

The Honorable Dick Thornburgh The Honorable Jay Stephens Paul Clinton Harris, Sr.

The Issue: **Maintaining the Corporate Compliance Commitment**

This edition of Washington Legal Foundation's CONVERSATIONS WITH examines the development and maintenance of compliance programs within public and private corporations. Former Attorney General of the United States and Pennsylvania Governor Dick Thornburgh leads an informative discussion with Senior Vice President, General Counsel, and Secretary of Raytheon Company, The Honorable Jay B. Stephens and Paul Clinton Harris, Sr., a partner with *Shook Hardy & Bacon L.L.P.* Thanks to federal laws and regulations, such as the U.S. Sentencing Guidelines and the Sarbanes-Oxley Act, corporate compliance programs have become imperative for businesses of all sizes. Our participants offer insights informed by their current and past roles as corporate counsels, private practitioners, and government enforcement officials on such pressing issues as the attorney-client privilege; federal prosecutors' expectations of compliance programs; and how to solidify commitment to compliance from the CEO down to entry-level employees.

Governor Thornburgh: It may seem intuitively obvious that businesses

would have programs to ensure compliance with laws and regulations, but the formal creation of such programs is a relatively recent phenomenon. Jay Stephens, when did we first start seeing the modern, more sophisticated corporate compliance program, and why?

Honorable Jay Stephens: The Aerospace and Defense industry was something of a pioneer in the development of formal corporate compliance programs. In 1986, the Defense Industry Initiative, or DII, was established in response to procurement integrity problems that had occurred in the 1970s and early 1980s. A major initiative of the DII was the establishment of modern compliance programs within the defense industry which, in turn, served as a model for other industries.

Another important catalytic event occurred in 1991 when the Organizational Federal Sentencing Guidelines, or "Chapter Eight," went into effect. Adoption of the organizational guidelines posed the real possibility of criminal liability as well as significant monetary fines for corporate misconduct. At the outset, the Sentencing Commission directed that two factors could mitigate possible criminal actions against organizations — cooperation with government



Dick Thornburgh
*Kirkpatrick & Lockhart Preston
Gates & Ellis LLP*



Jay B. Stephens
Raytheon Company



Paul Clinton Harris, Sr.
Shook Hardy & Bacon L.L.P.

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Paul Harris

enforcement and the existence of an effective compliance program. Implementation of these sentencing guidelines was a powerful impetus for the adoption or upgrading of compliance programs in the '90s.

In the past decade, compliance programs for public companies have become more complex and oriented toward financial controls and reporting to comply with Sarbanes-Oxley and other SEC reporting requirements. As enforcement became more aggressive both internationally and domestically in the past several years, there has been greater scrutiny of the effectiveness and scope of compliance programs.

Governor Thornburgh: What does "effective compliance program" mean? What are the elements that make a program "effective"?

Paul Clinton Harris: The Guidelines state that an effective compliance program is one that is reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct. At the most basic level an effective compliance program must meet the criteria established in the Sentencing Guidelines. In a nutshell those criteria include (1) requiring an organization to establish compliance standards and procedures; (2) demonstrable commitments to compliance by decision makers of the organization, including organizational leadership that is well-informed about the compliance program's content, procedures, and efficiency; (3) using reasonable efforts and due diligence not to place any individual in a position of substantial authority personnel who the organization knew, or should

have known, has a history of engaging in violations of law; (4) requiring compliance program training and communications that are educational, motivational, and sufficient; (5) well-publicized mechanisms to report violations, encouragement to report violations, and assurance that such reports are confidential and will be processed without repercussion; (6) disciplinary action for program violations and program modification to prevent similar future violations and appropriate incentives to perform in accordance with the program; and (7) when a violation is detected, requiring that the organization take reasonable steps to respond appropriately to the violations of law, including any modifications to the compliance program.

There's an important additional requirement, which is a due diligence requirement to conduct ongoing monitoring, evaluation, and risk assessments to implement the criteria specifically set forth in the Sentencing Guidelines. These are the standards by which government enforcement officials and agents determine whether a corporate compliance program meets the baseline criteria to be deemed effective.

Mr. Stephens: I agree with Paul's comments. In addition, I would stress that a compliance program must be real, and not just a box-checking exercise or set of laudatory policies. In particular, the program needs to be tailored to the company's specific risk profile and compliance vulnerabilities, subject to internal and independent auditing of processes and procedures, and have buy-in from the top echelon of the organization. The tone at the top, the commitment from the board and senior management, can be

an important differentiator.

Governor Thornburgh: Let's go through some of those key elements. What choices do companies normally make on who will maintain the corporate compliance program? What kind of models exist?

Mr. Harris: Well I think there is one other critical element to an effective compliance program that is not specifically listed in the Sentencing Guideline's criteria — that's the tone set by the words and actions of a company's top leaders, the CEO and the General Counsel in particular. Without the consistent and demonstrable support from the company's top leaders, including a dedicated commitment of sufficient resources, there is little chance of establishing and maintaining an effective compliance program.

At the core of your question are issues of accountability. The ancient Romans had a tradition: whenever one of their engineers constructed an arch, as the capstone was hoisted into place, the engineer assumed accountability for his work in the most profound way possible: he stood under the arch. If maintaining a compliance program can be compared to this Roman tradition, then it is essential that the designated compliance officer also have the appropriate resources and authority necessary to maintain a program for which he or she is to be held accountable. Moreover, government enforcement officials look unfavorably upon a compliance program that lacks sufficient budget, personnel and other resources necessary to carry out its proper function.

There are several models for corporate compliance functions and they all have particular advantages and disadvantages. The most important question the company must answer in deciding upon a particular model is: Which type of reporting relationship is likely to be the most effective? Of course, this decision should be custom-fitted to the particular organization, as opposed to one that is driven by other considerations (i.e., the model adopted by an industry competitor). The three most common models are: (1) the compliance function within the Legal Department, with the compliance officer reporting to the General Counsel; (2) the compliance council (comprising key functional areas) within the Legal Department, with the General Counsel chairing the council; and (3) the compliance officer with direct reporting authority to the board of directors and/or audit committee. Again, each has its own distinct advantages and disadvantages.

Governor Thornburgh: Prior to joining Shook Hardy & Bacon, you were Director of Enterprise Compliance at Raytheon. Do you feel that approach worked well?

Mr. Harris: At Raytheon, the compliance function is within the Office of General Counsel and the compliance director reports directly to the General Counsel. This model worked well for me and seemed to be the right model for Raytheon during the time I was there. Raytheon's Legal Department is streamlined and its in-house lawyers specialize at multi-tasking. The model Raytheon uses works to relieve some of the pressure on stretched legal resources within the company but also allows the compliance

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director to access and maximize in-house knowledge. An additional benefit to this model is that it avoids the expense of establishing an entirely new functional organization. Building new legal empires in corporate America has gone the way of the Romans. But perhaps the most valuable benefit to this model was the leadership, strength and respect that the general counsel brought to the table. Everyone in the company knew that I not only had the GC's attention but also the authority of his office to implement broad compliance initiatives.

Governor Thornburgh: Jay, could you elaborate on what Paul noted your role is as General Counsel in compliance at Raytheon?

Mr. Stephens: As Paul noted, our Ethics and Compliance function is part of Raytheon's Office of General Counsel. In addition, the General Counsel's Office is accountable for leading our Company's regulatory compliance efforts and for resolving any related investigations or litigation. We establish the architecture of our policies, educate employees regarding their responsibilities, provide advice to our business folks, and manage the resolution of any disputes we may have.

With regard to our Company's Ethics Program, I believe the General Counsel's office must promote a culture of integrity. The General Counsel is a key gatekeeper and frequently the arbiter of governance and compliance issues. Sometimes this requires the General Counsel to act as a statesperson, to step back and be sure that the activities of the Company are aligned with the long-term interests of the shareholders. Sometimes you are an advocate,

sometimes you exercise judicious advice, and sometimes you act to drive accountability. There are times when advice is not enough, and you need to take action based on the courage of your convictions. At the end of the day, the General Counsel's Office is an important progenitor of a company's ethical culture.

Governor Thornburgh: How does your compliance program communicate the requirements of and need to comply with the program's elements to company employees?

Mr. Stephens: We use a variety of in-person and web-based educational tools to drive a culture of integrity. In particular, we focus some of our educational effort on values to promote a values-based ethical culture. In the ethics area, for instance, we annually deliver live ethics awareness education classes to all our employees using video clips presenting various ethical issues and facilitators to lead discussions about the dilemmas faced by characters in the videos. These are based on actual cases and problems which we have encountered. In addition, employees are required to take a certain number of online compliance modules, tailored to address issues of particular concern to the employee in his or her business. The modules include a multiple choice test as part of the employee's certification of satisfactory completion of the compliance education. Compliance education includes a broad variety of topics from export control and Foreign Corrupt Practices Act (FCPA) to harassment and information privacy.

This past year we initiated another exciting web-based tool which we call "*EthicSpace*."

Two-minute video clips are delivered to every employee's desk via email. A storyline, based on actual cases and issues, unfolds over a series of episodes delivered over several weeks, like a mini-series. Our employees have responded exceptionally well to these ethics and compliance educational messages which are both entertaining and thought-provoking.

Governor Thornburgh: Paul, how can a company's compliance program create the right incentives for employees to report potential violations of laws or regulations within the company, rather than becoming "whistleblowers"?

Mr. Harris: Your question strikes at the heart of what it means to create a culture of compliance within a company. Of course, company policy should encourage employees to promptly report any potential violation of law or regulation or any misconduct relating to the company's operations or practices. But company policy should also explicitly prohibit any form of penalty, career disadvantage or retaliation against an employee who reports a violation in good faith.

I've found it helpful to emphasize that these reports may be anonymous through a hotline or ombudsman and that every effort will be made to keep confidential the identity of the reporting employees. It's important to remember that reporting requires an employee to step outside direct company hierarchy and do something that feels unnatural. Low-level employees, when witnessing a potential violation or misconduct, might shrug it off as "It's not my responsibility" or feel helpless to do anything about it. Worse, they may fear retribution for reporting the problem.

Here again, the tone at the top can play a decisive role in creating the kind of work environment in which employees feel comfortable raising concerns about potential violations or misconduct without fear of retribution. Also, it is important to emphasize that compliance is a collaborative function; it's an individualized responsibility and every employee has a role to play. Once a report is received, it is critical to maintain communications with the employee, and then work with the employee, as appropriate, to close the case as quickly as possible. Many employees fear lawyers and therefore are hesitant about reporting to Legal or Compliance. Companies should consider locating a hotline in each function, and establish a referral process to Legal or Compliance.

Not to beat a dead horse but this framework only works in an environment where ideals of openness and honesty receive more than just lip service from the top. Company leaders should constantly encourage employees at all levels of the organization to speak up and report potential violations and misconduct as a matter of corporate citizenship. When employees understand that violations and misconduct can harm the Company's reputation and can result in lost business opportunities, profitability and growth, and even the loss of jobs, these consequences can also provide strong reporting incentives.

Governor Thornburgh: What type of auditing and monitoring functions must be built into a compliance program so they remain up to date and "effective"?

Mr. Harris: The Guidelines require an organization to monitor and audit its

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operations, as a matter of responsible governance, in addition to requiring ongoing risk assessments. These terms — monitoring, auditing and risk assessments — are often confused and they are not synonymous. The main function of risk assessment is to identify and evaluate significant exposures to risk. An effective compliance program should always remain focused on the most serious and likeliest risks. Monitoring requires routine analysis of information and data to ensure that internal controls and procedures are working and functioning as designed and to measure their effectiveness against a specific purpose. Ideally, compliance monitoring should be built into key business processes that impact significant organizational risk.

Auditing is similar to monitoring but is more systematic and independent in nature. The two most common types of audits are compliance audits and incident-based audits. Compliance audits are an essential component of an effective compliance program because they are designed around the purpose of reviewing adherence to laws, regulations, policies and procedures. Compliance audits occur at regular intervals and are more comprehensive and thorough than routine monitoring practices. There are also program audits, internal control reviews and investigations in the compliance officer's toolbox. At various times independent consulting services, outside counsel or external auditors may be brought in to add value by providing expert advice or counsel in specific areas.

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that apply to a business or industry is constantly changing. The regulatory environment is not static and therefore an effective compliance program should function in a manner that reflects this reality.

Governor Thornburgh: Jay, how critical is it that upper-level management, especially the CEO and Chairman and Board of Directors, are fully on-board with the compliance program? How can general counsels address situations where senior management support isn't sufficient?

Mr. Stephens: We believe that the "tone at the top" is important in nurturing a culture of integrity. For the past several years, we have utilized an interactive ethics education program with our Board of Directors and also with our Company Leadership Team. We have focused on values-based cultural change issues to move the Company beyond legal compliance to the creation of a culture of integrity. This also demonstrates to all employees that the senior leadership of the Company is engaged and supportive of our efforts across the Company. We also measure our employees' views of our ethics and compliance efforts through our Employee Opinion Survey which seeks input from all employees on a range of education, process, accountability, and perception issues. Finally, we report our Ethics and Compliance Program metrics to our Board quarterly, and the Board reviews annually critical components of our ethics and compliance efforts.

Having the active involvement of the Board and our CEO is critical in our effort to nurture an ethical culture and a

commitment to full compliance with regulatory requirements. Following the spate of corporate scandals in the past several years and the advent of Sarbanes-Oxley, Boards have played a much more engaged oversight role of compliance and ethical issues that may impact a company. At Raytheon, our Board and our CEO are very engaged in setting the tone for our Company. They are deeply concerned about the Company's reputation with all our stakeholders and are fully engaged in the sound stewardship of our enterprise. Our Audit Committee carries primary Board responsibility for monitoring the integrity of our financial statements and controls and setting expectations of integrity and transparency in financial reporting and compliance. In 2002, we established a Public Affairs Committee to our Board which reviews and monitors the Company's policies, processes, and practices in key compliance areas, such as environmental, health and safety; export-import; FCPA; diversity; and our ethics program.

If there were a perceived lack of support by the CEO and Board for a strong compliance program, the General Counsel's job would be much tougher because he or she would need to build a strong business case for a robust compliance program. While the architecture of a company's compliance program may depend upon the specific industry involved, it is increasingly clear that protecting a company's public reputation is a major component of risk management, and that is key to the customer's confidence in the products or services of the company. The General Counsel would be well-advised to press the business case, drive the policy

development, foster the communication and education with employees, and to press accountability; because at the end of the day a strong ethics and compliance program is an important risk management tool on a number of fronts.

Governor Thornburgh: As Jay noted, the Sarbanes-Oxley Act expanded the role of Boards of Directors and especially their audit committees. How do the Act and those expanding roles play into compliance program creation and maintenance?

Mr. Harris: The most important impact that Sarbanes-Oxley Act has had on the expanding roles of Boards and audit committees is the requirement that they understand the nuts and bolts of the company's compliance program, in addition to their other duties. This top-down approach as required under the Act has led to far more interaction between Boards and audit committees and compliance officers, and I think this is a positive development. Boards and audit committees are involved in defining the scope of the compliance program, approving key policies and procedures, and requiring periodic, substantive reporting on compliance metrics.

Audit committees, in particular, are attuned to key risk areas in the company and frequently offer their strong opinions about what should be done to address them. Audit committee members tend to ask probing questions (with an uncanny ability to probe into areas compliance officers often least expect) and will not hesitate to use audit committee meetings as a forum to grill compliance officers about reporting procedures, compliance

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audit protocols and the results of compliance audits. It is not uncommon for compliance officers to periodically or even routinely face tough questions from the Board or the audit committee. The questions could stem from a broad range of issues, including, for example, compliance monitoring processes, trends in the reporting of potential violations or misconduct, key changes in regulation and how they impact the company, whether the compliance function has sufficient resources, personnel or organizational changes, etc.

Governor Thornburgh: Much has been made of the importance of implementing and maintaining a "proactive" compliance function as opposed to a system that merely reacts to the latest crisis. What does a "proactive" compliance function mean to you?

Mr. Harris: In simple terms it means the compliance function must consistently identify potential risks while they are large enough to identify but still small enough to effectively manage. It also means anticipating changes in regulation that will affect the company and, when necessary, modifying the compliance program to meet those potential risks or regulatory requirements. For example, as many U.S. companies are now establishing operations internationally, it would be "proactive" for the compliance function in a company which previously operated only within the continental U.S. but is now branching out internationally, to anticipate new risk areas such as the potential foreign bribery or violation of foreign data privacy statutes or foreign currency regulation. Once these potential risks are identified, then the next step is to review the compliance program and determine if

it is adequately structured to detect and prevent violations in the identified risk areas. In other words, make sure that the company's internal controls are functioning properly for the new business environment. This review may require changes in policy and procedures, and any changes will need to be communicated to affected employees. The compliance function then needs to monitor compliance with the new policy or procedures, going forward.

Governor Thornburgh: Both of you have dealt with compliance programs inside and outside of companies. Could you both describe for us the role of outside counsel in designing and maintaining such programs?

Mr. Harris: Outside counsel bring to the table certain assets, resources, experiences and strengths that may not exist within the company. Therefore the most important task of outside counsel is to form a team with in-house counsel or the designated compliance officer. To do this effectively, outside counsel should take the time to learn and appreciate how the company functions, understand what its business goals are, and get a sense of the organization's ethical culture. Once this is done, the compliance officer and outside counsel can set about the work of identifying serious and likely areas of risk and then designing a compliance program, using the Sentencing Guidelines as a framework.

It will be important in the long run for the compliance officer to be perceived within the company as leading the charge; he or she must establish himself/herself as the leader of the compliance function — the reasons for this are both real and percep-

tual. Outside counsel should not be leading the parade; their role is to support the compliance function. Moreover, the compliance officer needs to lead for more practical reasons: greater knowledge of how the organization functions, knowledge of where the natural cross-functional alliances are in the company, knowledge about personalities and quirks among management, and knowledge (and perhaps experience) relating to detecting and defusing potential implementation "land mines" within the organization. That said, outside counsel can add tremendous value to the task of designing and maintaining compliance programs, particularly when they have had substantive, hands-on experiences from which to draw as well as other assets and resources.

Mr. Stephens: Outside counsel can bring several things to the table. Most importantly, there are times when an internal investigation can best be performed by outside counsel because of the need for perceived independence, possible privilege protection, possible conflicts which could undermine the credibility of an inquiry or compromise ongoing relationships in a business, or because of scope and resource demands. Counsel needs to have an appropriate reporting relationship within the company to ensure that at the end of the process the company's values and interests are weighed and that the company can make the necessary accountability judgments. Outside counsel can be particularly helpful if there is a likelihood of related enforcement action or litigation.

Governor Thornburgh: Jay, how has your past experience at the U.S. Department of Justice informed your involvement with the compliance program at Raytheon?

Mr. Stephens: My background within the Justice Department gives me an appreciation for how the Department looks at organizational responsibility for potentially wrongful acts, how it sets and balances its enforcement priorities, and how it evaluates the gravity of various scenarios of alleged misconduct. I also have an appreciation and respect for the seriousness and good faith that prosecutors and regulators bring to their important responsibilities, as well as where they may be willing to consider the broader impact of their decisions. For example, the Department may well seek to balance cooperation and an effective compliance program in its decision mix. But Justice has emphasized the importance of the actual effectiveness of a compliance program — whether it is an integrated and functioning part of a company's business culture and processes, or whether it is just another chapter in the policy manual. The compliance program must be designed and tailored to address the specific regulatory framework for the relevant industry; and the Department will look beyond pure legal compliance to see whether the company has a values-based culture that shapes its decision-making processes.

Governor Thornburgh: Another question drawing on your past government experience, Jay — what shapes government enforcement officials' expectations on corporations' compliance programs, in terms of what type of program companies have and how vigorously they enforce them?

Mr. Stephens: Prosecutors look to the top of an organization to determine whether the alleged conduct was sanctioned, encouraged, or tolerated, or whether the dominant culture and

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processes were designed to eliminate the behaviors that may have led to the alleged conduct. As noted earlier, the tone at the top matters in assessing the effectiveness of an ethics and compliance program. Prosecutors will seek to hold accountable the most senior person they can reach. And an organization that has had prior incidents of misconduct has a much higher hurdle to clear in establishing the good faith bona fides of senior management — especially if subsequent efforts to establish a strong, carefully-tailored compliance program were half-hearted or perfunctory. The presence of a robust, vibrant ethics and compliance program may shape a prosecutor's view of an appropriate remedy, and particularly the scope and authority of a possible compliance monitor in the context of a deferred prosecution decision. While an effective compliance program is not a panacea, and does not provide an absolute shield to enforcement action, in the first instance it should mitigate the risk of an enforcement action — either through the avoidance of or early self-detection of misconduct-and subsequently, if there is enforcement interest, the company may have an opportunity to correct the problem itself or face mitigated penalties.

Governor Thornburgh: How about in the courts, Paul? Has case law developed where the existence of a program, or lack of an effective one, has made a difference in how a court ruled on an issue of civil or criminal liability?

Mr. Harris: I know that the existence of a compliance program is one of many factors that prosecutors will consider when determining a company's culpability score for charging purposes but I am

unaware of any case in which the courts have awarded credits for the existence of a compliance program when imposing civil or criminal liability. However, in 2004, a district court in Pennsylvania issued a decision in the case of *United States v. Merck-Medco Managed Care, LLC* in which a government contractor was adjudged to have violated a criminal statute, in part, because its compliance program was substandard and insufficient. This was the first time that the lack of an effective compliance program made a difference in how a court ruled on an issue of civil or criminal liability.

The Government charged Merck-Medco with violating the False Claims Act, alleging that Merck-Medco, at the time it submitted its false or fraudulent claim, had actual knowledge of the information or acted in reckless disregard or deliberate ignorance of the truth or the falsity of the information. The Government claimed that Merck-Medco's compliance programs were either non-existent or insufficient, in satisfaction of the "reckless" requirements under the False Claims Act. The Government asserted that Merck-Medco acted with "reckless disregard" with respect to implementing most, if not all, of the criteria set forth in the Sentencing Guidelines. The fact that the company also did not have a code of ethics in place dealt a blow to its defense.

Governor Thornburgh: As we have discussed here, compliance programs have become essential for legal-related reasons, but what other benefits do they offer to a company?

Mr. Stephens: The value of a company's reputation, its "brand" in the market,

may be difficult to quantify with precision, but its reputation is clearly an integral part of its value proposition. This value may be customer or industry driven. In the defense industry, a company's reputation with the customer is fundamental — not just from a regulatory perspective of possible suspension and debarment, but from a business perspective related to the evaluation of past performance and confidence in delivery of the critical technology. In the food or pharmaceutical industries, product safety drives core value.

A robust compliance and ethics program also has a very positive impact on employee morale and productivity. People want to work for a company that takes its ethical and compliance responsibilities seriously. As consumers, they want the businesses they interact with to treat them fairly, and as employees, they want to take pride in their company's commitment to doing things the right way. We frequently hear our employees express how proud they are to work for a company where integrity is a paramount value. And our Employee Opinion Survey results reflect this pride and the effect of our continued efforts to drive progress in this area.

Governor Thornburgh: We talked earlier about the need to regularly audit compliance programs, but what about situations where internal investigations must be conducted in response to inquiries by state or federal law enforcement or whistleblower allegations? How are the mechanisms of a compliance program involved when an internal investigation is conducted?

Mr. Stephens: On occasion, an internal

investigation is necessary to run-to-ground allegations that the company's compliance regimes may have been violated. There are several factors which shape this response. While regular audits are necessary to ensure that a compliance program has all the requisite components and is functioning properly, the capability to conduct internal inquiries is essential to bring credibility to a compliance program.

The investigative component of a compliance program ensures that employees know there is accountability built into a compliance program and that any allegations they may raise will be reviewed promptly and appropriately. The investigative side of a compliance program merits considerable thought, which could be the topic of an additional conversation. It is helpful to have an established protocol to guide decisions as to who will conduct what type of inquiries, how the results of those inquiries will be addressed, and timelines for the investigative and any corrective action decision process.

A clear, unbiased understanding of the facts is essential in order to develop appropriate corrective actions. Sometimes inquiries need to be conducted by outside counsel because of the complexity of the issue, the "legal" quality of the allegation, or the likelihood of follow-on enforcement action. Sometimes allegations involve workplace human resource issues; sometimes they involve issues of financial controls. After developing the facts, judgments need to be made regarding discipline, disclosure, and process corrections. Almost always, it is important for the company to take appropriate corrective action as part of

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any disclosure of process weaknesses or individual violations.

We also have an internal reporting process that brings certain matters to the purview of our Audit Committee and others to our Public Affairs Committee. In addition, as part of our ethics education effort, we seek to demonstrate accountability by noting disciplinary or other corrective actions taken when meritorious allegations have been substantiated. All this builds credibility in the program among employees, managers, and the regulatory/enforcement community. After all, an ethics and compliance program without a well-conceived investigative component may not even pass the "good intentions" threshold, and certainly would not be viewed by the enforcement community as a robust, operational program. We also learn from our inquiries and investigations, and those lessons become part of our ethics education process for all our employees.

Governor Thornburgh: One issue that arises in internal investigations, as well as corporate compliance programs, is the ability of companies to protect information from disclosure. What can companies do to protect information?

Mr. Harris: This remains an open and vexing question that revolves around the issue of what can be done to protect the attorney-client privilege. Of course, whether conducting an internal investigation or in the ordinary course of maintaining a compliance program, a compliance officer should take all reasonable measures to preserve privileged information from disclosure, such as memorializing that the investiga-

tion is for the purpose of providing legal advice or assistance and that the investigation is being conducted at the direction of management, establishing a system for labeling, segregating and filing privileged documents, issuing *Upjohn* warnings, as appropriate, and observing generally accepted protocols for protecting confidentiality. However, there is no guarantee that these reasonable efforts will achieve the goal of protecting information from disclosure.

Armed with newly-issued directives, aggressive prosecutors, governmental regulators and agency compliance enforcement officials have been pressing hard for corporate waivers of the attorney-client privilege. In the wake of corporate scandals and prosecutions of alleged corporate fraud, corporations are under tremendous pressure to acquiesce.

In recent years, two significant developments have served to weaken the privilege dramatically. The first development was the Justice Department's issuance of two memoranda commonly referred to as the Holder and Thompson Memoranda. Issued in June 1999 and January 2003, respectively, these memoranda were directed to the heads of the various Justice Department components and U.S. Attorneys and both set out several factors to be considered in the decision whether to charge an organization with a crime.

Among the factors both memoranda listed as warranting consideration is the existence and adequacy of the corporation's compliance program. Another factor addressed corporate cooperation, including a corporation's decision to waive attorney-client and work

-product privileges. The *Holder/Thompson Memoranda* explain that the waiver of these privileges — both with respect to internal investigations and communications between company employees and counsel — facilitates unfettered investigation. As such, the memoranda consider privilege waiver as one factor in evaluating the corporation's cooperation. While the latter factor has been at the center of recent controversy and public debate, it is its inclusion alongside the compliance program factor that evidences a lack of core appreciation for the interplay between the attorney-client privilege and an effective corporate compliance program.

The second significant development that weakened the attorney-client privilege was a 2004 amendment to the commentary of Section 8C2.5 of the Sentencing Guidelines that added a provision on waiver in determining a company's culpability score. Application Note 12 to that section states that waiver of attorney-client privilege and of work product protections is not a prerequisite to a reduction in culpability score, unless such waiver is necessary in order to provide timely and thorough disclosure of all pertinent information known to the organization. Thus, a corporation would be ineligible for a reduced sentence if it refused to waive the privilege under those circumstances. Responding to significant criticism of this policy, in April 2006, the Sentencing Commission unanimously voted to revoke it from Section 8C2.5.

Both of the aforementioned developments resulted in tremendous pressure being placed on corporations and their corporate compliance officers to waive the attorney-client privilege so as to appear

cooperative with government investigations. By resisting the pressure to inappropriately waive, corporations and their compliance officers can protect America's ability to obtain the legal guidance it needs to conform to the laws that govern it.

Governor Thornburgh: What calculations must corporations and their outside counsel make in deciding whether to waive their privileges, either voluntarily or in response to a government official's request?

Mr. Stephens: The attorney-client and work product privileges are core doctrines which are central to advising clients and resolving disputes, and to uninhibited communications between counsel and client. In the corporate compliance context, attorney-client privilege is quite complex with many practical implications. In the context of compliance programs and possible disclosures to government agencies, as a practical matter the biggest concern around privilege waiver frequently is the possible impact on third party civil litigation. With regard to the enforcement context, a company should not be required to waive privilege as a condition of receiving credit for cooperation.

As a practical matter, it is difficult for a company to present its internal findings from an internal compliance investigation without waiving privilege as it seeks to present the facts in a most persuasive case to obtain leniency. Sometimes, officers and employees want to rely on an advice of counsel defense. Frequently, actions of some officers or employees may be adverse to the interests of the company. Other times, the interests of the company

and its shareholders may be pitted against individual officers or employees. In a compliance setting, sometimes the government enforcement agency sees the legal function as its window on the compliance function within a company, and the legal function as a "voluntary" extension of the enforcement authority into the company. The long-standing effort to drive voluntary compliance is predicated upon a conflicted view of the attorney-client privilege.

Assertion of privilege generally is driven by a decision to stand and fight rather than to pursue a voluntary compliance/disclosure approach. But assertion of privilege is also important to protect against third party civil claims and to maintain channels of deliberative communication between counsel and officers and employees. All of this is complicated by the sometimes conflicting roles an in-house counsel must play between being a "deputized" IG and a vigorous advocate for the legally defensible positions a company has taken.

Governor Thornburgh: Does the "self-evaluative privilege" provide any protection for information developed through corporate compliance programs?

Mr. Harris: That is a question that corporate compliance officers face with increasing regularity in this extremely active enforcement environment. The public policy rationale for the so-called self-evaluative privilege is instructive. This privilege finds its origins in a 1970 medical malpractice case called *Bredice v. Doctors Hospital, Inc.*, in which defendants resisted discovery of the minutes of a hospital staff meetings related to implementing new standards and procedures to improve

the delivery of health care. The court ruled that minutes of the meetings were deemed privileged so that doctors could talk openly and freely, but the court did not specifically refer to the self-evaluative privilege in its decision. The court held that these meetings were intended to improve the quality of health care, which is more important than subjecting the minutes of the hospital staff meeting and doctors' comments to discovery. In effect, the court recognized that the public interest in improved health care standards was better served not by discovery but by retaining the confidentiality of the minutes of the staff meetings.

In the compliance context, there is a similar issue: To what extent are compliance audits or internal compliance reports protected from disclosure to a government enforcement agency? Compliance audits and internal reporting serve the purpose of identifying and correcting problems relating to compliance with applicable laws and regulations. The self-evaluative privilege works not only to buttress the effectiveness of the program itself but also can serve an important public interest: detecting fraud and other corporate misconduct. This holds true in many areas of compliance, including international arms exports, environmental, health care and transportation (i.e., the safety of passenger jets).

Nevertheless, overly aggressive federal and state government regulators and compliance officials press hard corporate waivers of attorney-client privilege and tend to look askance at the self-evaluative privilege and accord it little weight, if any at all. Whether a court would recognize

the self-evaluative privilege in the litigation context requires a different analysis, but certainly a company should not be required to produce a corporate risk roadmap to plaintiffs' counsel, particularly when certain missteps already have been identified, investigated and corrected. Unfortunately, there remains a threshold question whether this privilege exists. It has been recognized by some courts but is nowhere near universal recognition.

Bottom line: don't count on the self-evaluative privilege to provide any protection from disclosure in the compliance enforcement context or from discovery in civil litigation.

Governor Thornburgh: Are there any strategies companies and their counsel can pursue which allows them to share attorney client-privilege and work product information with the government, but ensure that it not get into the hands of competitors or plaintiffs' lawyers?

Mr. Stephens: There is no silver bullet here. A company can seek to cooperate without a privilege waiver, but needs to carefully negotiate limits and protections regarding information provided to the government. A company may seek to negotiate a confidentiality agreement, but some courts see those as a selective waiver. A company may also seek to protect business proprietary information, and to address such issues specifically in the production of certain documents. You can also seek to limit the type of information that is disclosed and avoid relinquishing clearly privileged communications involving advice and counsel. At the end of the day, a legislative solution or clear policy change may be necessary to

preclude a waiver finding as to private third parties when a company discloses privileged information to an enforcement agency or prosecutor. One proposed fix is a new Federal Evidence Rule 502; another is the Attorney Client Privilege Protection Act pending in the Congress. But at present, there are no guarantees, and companies and their counsel may presume that whatever is disclosed to the government could end up in the hands of opposing parties in parallel private litigation.

Governor Thornburgh: Jay, for Raytheon and other companies in your industry, are there specific laws or areas of the law which prove especially challenging in crafting and implementing a corporate compliance program?

Mr. Stephens: There are a number of areas of compliance that require special vigilance. As a publicly-traded company, Sarbanes-Oxley and SEC compliance demand special focus and attention. We have established a Disclosure Committee within our company to drive careful review of issues which may require disclosure as well as a review of prudent disclosure language. There are myriad issues in the SEC filing and SEC proxy areas that require constant attention, expertise, and action. We work hard to stay engaged and to get these matters right.

As a government contractor, we spend considerable time on our export-import compliance regime, especially since nearly 20% of our business is international, and this is a complex regulatory area integral to our business. Our international work also drives focused attention on a robust FCPA compliance program; we need to be

compliance program; we need to be cognizant of domestic law considerations as well as foreign law requirements in dozens of jurisdictions, and at the same time drive a robust operational compliance program. And of course, the Procurement Integrity Act, labor charging, and post-government employment all require effective compliance regimes. Monitoring the integrity of the procurement process and ensuring the protection of proprietary business information is also of special interest to us. Monitoring cost accounting issues also requires our attention. We are also very focused on environmental, health and safety issues; we have worked hard to be a responsible steward, reduce our footprint, and ensure that our employees work in a safe environment.

Governor Thornburgh: From your perspective Paul as a private practitioner, what areas of the law provide the greatest challenges when you are advising clients on compliance efforts?

Mr. Harris: Because I most often interface with in-house counsel who are more often than not quite knowledgeable about their particular area of responsibility within the company's Legal Department, the greatest challenges usually revolve around new or emerging areas of law or changes to existing laws or regulation. It's a constant struggle to keep up in a regulatory process that is dynamic, complex and, at times, confusing and contradictory. Nowadays it's not just U.S. law that must be considered and analyzed but also the laws of foreign countries (or "host nations"). This is becoming the rule rather than the exception in the 21st century global economy, especially as U.S. companies

increasingly look abroad for new market opportunities to fuel corporate growth. Corporate clients face a daunting set of new legal challenges and compliance requirements in areas that range from export controls to attorney-client privilege and from data privacy to foreign exchange control regulations. What all of this means is that corporate compliance efforts must continue to evolve and adapt alongside the development of the company's strategic plans and business objectives. If the compliance function is to be effective, it must have a respected seat at the table. If it doesn't have a seat at the table, then most likely the best a company can hope for is a compliance team that is at least competent at "putting out fires" or eleventh-hour crisis management. Of course, this reactive model would be the antithesis of how an effective proactive compliance program should function.

Governor Thornburgh: What do you think the future holds for corporate compliance programs? Are there new technological or other innovations that will simplify or otherwise change the way companies and their advisers design them? Do you see the expectations of corporate leadership and government regulators changing the rest of this decade, and beyond?

Mr. Harris: Clearly, law enforcement officials and federal regulators have placed antifraud initiatives and compliance enforcement on the front burner. Corporations must do so as well or risk criminal or civil penalties, loss of business opportunities, debarment-related penalties, and inevitable damage to the organization's reputation. An effective compliance

program will remain the first line of defense in this era of increased scrutiny well into the foreseeable future. An updated and robust compliance program that enables company-wide understanding of and adherence to the many criminal, civil and administrative provisions will always provide the best armor in this targeted area.

Mr. Stephens: Ethics and compliance programs will continue to evolve in the decade ahead. On the ethics front, companies will continue to move to values based compliance cultures. Building a corporate culture based on integrity will drive behaviors and expectations which shape the decision processes of a business. Compliance will become an even more integrated component of corporate governance; board oversight will move beyond financial controls and reporting to enterprise risk management in an effort to identify risks to the enterprise, including reputational risks, and relevant mitigation plans. Board oversight will also continue to focus more intently on the company's relationship to its many stakeholders and on the company's reputation. Internally, companies will use more sophisticated tools to track compliance responsibilities, to audit programs, and to identify risks and education priorities. Six Sigma analyses and accounting business process tools can assess risk, identify priorities, and provide data driven process solutions. The enforcement community, I believe, will continue to press voluntary compliance and to seek to leverage itself into or across businesses through compliance mechanisms such as compliance monitors and deferred prosecutions as well as through various carrots and sticks to try to make the in-house legal function an exten-

sion of the government regulatory and enforcement effort. There is a lot at stake since a company's reputation can be a real business value driver for the enterprise, and the reputation of the business community generally shapes public policy decision-making that impacts our economic value creation engine.

Governor Thornburgh: Jay, Paul, thank you for participating in this important discussion.

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The Honorable Dick Thornburgh is a former Attorney General of the United States, Governor of Pennsylvania, and Under-Secretary-General of the United Nations. He is currently Of Counsel to the law firm *Kirkpatrick & Lockhart Preston Gates & Ellis LLP*, and Chairman of Washington Legal Foundation's Legal Policy Advisory Board. Governor Thornburgh began his public service career as a United States Attorney in Pittsburgh and an Assistant Attorney General in charge of the Criminal Division. As a private attorney, he was appointed in 2002 as Examiner in the WorldCom bankruptcy proceedings, the largest ever filed, to report on wrongdoing and malfeasance that led to the company's downfall. Governor Thornburgh was also chosen in 2004 by CBS to conduct an investigation into the *60 Minutes Wednesday* segment on President Bush's service in the Texas Air National Guard.

The Honorable Jay B. Stephens is Senior Vice President, General Counsel, and Secretary of Raytheon Company. He is a member of Raytheon's senior leadership team and participates in the operational management and strategic planning of the company. Prior to joining Raytheon, he served as Associate Attorney General of the United States, U.S. Attorney for the District of Columbia, and Deputy White House Counsel to President Ronald Reagan. Before becoming Associate Attorney General, Mr. Stephens was corporate vice president and deputy general counsel for Honeywell International (formerly AlliedSignal). In addition, he was a partner with the law firm *Pillsbury Madison & Sutro*.

Paul Clinton Harris, Sr. is a partner with the law firm *Shook Hardy & Bacon L.L.P.* Prior to joining the firm, he was Senior Counsel and Director of Enterprise Compliance at Raytheon Company. Mr. Harris also previously served as Deputy Assistant Attorney General for the Civil Division and later, Deputy Associate Attorney General at the United States Department of Justice. He handled litigation under the Federal Tort Claims Act and assisted in the development of civil justice initiatives for the George W. Bush Administration. Mr. Harris played a key role in administering the September 11th Victim Compensation Fund. He has also served two terms as a state legislator in the Commonwealth of Virginia, representing the Fifty-Eighth House District.