on its website and that the information is available in print to any shareholder who requests it.  
Each company may determine its own policies, but all listed companies should address the most important topics, including the following:  
- Conflicts of interest. A “conflict of interest” occurs when an individual’s private interest interferes in any way – or even appears to interfere – with the interests of the corporation as a whole. A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern. The company should have a policy prohibiting such conflicts of interest, and providing a means for employees, officers and directors to communicate potential conflicts to the company.  
- Corporate opportunities. Employees, officers and directors should be prohibited from (a) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (b) using corporate property, information, or position for personal gain; and (c) competing with the company. Employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises.  
- Confidentiality. Employees, officers and directors should maintain the confidentiality of information entrusted to them by the company or its customers, except when disclosure is authorized or legally mandated. Confidential information includes all non-public information that might be of use to |
competitors, or harmful to the company or its customers, if disclosed.

- **Fair dealing.** Each employee, officer and director should endeavor to deal fairly with the company’s customers, suppliers, competitors and employees. None should take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or any other unfair dealing practice. Companies may write their codes in a manner that does not alter existing legal rights and obligations of companies and their employees, such as “at will” employment arrangements.

- **Protection and proper use of company assets.** All employees, officers and directors should protect the company’s assets and ensure their efficient use. Theft, carelessness and waste have a direct impact on the company’s profitability. All company assets should be used for legitimate business purposes.

- **Compliance with laws, rules and regulations (including insider trading laws).** The company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively.

- **Encouraging the reporting of any illegal or unethical behavior.** The company should proactively promote ethical behavior. The company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the company must ensure that employees know that the company will not allow retaliation for reports made in good faith.

---

### NASDAQ Listing Standards

Each Company shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available. A code of conduct satisfying this rule must comply with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act of 2002 ("the Sarbanes-Oxley Act") and any regulations promulgated thereunder by the Commission. See 17 C.F.R. 228.406 and 17 C.F.R. 229.406. In addition, the code must provide for an enforcement mechanism. Any waivers of the code for directors or Executive Officers must be approved by the Board. Companies, other than Foreign Private Issuers, shall disclose such waivers within four business days by filing a current report on Form 8-K with the Commission or, in cases where a Form 8-K is not required, by distributing a press release. Foreign Private Issuers shall disclose such waivers either by distributing a press release or including disclosure in a Form 6-K or in the next Form 20-F or 40-F. Alternatively, a Company, including a Foreign Private Issuer, may disclose waivers on the Company's website in a manner that satisfies the requirements of Item 5.05(c) of Form 8-K.

**IM-5610. Code of Conduct**

Ethical behavior is required and expected of every corporate director, officer and employee whether or not a formal code of conduct exists. The requirement of a publicly available code of conduct applicable to all directors, officers and employees of a Company is intended to demonstrate to investors that the board and management of NASDAQ Companies have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and take prompt action against any questionable behavior. For Company personnel, a code of conduct with enforcement provisions provides assurance that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct.

Rule 5610 requires Companies to adopt a code of conduct complying with the definition of a "code of ethics" under Section 406(c) of the Sarbanes-Oxley Act of
2002 ("the Sarbanes-Oxley Act") and any regulations promulgated thereunder by the Commission. See 17 C.F.R. 228.406 and 17 C.F.R. 229.406. Thus, the code must include such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations, as specified by the Sarbanes-Oxley Act. However, the code of conduct required by Rule 5610 must apply to all directors, officers, and employees. Companies can satisfy this obligation by adopting one or more codes of conduct, such that all directors, officers and employees are subject to a code that satisfies the definition of a "code of ethics."

As the Sarbanes-Oxley Act recognizes, investors are harmed when the real or perceived private interest of a director, officer or employee is in conflict with the interests of the Company, as when the individual receives improper personal benefits as a result of his or her position with the Company, or when the individual has other duties, responsibilities or obligations that run counter to his or her duty to the Company. Also, the disclosures a Company makes to the Commission are the essential source of information about the Company for regulators and investors — there can be no question about the duty to make them fairly, accurately and timely. Finally, illegal action must be dealt with swiftly and the violators reported to the appropriate authorities. Each code of conduct must require that any waiver of the code for Executive Officers or directors may be made only by the board and must be disclosed to Shareholders, along with the reasons for the waiver. All Companies, other than Foreign Private Issuers, must disclose such waivers within four business days by filing a current report on Form 8-K with the Commission, providing website disclosure that satisfies the requirements of Item 5.05(c) of Form 8-K, or, in cases where a Form 8-K is not required, by distributing a press release. Foreign Private Issuers must disclose such waivers either by providing website disclosure that satisfies the requirements of Item 5.05(c) of Form 8-K, by including disclosure in a Form 6-K or in the next Form 20-F or 40-F or by distributing a press release. This disclosure requirement provides investors the comfort that waivers are not granted except where they are truly necessary and warranted, and that they are limited and qualified so as to protect the Company and its Shareholders to the greatest extent possible.

Each code of conduct must also contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.


5615. Exemptions from Certain Corporate Governance Requirements
This rule provides the exemptions from the corporate governance rules afforded to certain types of Companies, and sets forth the phase-in schedules for initial public offerings, Companies emerging from bankruptcy and Companies transferring from other markets. This rule also describes the applicability of the corporate governance rules to Controlled Companies and sets forth the phase-in schedule afforded to Companies ceasing to be Controlled Companies.

(a) Exemptions to the Corporate Governance Requirements
(1) Asset-backed Issuers and Other Passive Issuers
The following are exempt from the requirements relating to Majority Independent Board [Rule 5605(b)], Audit Committee [Rule 5605(c)], Independent Director Oversight of Executive Officer Compensation [Rule 5605(d)] and Director Nominations [Rule 5605(e)], the Controlled Company Exemption [Rule 5615(c)(2)], and Code of Conduct [Rule 5610]:

(A) asset-backed issuers; and
(B) issuers, such as unit investment trusts, including Portfolio Depository Receipts, which are organized as trusts or other unincorporated associations that do not have a board of directors or persons acting in a similar capacity and whose activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) securities, rights, collateral or other assets on behalf of or for the benefit of the holders of the listed securities.

IM-5615-1. Asset-backed Issuers and Other Passive Issuers

Because of their unique attributes, Rules 5605(b), 5605(c), 5605(d), 5605(e) and 5610 do not apply to asset-backed issuers and issuers, such as unit investment trusts, that are organized as trusts or other unincorporated associations that do not have a board of directors or persons acting in a similar capacity and whose activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) securities, rights, collateral or other assets on behalf of or for the benefit of the holders of the listed securities. This is consistent with NASDAQ’s traditional approach to such issuers.


(2) Cooperatives

Cooperative entities, such as agricultural cooperatives, that are structured to comply with relevant state law and federal tax law and that do not have a publicly traded class of common stock are exempt from Rules 5605(b), (d), (e), and 5615(c)(2). However, such entities must comply with all federal securities laws, including without limitation those rules required by Section 10A(m) of the Act and Rule 10A-3 thereunder.