S. HRG. 109–918

THE BOEING COMPANY GLOBAL SETTLEMENT AGREEMENT

HEARING

BEFORE THE

COMMITTEE ON ARMED SERVICES UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

AUGUST 1, 2006

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AUGUST 1, 2006

THE BOEING COMPANY GLOBAL SETTLEMENT AGREEMENT

TUESDAY, AUGUST 1, 2006

U.S. SENATE,
COMMITTEE ON ARMED SERVICES,
Washington, DC.

The committee met, pursuant to notice, at 2:35 p.m. in room SH–216, Hart Senate Office Building, Senator John Warner (chairman) presiding.

Committee members present: Senators Warner, McCain, Sessions, Talent, Graham, Thune, Reed, and Dayton.

Committee staff members present: Charles S. Abell, staff director; Leah C. Brewer, nominations and hearings clerk; and John H. Quirk V, security clerk.

Majority staff members present: Ambrose R. Hock, professional staff member; Stanley R. O'Connor, Jr., professional staff member; Lynn F. Rusten, professional staff member; and Scott W. Stucky, general counsel.

Minority staff member present: Peter K. Levine, minority counsel.

Staff assistants present: Micah H. Harris and Jill L. Simodejka.

Committee members' assistants present: Christopher J. Paul and Pablo E. Carrillo, assistants to Senator McCain; Chris Arnold, assistant to Senator Roberts; Arch Galloway II, assistant to Senator Sessions; Clyde A. Taylor IV, assistant to Senator Chambliss; Frederick M. Downey, assistant to Senator Lieberman; Elizabeth King, assistant to Senator Reed; William K. Sutey, assistant to Senator Bill Nelson; and Luke Ballman, assistant to Senator Dayton.

OPENING STATEMENT OF SENATOR JOHN WARNER, CHAIRMAN

Chairman WARNER. The committee meets today to receive the testimony of Deputy Attorney General of the United States, Department of Justice (DOJ), and from the Chairman, President, and Chief Executive Officer (CEO) of the Boeing Company on the recent Boeing Company Global Settlement Agreement. Mr. McNulty, you and I have known one another for many years and I must say that I am very proud of the career that you have had, beginning in the United States Attorney's Office in the eastern section of Virginia, and your recent recognition and elevation to this important post is a testimony to your professional competence, and I am delighted to have you before the committee.

We welcome the Deputy Attorney General, Mr. McNulty, and Mr. McNerney, Chairman, President, and CEO of the Boeing Company.

We meet today to discuss the results of two DOJ investigations of the Boeing Company, both begun 3 years ago, into allegations of improper use of proprietary information obtained from a competitor to compete for launch services contracts under the Air Force's Evolved Expendable Launch Vehicle (EELV) program and an investigation of the circumstances surrounding the hiring of Darleen Druyun, a senior Air Force official, by Boeing.

On July 17, 2003, a grand jury indicted two Boeing employees on charges of conspiring to conceal and possess trade secrets in violation of title 18, United States Code. Both remain charged, awaiting trial to begin in late 2006.

In April 2004, Ms. Druyun pleaded guilty to negotiating employment with Boeing while she was participating personally and substantially as an Air Force official overseeing the negotiation of the proposed multi-billion dollar lease of Boeing KC–767A tanker aircraft.

In February 2005, Michael Sears, Boeing Chief Financial Officer (CFO), pled guilty to related charges. Both Druyun and Sears were sentenced to terms in Federal prison. Although the United States Attorney's Office decided not to seek criminal charges against the company, the United States on June 30, 2006, entered into a global settlement with Boeing for $615 million.

I understand this included a $50 million monetary penalty pursuant to a criminal deferred prosecution agreement and $565 million in resolution of civil claims. I have been informed that this settlement was the largest ever by a Department of Defense (DOD) contractor.

This entire matter brings into question a number of concerns that are appropriate for discussion in this important hearing. First and foremost, how does a company with the pride and prestige of Boeing produce employees that are capable of this kind of criminal behavior? Companies doing business with the United States Government are expected to adhere to the highest legal and ethical standards. We would expect nothing less from a company of Boeing's stature and rich heritage.

My understanding is that Boeing employs some 55,000 men and women in their workforce. I am quite sure that they would prefer to work for a company that is fully committed to operating at the highest standards of ethical behavior. It is important that they understand the direct impact unethical conduct can have on the company's bottom line.

I would like to insert here that I have had the opportunity on two occasions recently to talk to the CEO of Boeing and I think he is prepared in a very forthright manner to address in testimony the very issues that I have just raised today.

We will be interested in hearing Mr. McNerney's views on a cultural climate at Boeing, both past and present, that has fostered criminal misconduct by some of its employees and what steps he has taken to date and what he plans for the future to restore Boeing's reputation and move the company in a new direction.

It is my understanding that the Boeing Company has decided not to seek a tax deduction for the $615 million in settlement charges stemming from the settlement. That is an important first step on the path of redemption. Boeing was not required to abide by this

decision as part of the settlement agreement, but chose instead to pursue this path on its own initiative as a part of their business strategy. I believe the Boeing Company took a long-term approach in an effort to restore its reputation and made a sound decision.

I would like to put in the record at the conclusion of my statement here a letter that I and other members of this committee, notably my distinguished colleague, Mr. McCain, signed on this very issue prior to the decision with regard to the tax.

Chairman WARNER. Congress has pressed hard for real change in defense acquisition and corporate ethics. The DOJ has said much about the need for change and reform in defense acquisition and ethics and corporate America as well. Under your leadership, Mr. McNulty, when you were the United States Attorney for the Northern Virginia region you took many initiatives in this very area.

We will be interested in hearing the Department's reasoning behind the remedies it considered and asserted against Boeing in the global settlement agreement and why they are in the best interests of the American taxpayer. Clearly, the United States Attorney's Office could have pursued charges against the company, but chose not to do so based on factors outlined in the Department's Principles of Federal Prosecution of Business Organizations. We need to hear from the Deputy Attorney General the reasons why the Department chose this course of action, and I thank you for your presence.

I would simply add that in my view this case will depend largely on what has taken place to this moment and what will take place in this hearing. But this case will serve as a model for all America's industrial base and businesses to study carefully. The learning that can come from this could be enormous in helping to shore up the ethics and business conduct of our very proud infrastructure of businesses in this Nation.

So I look upon it as an exceedingly important chapter in our country.

[The prepared statement of Senator Warner follows:]

PREPARED STATEMENT BY SENATOR JOHN WARNER

The committee meets today to receive the testimony of the Deputy Attorney General of the United States Department of Justice (DOJ), and from the Chairman, President and Chief Executive Officer (CEO) of the Boeing Company on the recent Boeing Company Global Settlement Agreement.

We welcome Deputy Attorney General Paul J. McNulty and W. James McNerney, Jr., Chairman, President and CEO of the Boeing Company to today's hearing. We meet today to discuss the results of two DOJ investigations of the Boeing Company, both begun 3 years ago, into allegations of improper use of proprietary information obtained from a competitor to compete for launch services contracts under the Air Force's Evolved Expendable Launch Vehicle program, and an investigation of the circumstances surrounding the hiring of Darleen A. Druyun, a senior Air Force official by Boeing.

On July 17, 2003, a grand jury indicted two Boeing employees on charges of conspiring to conceal and possess trade secrets in violation of title 18, United States Code. Both remain charged awaiting trial to begin in late 2006. In April 2004, Ms. Druyun pleaded guilty to negotiating employment with Boeing while she was participating personally and substantially as an Air Force official overseeing the negotiation of the proposed multi-billion dollar lease of Boeing KC–767A tanker aircraft. In February 2005, Michael Sears, Boeing's Chief Financial Officer (CFO), was convicted on related charges. Both Druyun and Sears were sentenced to terms in prison.

Although the United States Attorney's office decided not to seek criminal charges against the company, the United States, on June 30, 2006, entered into a global settlement with Boeing for $615 million. I understand that this included a $50 million

"monetary penalty" pursuant to a criminal deferred prosecution agreement and $565 million in resolution of civil claims. I've been informed that this settlement was the largest ever by the Department with a defense contractor.

This entire matter brings into question a number of concerns that are appropriate for discussion in this important hearing. First and foremost, how does a company with the pride and prestige of Boeing produce employees that are capable of this kind of criminal behavior? Companies doing business with the United States Government are expected to adhere to the highest legal and ethical standards. We would expect nothing less from a company of Boeing's stature and rich heritage.

It's my understanding that Boeing employs some 155,000 men and women in their workforce. I'm quite sure that they would prefer to work for a company that is fully committed to operating at the highest standards of ethical behavior. It's important that they understand the direct impact that unethical conduct can have on the company's bottom line.

We will be interested in hearing Mr. McNerney's views on a cultural climate within Boeing, both past and present, that has fostered criminal misconduct by some its employees, and what steps he has taken to date, and what he plans for the future, to restore Boeing's reputation and move the company in a new direction.

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Congress has pressed hard for real change in defense acquisition and corporate ethics. The DOJ has said much about the need for change and reform in defense acquisition and ethics in corporate America as well. We will be interested in hearing the Department's reasoning behind the remedies it considered and asserted against Boeing in the global settlement agreement, and why they are in the best interests of the American taxpayer.

Clearly, the United States Attorney's Office could have pursued criminal charges against the company, but chose not to do so based on factors outlined in the Department's Principles of Federal Prosecution of Business Organizations. We need to hear from the Deputy Attorney General the reasons why the Department chose this course of action.

I thank you for your presence here today before the committee and look forward to your testimony.

[The information referred to follows:]

United States Senate

WASHINGTON, DC 20510

June 29, 2006

The Honorable Alberto Gonzales
Attorney General
Department of Justice
Main Justice Building, Room 5111
Pennsylvania Ave., NW
Washington, D.C. 20530

Dear General Gonzales:

We write to you regarding the Department of Justice's ("Justice Department") proposed global settlement of several matters relating to the Boeing Company ("settling company"). We understand that this settlement, which is close to being finalized and valued at $615 million, will resolve all civil and criminal claims arising from (1) the settling company's improper hiring of a former Air Force official in connection with the Air Force's multibillion acquisition of tanker aircraft and (2) its apparent theft of Lockheed Martin proprietary data that it used to win contracts for Air Force and NASA rockets.

We are very concerned about the possibility that this settlement may be structured in a way that allows for payments made by the settling company to be tax deductible, thereby leaving the American taxpayer to effectively subsidize its misconduct. In addition, we are concerned about the possibility that the settlement may allow the settling company to pass the cost of its misconduct, or a significant portion of it, on to its insurers.

In our view, this would be unacceptable. Congress has pressed hard for real change in defense acquisition and corporate ethics. We are not interested in settlements that are designed to look good in newspaper headlines but fail to bring real accountability.

Accordingly, we ask you to consider (1) the tax treatment of payments the settling company will be required to make under this agreement and (2) what third parties might ultimately be required to make those payments. In particular, we are interested in what deductibility under this settlement will mean in terms of loss of revenue to the Treasury and what portion of this settlement will be payable by the settling firm's insurers.

In our view, a failure to consider properly the tax treatment and the ultimate payor of this settlement is contrary to the interests of the American people. It is essential that the Justice Department not act as an indifferent or unwitting partner to any settling firm attempting to minimize its settlement costs through the tax code or the law on indemnification.

Given the policy implications of this settlement, and other similar settlements, hearings may be warranted. To help us to determine the appropriateness of such hearings, please provide us by (whichever is sooner) Wednesday, July 12, 2006, or before the settlement is executed, your analysis regarding the general tax treatment of the settlement and whether or not these costs may be borne by insurers of the settling firm.

The Justice Department has said much about the need for change and reform in defense acquisition and ethics in Corporate America. Now is the opportunity to show the American people action that assures that those responsible will bear the full burden of their misconduct. Artfully crafted settlements of corporate wrongdoing that have the costs paid for by somebody else, will only convince us, and more importantly the American people, that words are all there is.

Thank you for your prompt consideration of this matter.

Cordially yours,

Charles E. Grassley
Chairman
Senate Finance Committee

John McCain
Chairman
AirLand Subcommittee,
Senate Armed Services Committee

John Warner
Chairman
Senate Armed Services Committee

Chairman WARNER. I thank my good colleague, Senator McCain, and I would now turn to you for opening remarks, and then we will turn to Mr. Reed.

Senator MCCAIN. Thank you very much, Mr. Chairman. I would like to say how encouraged I am by Boeing's decision not to write off any part of the payments it was required to make on the settlement agreement. Many have boasted about how dedicated they are to reform and new beginnings. Actions speak louder than words and the fact of the matter is that Boeing did not have to make the decision it made on deductibility, but it did. When coupled with the internal changes the company has made, what Boeing did here conveys to me how serious the company is to truly reforming and starting fresh.

I welcome that change and look forward to working with the company on addressing how we can reform a broken defense procurement system. I have a few concerns that arise from this global settlement agreement. First, why did the DOJ use a deferred prosecution agreement in this particular case. Deferred prosecution agreements under which the Department agrees not to prosecute the wrongdoer in exchange for his satisfying certain stipulations have been around for a while. But its use in high-quantum corporate criminal cases is of relatively recent vintage. While their increased use in such cases may give rise to concern, unique concerns

are raised by their use to address defense procurement fraud and public corruption.

Where a corporate wrongdoer might have conspired to commit public corruption, are deferred prosecutions an appropriate vehicle? Given consolidation in the defense sector, are major defense firms in fact too few and too big to prosecute?

My other concerns relate to how the DOJ handled the deductibility issue. In response to a letter that Chairmen Warner and Grassley sent, the Department explained its policy is not to address deductibility in its fraud settlement agreements. I repeat, the Department said it was not its policy to address deductibility in its fraud settlement agreements. How then can you know whether the agreement is meaningful or not?

While the DOJ's policy may make sense in relatively low-quantum settlements, in high-quantum settlements it might not. That is because how the government addresses corporate misconduct that gives rise to settlements of $100 million or more has policy implications. If the settlor is permitted to recover what it pays to the Government from any third party, that is either the taxpayer or its insurers, the deterrence value and punitive effect of the settlement will be diluted.

In defense procurement fraud and public corruption cases like this one, deterrence value and punitive effect are everything. Therefore, in high-quantum corporate fraud settlements the Department should revise its policy by specifically allocating the payments under a given settlement as either penalty or otherwise and specifically prohibit the settlor from recovering penalty from any third party. Particularly in defense procurement fraud cases, this could really make a difference.

I thank you, Mr. Chairman, for holding this hearing.

Chairman WARNER. Thank you very much, Senator McCain.

The letter to which I referred and you referred, dated June 29, signed by myself and you and Charles Grassley, has been put in the record. The DOJ reply dated July 14 to our letter likewise will be put into the record.

[The information referred to follows:]

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

July 14, 2006

The Honorable John Warner
Chairman
Committee on Armed Services
United States Senate
Washington, D.C. 20510

Dear Senator Warner:

This responds to your letter of June 29, 2006, to the Attorney General concerning tax and other issues in connection with the Department's recent $615 million settlement with The Boeing Company. We are sending a similar response to the other signatories on your letter.

Your letter specifically asks the Department to consider: (1) the tax treatment of Boeing's payments under a settlement agreement and (2) whether the payments might ultimately be made by Boeing's insurers or other third parties. As you may know, the parties reached a tentative agreement on the amount of the settlement in the early weeks of May, and signed the final agreements (civil and criminal) on June 30, 2006. Although we received your letter after the agreements were signed, we believe we acted properly by following our standard procedure, which is to ensure that our agreements are tax neutral and to leave the difficult issues of deductibility to the expertise of the tax lawyers and the Internal Revenue Service (IRS). With regard to the second issue, our concern is that the Government's claims are paid. Therefore, we do not get involved in private agreements parties may have with third party payers. As you probably know by now, however, a Boeing spokesperson reported to *The New York Times* that the company does not have insurance to cover the payments. (Leslie Wayne, "3 Senators Protest Possible Tax Deduction for Boeing in Settling U.S. Case," *The NewYork Times*, July 7, 2006, at C3.)

Elaborating on the tax issues, it is the Department's policy and practice in settling fraud investigations to remain tax neutral and defer those issues to consideration by the IRS after settlement. The Department and the IRS agreed some time ago that this approach was both practicable and appropriate. It is practicable because it separates distinct issues, allowing for more efficient resolution. As was certainly exemplified by this case, civil fraud negotiations are complex enough, often involving contested theories of liability, applied alternatively or cumulatively, to separate parts of an investigation in which the facts, too, are in dispute. In the end, the parties may agree on no more than a settlement amount. Were every fraud negotiation to devolve into an assessment of tax liability as well as fraud liability, resolution would not only

require more time, it would require the involvement of both the company's and the Government's tax lawyers. This is where the appropriateness of the Department's tax neutral approach comes in. The policy defers to the IRS in its role as arbiter of its rules and regulations to evaluate the taxpayer's obligation based on the facts and the law.

As a general matter, compensatory damages are deductible while penalties are not. The Department and the IRS have devised a system that routinely provides the IRS the information it needs to ensure that taxpayers are treating their settlement payments properly. Indeed, this information-sharing arrangement is consistent with the Government Accountability Office's recommendation that the IRS "work with federal agencies that reach large civil settlements to develop a cost effective permanent mechanism to notify IRS when such settlements have been completed and to provide IRS with other settlement information that it deems useful in ensuring the proper tax treatment of settlement payments." Government Accountability Office, *Tax Administration: Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments*, GAO-05-747, p. 26 (September 2005).

The system is working. Boeing has paid $565 million in resolution of the Government's civil claims and a $50 million monetary penalty pursuant to a criminal agreement. The Department and IRS are already in contact and sharing information to ensure that Boeing meets its tax obligations under the laws established by Congress, as it has its fraud liability.

We hope this information is helpful. Please do not hesitate to contact this office if you would like additional assistance regarding this or any other matter.

Sincerely,

William E. Moschella
Assistant Attorney General

cc: The Honorable Carl Levin
Ranking Minority Member

Chairman WARNER. My colleague from Rhode Island.

Senator REED. Thank you very much, Mr. Chairman. I join you in welcoming the witnesses today for this hearing. For the last several years the Boeing Company has been operating under an ethical cloud. First Boeing officials were determined to have improperly obtained the proprietary information of a competitor on the EELV program. Then Boeing officials were found to have improperly hired a senior Air Force official and her daughter while that official was making critical acquisition decisions favoring the company on a series of Air Force programs.

These actions contributed to the collapse of the $25 billion Air Force tanker lease proposal and helped end the public career of the then-Secretary of the Air Force.

The global settlement that our witnesses will discuss brings to an end the criminal phase of this issue, at least as it pertains to the Boeing Company. I welcome this development. The ethical cloud hanging over Boeing has not been good for the company, the

Air Force, or the country. Boeing is our second largest defense contractor, handling roughly $20 billion of DOD contracts every year. Boeing is also a major player in the U.S. economy, employing tens of thousands of workers around the country in its commercial and defense businesses. We need the goods and services that Boeing provides, but we cannot purchase them at the expense of our legal and ethical standards.

Mr. Chairman, this settlement agreement does not end the tanker lease scandal. The problems that we experienced with the tanker lease laid bare significant shortcomings in DOD's acquisition organization, workforce, policies, and practices. The systemic problems still remain to be addressed. I hope that we will have DOD officials at future hearings so that we can hear about the steps that they are taking to resolve these issues.

I look forward to the testimony of our witnesses. Thank you, Mr. Chairman.

Chairman WARNER. Thank you, Senator Reed.

In my opening comments I failed to recognize Mr. Rosenberg. We welcome you, the current United States Attorney for the Eastern District of Virginia, known as Mr. McNulty's successor. Would that be correct?

Mr. ROSENBERG. It is correct.

Chairman WARNER. Would you introduce Mr. Schiffer?

STATEMENT OF HON. PAUL J. MCNULTY, DEPUTY ATTORNEY GENERAL, UNITED STATES DEPARTMENT OF JUSTICE; ACCOMPANIED BY STUART SCHIFFER, DEPUTY ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION; AND CHARLES ROSENBERG, UNITED STATES ATTORNEY FOR THE EASTERN DISTRICT OF VIRGINIA

Mr. MCNULTY. Yes, I will, Mr. Chairman. Stuart Schiffer is with me today.

Chairman WARNER. Speak into the mike with a little more force, counsel.

Mr. MCNULTY. Thank you, Mr. Chairman.

Chairman WARNER. Pretend you are in the courtroom and you are ready to get the jury's attention. Here we go.

Mr. MCNULTY. He is the Deputy Assistant Attorney General for the Civil Division. He is a 43-year veteran of the DOJ.

Mr. Chairman, Senator McCain, Senator Reed, I appreciate the opportunity to appear before this committee regarding the settlement with the Boeing Company. As I have just said, Chuck Rosenberg, the U.S. Attorney from the Eastern District of Virginia, whose office handled the Darleen Druyun-Michael Sears portion of this case. Also Stuart Schiffer from the Civil Division oversaw the civil settlement.

Mr. Chairman, I thank you very much for your kind support and kind words today.

This enforcement action is the largest penalty ever paid by a defense contractor and is one of the largest civil fraud recoveries of all time. I would like to briefly describe the Boeing investigation and the significant features of the settlement agreements. The Boeing matter involves two investigations, both begun more than 3 years ago. In September 2002, the United States Attorney's Office

for the Central District of California in Los Angeles opened an investigation into allegations that Boeing had improperly used proprietary information obtained from a competitor, Lockheed Martin Corporation, to compete for launch services contracts under the Air Force's Evolved Expendable Launch Vehicle program, known as the EELV.

The investigation focused on allegations involving Kenneth Branch, a former Lockheed employee, who was hired to work on the EELV proposal of Boeing's predecessor, McDonnell Douglas. Branch was hired by a Boeing employee by the name of William Erskine. In June 1999 another Boeing employee reported to Boeing management that Erskine had hired Branch in return for Branch providing Erskine with Lockheed documents pertinent to Lockheed's EELV proposal.

Boeing conducted an internal investigation and in August 1999 terminated Branch and Erskine. Boeing also informed Lockheed and the Air Force that it had certain documents proprietary to Lockheed in its possession. But little was done at that time because Boeing identified only a few, relatively insignificant documents.

In November 2001, in the course of civil litigation between Lockheed and Boeing, Lockheed discovered that Boeing had additional documents in its possession. This discovery prompted Lockheed to refer the matter to the Air Force and the DOJ, which triggered an investigation by the Defense Criminal Investigative Service (DCIS), along with the Los Angeles U.S. Attorney's Office. Boeing hired outside counsel to conduct an internal investigation.

At the instigation of the DOJ, the EELV investigation expanded into an investigation of similar launch service contracts with National Aeronautics and Space Administration (NASA) where Boeing and Lockheed were again competitors. The NASA allegations involved a billion dollar task order that was awarded to Boeing sole source. The issue there was whether Boeing's alleged fraud in the EELV competition gave the company an unfair advantage in the NASA procurement, so much so that NASA was persuaded to award the task order to Boeing without giving Lockheed even the opportunity to compete. The Air Force Office of Special Investigations and the NASA Office of Inspector General (IG) joined in the investigation.

On July 17, 2003, a grand jury indicted Branch and Erskine on charges of conspiring to conceal and possess trade secrets in violation of U.S.C. 1832, a few sections there. Both remain charged, with their trial currently scheduled to begin in late 2006.

In September 2003, when I was the United States Attorney for the Eastern District of Virginia, we opened an investigation of the circumstances surrounding the hiring of Darleen A. Druyun, a senior Air Force official, by Boeing. This was about a year after the United States Attorney for the Central District of California opened that office's investigation. Druyun had been the Principal Deputy Assistant Secretary of the Air Force for Acquisition and Management and in that position supervised and oversaw the management of the Air Force acquisition programs until her retirement in November 2002, when she was hired by Boeing.

In the summer 2003, and in large measure because of the efforts of this committee, questions arose about the proposed KC–767A

tanker lease from Boeing and the contemporaneous hiring of Druyun by Boeing in late 2002. This triggered an investigation by the DCIS and the Federal Bureau of Investigation in conjunction with the U.S. Attorney's Office in Alexandria, Virginia, as well as an internal investigation by the outside counsel hired by Boeing.

During the investigation it also came to light that in the summer of 2000 Druyun had asked Boeing to hire her future son-in-law and later her daughter. Boeing acceded to both requests. During this period from 2000 to 2002, Druyun played a role in the negotiation, award, and modification of numerous Boeing contracts. Although Druyun has admitted bias as a result of Boeing's favors, her admissions were insufficient to establish any direct specific loss.

Boeing fired Sears and Druyun, both of whom pleaded guilty to violations of conflict of interest laws and have served terms in prison.

Now, the facts are far more complicated, but that is the gist of the two investigations. On June 30, 2006, Mr. Chairman, the United States entered into a global settlement with Boeing for $615 million. This included a $50 million monetary penalty pursuant to a criminal prosecution agreement and $565 million in resolution of civil claims. As I said at the outset of my statement, this settlement is the largest ever by the Department with a defense contractor.

Now, I am going to briefly describe the criminal and civil resolutions and I am not going to attempt to read everything in the statement. The statement is very thorough with regard to the details of those, so I am going to just highlight some things.

Following the Los Angeles indictments of Branch and Erskine and the criminal convictions of Druyun and Sears, the Department turned its sights to holding the Boeing Company accountable for the conduct of its employees. We entered into lengthy discussions with Boeing. Based on the factors outlined in the Department's Principles of Federal Prosecution of Business Organizations, the United States Attorney's Office decided to enter into an agreement with Boeing not to seek criminal charges against the company. Those factors include Boeing's timely and voluntary cooperation in the Druyun matter, its willingness to cooperate in the investigations, the company's policies and procedures in place at the time of the conduct, the remedial actions taken by Boeing, including efforts to improve and make more effective its corporate compliance program, its termination of wrongdoers, and the adequacy of other remedies, including civil settlement.

The criminal agreement obligated Boeing, among other things, to pay a $50 million criminal monetary penalty and to implement an effective ethics and compliance program, with particular attention to the hiring of former government officials and the handling of competitor information. In addition, Boeing accepted and acknowledged responsibility for the conduct of its employees in the EELV and Druyun matters.

The U.S. Attorney's Office may prosecute Boeing for the Druyun matter or assess an additional monetary penalty if Boeing violates the agreement during the next 2 years. Meanwhile, as the facts were becoming known in these investigations, the government's civil attorneys began formulating theories of recovery. Now, in

doing this the government has several tools at its disposal, including the False Claims Act (FCA) and the Procurement Integrity Act. These tools come with a variety of penalties and remedies. The monetary penalties are both compensatory and punitive. They are not necessarily tied explicitly to the government's loss and are not therefore entirely compensatory as that term is used for tax deduction purposes. The statement that I have submitted, Mr. Chairman, outlines those tools and remedies in more detail.

Some of these remedies are mutually exclusive, which means we can collect on one but not both. Others are cumulative. Furthermore, different remedies or a different mix of remedies can and do apply to different factual segments of the case.

For example, the remedies available to address Boeing's alleged fraudulent procurement of the EELV and NASA contracts are different than those to address contracts allegedly tainted by the conflict of interest engendered by Boeing's negotiations with Druyun in hiring her children.

Cases such as Boeing's are further complicated by the fact the contracts at issue are critical to national security. They cannot practically be terminated. The government must go forward with the contracts and attempt to measure today the impact of Boeing's fraud on the future. The Air Force and NASA contracts at issue here are in their relative infancy. Boeing is likely to continue to perform these contracts through at least 2020. No doubt an element of the government's claim was intended to address future impact, in contrast to past loss.

The point is that the government reaches its ultimate demand through a careful analysis of many complex issues, including the strengths and weaknesses of the facts and overlapping legal theories of recovery.

Now, as a general matter the government initiates settlement discussions by presenting its version of the facts and asserting applicable claims and remedies. A company is then given the opportunity to respond before a matter proceeds to litigation. In this matter, Boeing availed itself of that opportunity. From its own internal investigations, Boeing presented additional and in some instances countervailing facts, as well as legal arguments bearing on the matter.

In the statement I summarize the extensive differences that exist on both the factual and legal matters. It gives a very clear picture of the complexity of the investigation and the negotiations in this civil enforcement action with regard to Boeing.

The final amount of a civil settlement reflects the uncertainty of certain provable facts and sustainable legal theories. While there is give and take on both sides, the compromise ultimately reached is in the amount of the settlement, not in all the underlying facts and legal issues. Indeed, if we were to insist on reaching agreement on the facts and the law that supported the settlement, I fear that every fraud investigation would drag out for years in court and leave these matters for the judge and the jury to determine the facts and the basis for liability.

It is important to remember that the goal of a civil settlement is to protect the monetary interests of the government. We do that

best by insisting that the parties agree to a settlement amount and that the government's claims are paid.

Senator McCain has raised the tax issue and in the statement I have a lengthy discussion as well of the tax matter in this case. I will defer discussing that perhaps for the question and answer time, and so I will just summarize that the Department followed its longstanding policy with regard to the tax issue here, which has been in place and which was implemented in consultation with the Internal Revenue Service (IRS), of deriving settlement amounts using tax-neutral language.

In conclusion, Mr. Chairman, members of the committee, I believe this was an outstanding resolution of an extremely difficult case. Boeing has paid the United States $615 million in penalties and damages. Boeing has accepted responsibility and is taking action to ensure that such activity does not impede its efforts to continue to do business with the United States in the future.

The matter, while it was extensive and involved considerable time, was expeditious in relation to litigation and how litigation can often take a very long period of time, especially when there are a number, a large number of issues at stake. So we also believe that this matter was brought to a resolution in a relatively timely way.

Finally, Mr. Chairman, I look forward to talking about procurement fraud generally and the efforts by the DOJ and our law enforcement partners to be as proactive as possible to pursue procurement fraud, especially in the defense arena, as aggressively as possible. You referred to the initiative in the Eastern District of Virginia and now as Deputy Attorney General I hope that we can have a national initiative that will really emphasize a coordinated approach to combatting procurement fraud.

Thank you very much, Mr. Chairman, for your attention, and I look forward to your questions.

[The prepared statement of Mr. McNulty follows:]

PREPARED STATEMENT BY PAUL MCNULTY

Mr. Chairman, I appreciate the opportunity to appear before you to address the committee regarding the recent settlement with The Boeing Company. I think that by reaching a common understanding of the facts and circumstances surrounding this agreement, you will agree that the Department reached a good settlement in the interests of the American taxpayer. Let me briefly describe the Boeing investigation and how the Government negotiates settlements in such cases.

INVESTIGATION

In fact, Boeing involved two investigations, both begun more than 3 years ago. In September 2002, the United States Attorney's Office for the Central District of California, in Los Angeles, opened an investigation into allegations that Boeing had improperly used proprietary information obtained from a competitor, Lockheed Martin Corporation, to compete for launch services contracts under the Air Force's Evolved Expendable Launch Vehicle Program (EELV). The investigation focused on allegations involving Kenneth Branch, a former Lockheed employee who was hired to work on the EELV proposal of Boeing's predecessor, McDonnell Douglas. Branch was hired by a Boeing employee by the name of William Erskine. In June 1999, another Boeing employee reported to Boeing management that Erskine had hired Branch in return for Branch providing Erskine with Lockheed documents pertinent to Lockheed's EELV proposal. Boeing conducted an internal investigation and, in August 1999, terminated Branch and Erskine. Boeing also informed Lockheed and the Air Force that it had certain documents proprietary to Lockheed in its posses-

sion, but little was done at that time because Boeing identified only a few relatively insignificant documents.

In November 2001, in the course of civil litigation between Lockheed and Boeing, Lockheed discovered that Boeing had additional documents in its possession. This discovery prompted Lockheed to refer the matter to the Air Force and the Department of Justice (DOJ), which triggered an investigation by the Defense Criminal Investigation Service (DCIS) along with the Los Angeles United States Attorney's Office. Boeing hired outside counsel to conduct an internal investigation.

At the instigation of the DOJ, the EELV investigation expanded into an investigation of similar launch services contracts with National Aeronautics and Space Administration (NASA) where Boeing and Lockheed were again competitors, and another Air Force procurement for the Exoatmospheric Kill Vehicle (EKU). The NASA allegations involved a billion-dollar task order that was awarded to Boeing sole source. The issue there was whether Boeing's alleged fraud in the EELV competition gave the company an unfair advantage in the NASA procurement, so much so that NASA was persuaded to award the task order to Boeing without giving Lockheed even the opportunity to compete. The Air Force Office of Special Investigations and the NASA Office of the Inspector General joined in the investigation.

On July 17, 2003, a grand jury indicted Branch and Erskine on charges of conspiring to conceal and possess trade secrets in violation of 18 U.S.C. §§ 1832 (a)(1), (a)(3), and (a)(5). Both remain charged with their trial currently scheduled to begin in late 2006.

In September 2003, when I was the United States Attorney for the Eastern District of Virginia, we opened an investigation of the circumstances surrounding the hiring of Darleen A. Druyun, a senior Air Force official, by Boeing. This was about a year after the United States Attorney for the Central District of California opened that office's investigation. Druyun had been the Principal Deputy Assistant Secretary of the Air Force for Acquisition and Management, and in that position supervised and oversaw the management of the Air Force acquisition programs until her retirement in November 2002, when she was hired by Boeing.

In the summer 2003, Congress and the media had begun asking questions about the proposed KC–767A tanker lease from Boeing and the contemporaneous hiring of Druyun by Boeing in late 2002. This triggered an investigation by the DCIS and the Federal Bureau of Investigation in conjunction with the United States Attorney's Office in Alexandria, as well as an internal investigation by outside counsel hired by Boeing.

During the investigation, it also came to light that in the summer 2000, Druyun had asked Boeing to hire her future son-in-law and later her daughter. Boeing acceded to both requests. During this period—from 2000–2002—Druyun played a role in the negotiation, award, and modification of numerous Boeing contracts. Although Druyun has admitted bias as a result of Boeing's favors, her admissions were insufficient to establish any direct or specific loss. Boeing fired Sears and Druyun, both of whom pleaded guilty to violating the conflict of interest laws and have served terms in prison.

The facts are far more complicated, but that is the gist of the two investigations. On June 30, 2006, the United States entered into a global settlement with Boeing for $615 million. This included a $50 million "monetary penalty" pursuant to a criminal deferred prosecution agreement and $565 million in resolution of civil claims. This settlement was the largest ever by the Department with a defense contractor.

CRIMINAL RESOLUTION

The United States Attorney's Offices separately entered into lengthy discussions with Boeing. In Los Angeles, a grand jury indicted Branch and Erskine, the two Boeing employees responsible for securing the Lockheed documents in an effort to win launch services contracts under the Air Force's EELV program. Meanwhile, as I mentioned, the investigation in Alexandria resulted in Boeing terminating Druyun and Sears for cause in November 2003, and in their subsequent guilty pleas. In April 2004, Druyun pleaded guilty to negotiating employment with Boeing while she was participating personally and substantially as an Air Force official overseeing the negotiation of the proposed multi-billion dollar lease of Boeing KC–767A tanker aircraft. In February 2005, Sears was convicted on related charges. Both Druyun and Sears were sentenced to terms in prison.

Following Sears' conviction, we entered into discussions with Boeing concerning a resolution of the criminal case. After a period of separate negotiations, the two United States Attorneys' Offices joined forces to pursue a global resolution of the two investigations.

Based on the factors outlined in the Department's Principles of Federal Prosecution of Business Organizations, the United States Attorneys' Offices decided to enter into an agreement with Boeing not to seek criminal charges against the company. Those factors include Boeing's timely and voluntary cooperation in the Druyun matter; its willingness to cooperate in the investigations; the company's policies and procedures in place at the time of the conduct; the remedial actions taken by Boeing, including efforts to improve and make more effective its corporate compliance program; its termination of the wrongdoers; and the adequacy of other remedies, including civil settlement. The criminal agreement obligated Boeing, among other things, to pay a $50 million criminal monetary penalty and to implement an effective ethics and compliance program, with particular attention to the hiring of former Government officials and the handling of competitor information. In addition, Boeing accepted and acknowledged responsibility for the conduct of its employees in the EELV and Druyun matters. The United States Attorney's Office may prosecute Boeing for the Druyun matter, or assess an additional monetary penalty, if Boeing violates the agreement during the next 2 years.

CIVIL RESOLUTION

The Boeing investigations posed a complex set of facts and equally complex issues of law. Although these issues also weighed into the criminal agreement, we discuss them here as they have direct bearing on the civil settlement amount.

As the facts were being developed, the Government's civil attorneys began formulating theories of recovery. The Government's principal civil fraud remedy is the False Claims Act (FCA). This statute enables the Government to recover three times its actual damages, plus a civil penalty of $5,500 to $11,000 for each false claim a "person," which includes a corporation, knowingly submits or causes to be submitted to the Government. The single portion of the damages is intended to compensate the Government for its out-of-pocket loss—restitution, if you will—while the multiple and civil penalty portions are over and above those costs. The multiple and civil penalty portions of the False Claims Act are intended as a deterrent, signaling to those who might commit fraud that the consequences are far more onerous than merely paying the Government back money that wasn't theirs to begin with. They also defray the costs of investigation and prosecution and address less tangible injuries such as harm to the integrity of public programs and contracts.

But the FCA isn't our only remedy. We have many others. The remedies we considered and asserted against Boeing included the FCA, the Procurement Integrity Act (PIA), common law claims for unjust enrichment, fraudulent procurement of contracts, and inducing a breach of fiduciary duty, as well as other statutory and common law remedies. The PIA entitles the Government to recover "civil penalties," as do many other statutes. The common law remedies range from voiding contracts and recovering consideration paid to recovering profits. As you can see, these remedies are not tied explicitly to the Government's loss. As such, they are not entirely "compensatory" as that term may be used to determine deductibility for tax purposes. Rather, they are measured by the wrongdoer's ill-gotten gains or designed to enable the Government to rid itself of tainted contracts.

Some of these remedies are mutually exclusive, which means we can collect on one but not both. Others are cumulative. Furthermore, different remedies—or a different mix of remedies—can and do apply to different factual segments of the case. For example, the remedies available to redress Boeing's alleged fraudulent procurement of the EELV and NASA contracts are different than those to redress contracts allegedly tainted by the conflict of interest engendered by Boeing's negotiations with Druyun and hiring her children. Cases such as Boeing are further complicated by the fact that the contracts at issue are critical to the national security. They cannot practicably be terminated. The Government must go forward with the contracts and attempt to measure today the impact of Boeing's fraud on the future. The Air Force and NASA contracts at issue here are in their relative infancy. Boeing is likely to continue to perform these contracts through at least 2020. No doubt, an element of the Government's claims was intended to address future impact, in contrast to past loss.

The point is that the Government reaches its ultimate demand through a careful analysis of many complex issues, including the strengths and weaknesses of the facts and overlapping legal theories of recovery.

While the Government is performing its investigation and analyzing possible remedies, the putative defendant is doing the same. As a general matter, the Government initiates settlement discussions by presenting its version of the facts and asserting applicable claims and remedies. Putative defendants are then given the opportunity to respond before a matter proceeds to litigation. In this matter, Boeing

availed itself of that opportunity. From its own internal investigations, Boeing presented additional, and in some instances, countervailing facts as well as legal arguments bearing on the matter.

Both parties vigorously advocated the facts and the law in their favor. The contested issues in Boeing were legion and complex. In the EELV matter, they included whether the documents contained "bid or proposal" or "source selection" information within the meaning of the Procurement Integrity Act; whether the documents were significant and gave Boeing an unfair advantage, or were dated and irrelevant; whether Boeing's final bid was derived independently by persons who had never seen the documents or had access to the information and, if so, whether that mattered. There were also issues in determining whether the costs incurred by the Air Force in reallocating the launch missions between Boeing and Lockheed were proximately caused by Boeing's conduct and a proper basis for damages, or whether other factors, e.g., Lockheed's misguided proposal strategy and a failing commercial market, warranted the reallocations. (In 1998, when the first 28 missions were awarded, everyone anticipated a robust commercial market and bid the missions accordingly, expecting that the volume would reduce the price per launch. By 2003, when the Air Force reallocated the missions, it was apparent that a commercial market had not materialized, resulting in increased prices for the reallocated missions.) Finally, there were issues of causation relating to whether Boeing's conduct with respect to the EELV could fairly be said to have impacted on the NASA award.

The facts were relatively clear and undisputed in the Druyun matter. Of course, the basic facts were set forth in the criminal plea agreements of Druyun and Sears. Even so, the legal theories were vigorously contested. These included whether Boeing's conduct sufficiently tainted the contracts to give rise to civil penalties under the FCA, whether there was evidence to demonstrate provable impact on the contracts, and whether Boeing's favors in hiring Druyun's children violated the gratuities statute or rose to the level of a conflict of interest entitling the Government to common law remedies for recovering Boeing's profits under the affected contracts.

The amount of a civil settlement reflects the uncertainty of certain provable facts and sustainable legal theories. While there is give and take on both sides, the compromise ultimately reached is in the amount of the settlement, not in the underlying facts or legal issues. Indeed, if we were to insist on reaching agreement on the facts and the law that supported the settlement, I fear that every fraud investigation would end up in court for the judge and the jury to determine the facts and the basis for liability.

It is important to remember that the goal of a civil settlement is to protect the monetary interests of the Government. We do that best by insisting that the parties agree to a "settlement amount." Likewise, our concern is that the Government's claims are paid. Therefore, we do not get involved in private agreements parties may have with third party payers such as insurers.

Certainly, there are terms we include in every settlement agreement to protect important Government interests. Although frequently contested, these terms are not controversial. For example, consistent with the Federal Acquisition Regulation, contractors agree not to charge their attorneys' fees, their costs of investigation, and the settlement payment to Government contracts. But we do not require an admission of wrongdoing or, once again, agreement on the underlying basis of the settlement. To do so, would impede negotiations without serving the purpose of civil settlement. Moreover, the Government has better and more beneficial ways of handling these issues.

TAX ISSUES

Regarding the tax issues raised by certain members, the Department followed its longstanding policy, which has been in place for many years and which was implemented in consultation with the Internal Revenue Service (IRS), of characterizing settlement amounts using tax neutral language. Attorneys negotiating our fraud cases use the expertise and experience they have acquired as civil fraud attorneys to protect the public interest that prompted the suit. In doing so, as I've just discussed in relation to the Boeing settlement, they focus on the legal and evidentiary merits of the particular case, and the assessment of risk attendant to further litigation and trial. For example, in negotiating the settlement of a fraud investigation, the Department's attorneys consider applicable legal authorities of differing relative weights, the strength of the evidence establishing various fraudulent scenarios, and the various methods for measuring damages and/or assessing penalties applicable to each circumstance. There also may be disputed facts concerning the degree of a defendant's culpability that would bear on the appropriate multiple of single damages. In the end, the parties may agree on no more than a settlement amount to

resolve the investigation without agreeing on a value for the individual parts of the investigation or the legal basis. In arriving at the $565 million civil settlement in this case, Boeing was well aware that the Government was asserting claims against it that were well beyond seeking merely compensatory damages. I note from reports in the press that Boeing has decided not to "write-off" the settlement for tax purposes. NYTimes.com, Boeing Reports $160 Million Loss, http://www.nytimes.com/aponline/business/AP-Earns-Boeing.html?ex=1154577600&en=13abaf8551a80f14&ei=5070&emc=eta1 (last visited July 26, 2006).

The Department's "tax neutral" approach to these cases ensures that the IRS retains sufficient latitude to evaluate the taxpayer's obligation in its role as taxing authority and final arbiter of its rules and regulations. In almost all fraud cases, such as the matter involving Boeing, DOJ lawyers simply lack the necessary expertise in the intricacies of the tax code, and the knowledge of a defendant's particular tax situation, that would warrant substituting their judgment for that of the IRS. Indeed, in its recent report on this issue in which the Government Accountability Office (GAO) examined large civil settlements attained by Federal agencies over a multiyear period, the GAO noted that "it may not always be clear which payments are deductible, in part because the Internal Revenue Code does not address the deductibility of all types of payments that may be made pursuant to a civil settlement and the statutes imposing the payments may be unclear regarding whether they are punitive, compensatory, or both." GAO Report No. 05–747, Tax Administration: Systematic Information Sharing Would Help IRS Determine the Deductibility of Civil Settlement Payments, 1 (September 15, 2005).

After concluding its review of the DOJ's civil settlement process (and that of other Federal agencies), the GAO did not conclude that Department attorneys should negotiate the tax treatment of these civil settlements. Rather, the GAO concluded that the solution was to be found in systematic information sharing among Federal agencies and the IRS that would be beneficial to ensuring the correct tax treatment of the settlement amounts. The Department has for several years now worked with the IRS to facilitate follow-on investigations of the tax ramifications of our larger fraud settlements. In the wake of this GAO report, we also have initiated meetings with IRS personnel to facilitate a systematic sharing policy that can expand this process into other enforcement areas within the jurisdiction of the DOJ.

I add two other points to this discussion: First, the Department's current tax neutral policy encourages greater consistency of the tax treatment of these settlements, since it avoids a tax treatment that may vary among the Federal districts in which such settlements occur. Again, these determinations are better left to the IRS and not to individual lawyers within the DOJ who are positioned throughout the country.

Second, I think it is fair to assume that many offers of settlement that the Department receives from defendants such as Boeing are colored by the defendant's own assessment of the subsequent tax treatment. It seems likely that a defendant's settlement offer to the Government will be less generous if it also had to agree that the full amount was nondeductible. Likewise, a defendant's civil settlement offer may be increased in recognition that at least a portion of the amount paid directly to the Government will provide favorable tax treatment. Assuming the subsequent treatment is permitted by the tax code, there is nothing inherently wrong with such considerations. In fact, the inherent uncertainty of that liability may result in more favorable settlements for the Government. If, however, tax treatment were required as part of the settlement process, the Government would be put at a distinct disadvantage. Bear in mind that it is impossible for Department attorneys to know the intricacies of our defendants' financial affairs to such a degree that we can comfortably predict the bottom-line impact a certain deduction will have on a defendant's tax bill. So, if a defendant indicated in the course of a settlement that its offer to the Government would be reduced by $X to accommodate the ensuing tax bill it faced as a result of the negotiated tax treatment, we simply lack the ability to meaningfully verify that. Such an argument by defendants which, we can assume, would sometimes be disingenuous or simply mistaken, could result in settlements less beneficial to the Government since the Government attorneys could not verify a key element of the negotiation. Only the IRS has the authority and the technical skill to make such judgments, after receipt of the necessary financial information from the taxpayer.

CONCLUSION

In conclusion, this was an outstanding resolution to an extremely difficult case. Boeing has paid the United States $615 million in penalties and damages—more than any other defense contractor in a fraud matter. Boeing has accepted responsi-

bility and is taking action to ensure that such activity doesn't impede its efforts to continue to do business with the United States in the future. Finally, the Department's policy of remaining tax neutral—a longstanding policy established in consultation with the IRS and recommended by the GAO—is sound. That policy leaves civil fraud issues to the Government's fraud experts and the tax implications of any settlement (often unknowable during negotiations) to the Government's tax experts. I firmly believe that ultimately, this policy is the only appropriate way to handle these matters, the most efficient to resolve both civil fraud cases and the tax ramifications of those cases, and the most beneficial to the American taxpayer.

Chairman WARNER. Thank you very much, Mr. McNulty. Do either of your colleagues wish to supplement the written statement?

Mr. MCNULTY. No, Mr. Chairman. They will just be here to help with questions.

Chairman WARNER. As I went back over this case in preparation for this hearing, the decision which was extremely difficult, you have outlined the reasons why you reached the decision, no criminal charges against the company. But did not the record reflect that Boeing's CFO was acting in every way to benefit the company rather than himself when he hired Mrs. Druyun?

Mr. MCNULTY. I think that is a fair characterization, Mr. Chairman, that the actions of corporate officers in these kinds of cases normally involve benefit to the company. In fact, that provides the legal basis for the DOJ to pursue the company. Now, whether the Department or the government prosecutes the company or reaches a resolution of another sort is determined on a case-by-case basis. But the very fact that we can go against the company is based upon the legal fact that the senior official has taken actions which benefit the company and the official is acting on behalf of the company.

Chairman WARNER. He may have been eligible for a bonus or something for getting Druyun to come over and join the company. So there may have been some benefits to him personally.

Mr. MCNULTY. Sure.

Chairman WARNER. But here he primarily was acting on behalf of the company when he did that and the company was the direct beneficiary.

Mr. MCNULTY. That is right, Mr. Chairman.

Chairman WARNER. Do you not impute in some respects the wrongdoings of a person in his position to the company as a basis for proceeding with a criminal charge?

Mr. MCNULTY. That is correct. You have essentially stated the legal basis for why the government proceeds against companies and not just individuals. Now, that then presents the question, should the company be charged criminally or not. You, I am sure, have heard of what has become rather well known now, the Thompson Memo.

Chairman WARNER. That was my next question.

Mr. MCNULTY. Okay. Then I will pause.

Chairman WARNER. Let us talk about that Thompson Memo, which provides the guidelines for prosecution of corporations, and why they were established and if they were used in this case.

Mr. MCNULTY. Just to summarize that point, my predecessor, Larry Thompson, Deputy Attorney General, at the beginning of the corporate fraud initiative of this administration, which has succeeded in prosecuting nearly 1,000 corporate executives over a pe-

riod of 4 years, sent out a direction to all United States Attorneys giving guidance on what should be considered when making the decision as to whether the corporation, the business organization, should be prosecuted. It laid out nine factors, and that has received considerable attention more recently because some in the legal community have raised objections to some of the factors to be considered.

But that kind of consideration is what is at work in all of these cases when looking at the question of charging the corporation criminally, not just the individuals. In my statement when I talked about the facts involved in reaching a settlement with Boeing, I referred to the self-reporting, the cooperation, the nature of the conduct in relation to the company, and the efforts to try to police, monitor, and establish new procedures. All those things are a part of the Thompson Memo for consideration and what we found to be present in some regard in this case, which led to the decision not to prosecute but to enter into an agreement, a deferred prosecution agreement.

Chairman WARNER. I think it would be helpful for the committee if you took the Thompson Memo, as you say, there are nine basic criteria, and state each criteria and beneath that, the reasons why you felt it was or was not applicable in this decision process, so that this decision should be supported by a very complete record.

[The information referred to follows:]

Thompson Memorandum Criteria As Applied to the Druyan case: Eastern District of Virginia

1. The Nature and Seriousness of the Offense.

The criminal offense of Michael Sears, the Chief Financial Officer and second highest ranking executive of the Boeing Corporation ("Boeing" or "the Company"), was a serious offense. The actions of Sears aided and abetted a senior Air Force official, Darleen Druyun, in her illegal negotiation of employment with the nation's second largest defense contractor ("Druyun Matter").

2. The Pervasiveness of Wrongdoing Within the Company, Including the Complicity in, or Coordination of, the Wrongdoing by Boeing Management.

While senior management of Boeing was aware that Michael Sears sought to hire Darleen Druyun, there was no evidence developed in the investigation, or cooperation of Michael Sears, that senior management other than Michael Sears was aware that Darleen Druyun had not disqualified herself from acting on Boeing matters prior to her negotiations. The illegal actions of Michael Sears were not condoned by other senior management, which took swift action in terminating Sears for cause in November 2003 when an internal investigation uncovered the illegal conduct.

3. The Company's Past History

Boeing has no history of improperly hiring government officials or of related offenses.

4. The Company's Timely and Voluntary Disclosure, and its Willingness to Cooperate in the Investigation.

Boeing provided timely and voluntary cooperation relating to the Druyun Matter investigation conducted in the Eastern District of Virginia. First, Boeing retained outside counsel to conduct an independent review of the Druyun's hiring and promptly provided the results of that investigation to the government. The evidence included witness interviews and incriminating e-mails supplied by an essential witness, that were critical to the prosecution of this case. Boeing agreed to a limited waiver of the attorney client privilege- with respect to this material-, requesting only that this material be protected under the grand jury secrecy provisions of Rule 6(e) of the Federal Rules of Criminal Procedure. Boeing also provided additional relevant documents, volunteered additional information it believed potentially relevant, and made corporate employees readily available for interviews by government investigators. The exemplary disclosure and cooperation of Boeing was the most important factor in the EDVA's determination to enter an agreement not to seek criminal charges against the corporation.

5. The Existence and Adequacy of the Boeing's Compliance Program.

Boeing had an extensive compliance program at the time of the Druyun Matter. Michael Sears circumvented the normal hiring procedures which required a conflict of interest review by Boeing's law department.

6. The Company's Remedial Actions, Including Efforts to Implement an Effective Corporate Compliance Program or to Improve an Existing One, to Replace Responsible Management, to Discipline or Terminate Wrongdoers, to Pay Restitution and to Cooperate With the Relevant Government Agencies.

Boeing has undertaken significant efforts to review and improve its corporate compliance program to prevent a repeat of the Druyun Matter. That has included improving the process for hiring government employees, establishing an Office of Internal Governance and improving ethics training. The two Boeing employees involved in the illegal employment negotiations, Sears and Druyun, were both terminated for cause by the Company.

7. Collateral Consequences Including Disproportionate Harm to Shareholders, Pension Holders and Employees Not Proven Personally Culpable, and Impact on the Public Arising From the Prosecution.

This was considered not applicable in the determination of an appropriate resolution of this investigation.

8. The Adequacy of the Prosecution of Individuals for Company's Malfeasance.

The severe sanction to Sears and Druyun for their illegal conduct is adequate to deter similar conduct by senior corporate officers and government officials.

9. The Adequacy of Remedies Such as Civil or Regulatory Enforcement Actions.

The $565 million civil settlement and $50 million criminal penalty, paid to resolve both the EELV Matter and the Druyun Matter, are the largest total recovery to the United States in a defense contractor fraud settlement.

Thompson Memorandum Criteria As Applied to the EELV and NLS Case: Central District of California

1. The Nature and Seriousness of the Offense, Including the Risk of Harm to the Public.

The criminal offenses at issue, namely, violations of 18 U.S.C. § 1832(a) (concealment and possession of trade secrets) and 41 U.S.C. § 423(b) (violation of the Procurement Integrity Act), arose from Boeing's possession and use of Lockheed Martin Corporation proprietary information in connection with the Air Force's Evolved Expendable Launch Vehicle (EELV) and the NASA Launch Service (NLS) procurement processes. These serious criminal offenses resulted in awards of significant contracts to Boeing by both the Air Force and NASA.

2. The Pervasiveness of Wrongdoing Within the Company, Including the Complicity in, or Condonation of, the Wrongdoing by Corporate Management.

The wrongful possession and use of Lockheed Martin proprietary information involved a number of Boeing employees: Kenneth Branch and William Erskine, both aerospace engineers who worked on launch operations for Boeing's EELV program; an engineer (the "Boeing engineer") who headed a "capture" team tasked with acquiring technical, cost, and other data regarding Lockheed Martin's EELV program; a parametrician (the "Boeing parametrician") who prepared estimates of manufacturing and production costs for Boeing and Lockheed launch vehicles and worked with the Boeing engineer; a marketing director (the "Boeing marketing director") who circulated Lockheed Martin proprietary documents to seven other Boeing employees; and a manager (the "Boeing manager") who worked with the parametrician on procurements under the NLS contract. There is no evidence that any members of Boeing's senior management were involved in the wrongdoing. Indeed, after the possession of Lockheed Martin proprietary information by Branch and Erskine was reported to Boeing management by a Boeing employee in June 1999, Boeing conducted an internal investigation and terminated both Branch and Erskine. Similarly, the Boeing marketing director and Boeing manager were fired. The Boeing engineer was disciplined and subsequently resigned, and the Boeing parametrician resigned.

3. The Company's Past History.

The only similar offenses involving the improper possession and use of proprietary information by Boeing of which the government is aware are those described in the settlement agreement's definition of the "EELV Matter."

4. The Company's Timely and Voluntary Disclosure of Wrongdoing, and its Willingness to Cooperate in the Investigation.

Boeing has provided voluntary cooperation relating to the investigation conducted in the Central District of California of the EELV Matter. In connection with the Exoatmospheric Kill Vehicle procurement, Boeing retained outside counsel to conduct an independent review of allegations of possession and use of a competitor's proprietary information and voluntarily provided the government with the complete results of that investigation, voluntarily waiving both attorney-client privilege and work product protection to do so. In connection with the EELV and NLS procurement processes, Boeing also retained outside counsel to conduct independent investigations of the possession and use of Lockheed Martin proprietary information. The results of those investigations were not immediately provided to the government as the result of ongoing litigation between Boeing and Lockheed Martin. After extensive discussions, however, Boeing provided the government with the results (including interview reports) of its internal investigation relating to the EELV procurement process, waiving attorney-client privilege but redacting the materials provided to preserve work product protection, and orally provided the government with factual information discovered in the course of its internal investigation of the NLS procurement process, while retaining its attorney-client privilege and work product protection with respect to materials generated in the course of that investigation. Boeing also provided relevant documents and made corporate employees available for interviews by government investigators.

5. The Existence and Adequacy of the Boeing's Compliance Program.

Boeing had an ethics and compliance program in place at the time of the conduct at issue. The Boeing employees who possessed and used a competitor's proprietary information disregarded the directives of the ethics and compliance program. Since the conduct at issue, as part of its remedial actions discussed below, Boeing has substantially improved its ethics and compliance program.

6. The Company's Remedial Actions, Including Efforts to Implement an Effective Corporate Compliance Program or to Improve an Existing One, to Replace Responsible Management, to Discipline or Terminate Wrongdoers, to Pay Restitution and to Cooperate With the Relevant Government Agencies.

Boeing has undertaken a number of remedial actions, including significant efforts to review and improve its corporate compliance program to prevent a repeat of the EELV Matter misconduct. The remedial actions are outlined in Appendix D to the settlement agreement, and include establishment of an Office of Internal Governance, improvements in training regarding ethics and the use and misuse of competitors' proprietary information, improvements in monitoring sources of information, and certification requirements for capture/proposal teams on large contracts. Two of the Boeing employees involved in the illegal possession and use of proprietary information, Branch and Erskine, were terminated by Boeing.

7. Collateral Consequences Including Disproportionate Harm to Shareholders, Pension Holders and Employees Not Proven Personally Culpable, and Impact on the Public Arising From the Prosecution.

This was considered not applicable in the determination of an appropriate resolution of this investigation.

8. The Adequacy of the Prosecution of Individuals for Company's Malfeasance.

Branch and Erskine have been indicted and are pending trial. In the course of the investigation, the parametrician was granted immunity to obtain his testimony. The evidence developed in the course of the investigation was not believed to support pursuit of criminal charges against the Boeing engineer, marketing director, or manager.

9. The Adequacy of Remedies Such as Civil or Regulatory Enforcement Actions.

The $565 million civil settlement and $50 million criminal penalty, paid to resolve both the EELV Matter and the Druyun Matter, are the largest total recovery to the United States in a defense contractor fraud settlement.

Chairman WARNER. On the question of suspension or debarment, the civil settlement agreement excepts from the release by the United States any suspension or debarment action. To your knowledge, has any such action been instituted against Boeing by the Air Force or any other agency or department of the government?

Mr. MCNULTY. I may have to defer to Mr. Schiffer on this. I know there have been a number of actions taken in different matters and so I want to make sure we are very clear on that.

Mr. SCHIFFER. Mr. Chairman, the three Boeing units that were involved in the rocket matters were suspended for almost 2 years, July 2003 until May 2005.

Chairman WARNER. Is that the full scope of the actions, then, to the best of your knowledge?

Mr. SCHIFFER. Yes, to date that is what has occurred.

Chairman WARNER. Mr. McCain, I must absent myself for a moment and I will be back. Will you take the chair.

Senator MCCAIN [presiding.] Thank you, Mr. Chairman. Do you want to go to Senator Reed, sir?

Chairman WARNER. That is all right. Why do you not go ahead.

Senator MCCAIN. Senator Reed.

Chairman WARNER. All right, let Senator Reed go.

Senator REED. Thank you, Mr. Chairman.

Thank you, Senator McCain. I appreciate that.

Thank you, gentlemen, for your testimony today. Prior to your current position, Mr. McNulty, you were the Eastern District of Virginia Federal Attorney, and you had there a task force on contract fraud. So you have had a lot of experience, not just in this case but other cases. Is it your impression that this type of conduct is unique to Boeing or is it more widespread within the industry, requiring a much more aggressive posture?

Mr. MCNULTY. It is an interesting question because certainly there is a significant amount of fraud involved in government contracting. By that I mean a certain percentage has been determined

to exist in government contracts as a general matter, whether that is 5 percent, 6 percent, 7 percent of all government contracts. So that the more contracting that is going on, the more potential there is for fraud.

My hesitancy is that the facts of this case are unique. You have the question here of a revolving door, the conflict-of-interest associated with someone who is working in the government and then comes to the company for employment. That matter was of significant concern to the DOD as a result of the Druyun case and led to an initiative by the DCIS under the IG's office to actually look at senior officials who were leaving DOD and see where they were going. I think that is an ongoing matter for the DCIS.

So then you have that set of circumstances, then you have the proprietary information question in this case, and there are many other instances of proprietary information falling into the hands of individuals in questionable ways, so I think you see conduct here that in some ways is a bit unusual, other conduct that is not so unusual, and probably not hard to find, given the large amount of government contracting that is going on.

Senator REED. Thank you. Specifically regarding the Boeing case, the settlement calls for the adoption of many measures: training employees, disciplinary action for employees who violate these ethics standards, establishing ethics standards. Do you have adequate tools to ensure that these provisions will be enforced?

Mr. MCNULTY. That is a challenging question and something we are looking at. You may have heard of the corporate fraud task force which was set up 4 years ago this month to bring together the Federal agencies associated with the whole corporate fraud enforcement effort. We met just last week and we discussed this very question of how we can work better together to monitor and to enforce these agreements.

One of the critical points of these provisions is that they have self-reporting and self-monitoring requirements. Now, that is stronger than it sounds, because these are outside entities, firms, that are brought in as independent monitors to these companies to oversee the conduct, and failure to report conduct that is identified in that way is a violation of the agreement and could cause the agreement to be set aside and criminal penalties and prosecution would follow.

I think that the structure or the mechanics of these agreements for purposes of monitoring is sound. But I do think we have to do as much as we can and to make sure we have adequate resources for government oversight, as well as this outside third party oversight of the provisions in these agreements. It is a strain to find enough resources to do that, because it is hard enough to find the resources to investigate the cases, let alone then monitor them in an ongoing way.

Senator REED. I understand that the agreement expires after 2 years. Is there anything to ensure that these principles developed continue on after the expiration of the agreement?

Mr. MCNULTY. There is a lot of incentive for having these kinds of principles in place. We were talking a moment ago with the chairman about the Thompson Memo and the factors to be considered there. If a company has had the self-governing oversight

mechanisms in place and then has a violation or misconduct occur, it is more likely to be seen as making good faith efforts to avoid such conduct because of having those kinds of compliance agreements or monitoring mechanisms in place.

So there is a strong incentive for the company to keep those things going when they have created them. I think that the practice of corporate governance has embraced this process more and more and it is becoming a standard way of proceeding.

Senator REED. Let me ask a final question which touches on your response to my first question about the perception that this problem goes beyond one company. That is that in particular respect to Iraq there has been evidence accumulating of fraud, mismanagement, and many other unfortunate things in contracting out there. Several cases were filed under the FCA. Only a few have really gotten into the stage of discovery and trial and settlement. That is in one respect because they are sealed until the DOJ makes the decision whether they will participate or not and it essentially freezes the activity.

I understand there are numerous cases like this that have been brought and are currently being reviewed by the DOJ. I also understand that you have had referrals from the Defense IG, the Special IG for Iraq Reconstruction. But not many of these cases seem to be making it past DOJ review.

Can you give some insights as to what is happening and whether there is going to be an aggressive attempt to try to come to grips with what seems day after day gross mismanagement and out and out fraud?

Mr. MCNULTY. Yes, Senator. I believe you are talking mostly about the qui tam process, where individuals can bring allegations of fraud, misconduct, to the attention of the government. Under that law the government has a specified period of time in which to take the case and pursue it or to decline it. But if it declines the case then the relator, the person who has brought the information, is free to pursue the case in Federal court.

So the qui tam process does not result in claims not being able to move forward. It is really a question of how claims will move forward. Will they move forward with the government pursuing the claims on behalf of the relator or the relator go directly into court?

One of the issues we have addressed in some of these cases is the nature of the FCA's application to the conduct that has occurred in Iraq because of the nature of the funds. The issue more specifically is whether or not the moneys involved constitute the types of funds that are payments under the FCA, and that has been litigated. I think it continues to be litigated, as to how to treat those moneys. That may account for what may be perceived as a failure to move as aggressively as possible. But it is more of a legal hurdle than it is a reflection of a lack of commitment to doing that.

There have been some cases. I know of a number of investigations going on and these investigations are very complicated, complicated by the fact of witnesses, the trail of evidence not being easily found or traced, given the nature of the conduct itself. But there are a number of investigations that are ongoing and some charges have been brought.

Do you want to say anything more about the qui tam matter?

Mr. SCHIFFER. Senator, I should at the start mention that I have seen numbers in the press about qui tam cases that remain under seal and at least some of the numbers I have seen are rather grossly exaggerated. There are a number of these cases. As the Deputy Attorney General has said, they are complicated. The place where the conduct occurred, the nature of the money, the nature of the entity that awarded the contracts, whether these are government bodies or not, such as the Coalition Provisional Authority (CPA).

We do seek extensions of time, as the statute permits. We only obtain those when a judge finds that we have shown good cause for the extensions. We are getting ready to announce in the next few days one settlement with a subcontractor. It is going to be a small amount of money when one considers the overall funding, but I think it shows that we take these cases seriously, and we will continue to pursue them.

Senator REED. Thank you very much, gentlemen.

Thank you, Senator McCain.

Senator MCCAIN. Mr. McNulty, in 2005, as U.S. Attorney for the Eastern District of Virginia, you testified about your forming a procurement fraud working group, a multi-agency working group focused on procurement reform. Is that working group still in existence?

Mr. MCNULTY. Yes, it is.

Senator MCCAIN. You mentioned you hope you can form a national task force on procurement fraud. Does that mean you are going to or does it mean you just hope, or what?

Mr. MCNULTY. No, Senator. It is an intention to do so. In fact, the Assistant Attorney General for the Criminal Division, Alice Fisher, is working with me on a plan right now.

Senator MCCAIN. When do we expect that to happen?

Mr. MCNULTY. I would say that in the next 60 days we will have the details of our initiative worked out.

Mr. MCNULTY. Thank you.

Senator MCCAIN. Now, you reached a civil agreement of $565 million and $50 million in civil criminal agreement, right, on the Boeing case?

Mr. MCNULTY. Right.

Senator MCCAIN. Now, is not the purpose of reaching these agreements to punish the wrongdoers, to reach a settlement so that it is a form of punishment? Otherwise they would not have to pay anything, right?

Mr. MCNULTY. In large measure it is punishment. It is also getting the moneys lost to the government back.

Senator MCCAIN. Now, in this case, much to their credit, Boeing decided to assume these expenses. Suppose that they had decided to write it off in a tax writeoff. You in your statement say "The Department's tax-neutral approach to these cases ensures that the IRS retains sufficient latitude to evaluate the taxpayer's obligation in its role as the taxing authority and final arbiter of its rules and regulations."

If they write it off, then who pays for that, Mr. McNulty? It seems to me the taxpayer does, because then it is taxes that the company does not pay. So if it is to settle a case but also to enact some punishment on a corporation, how in the world do you duck

the obligation to determine whether that fine can be laid off on the taxpayers or not?

Mr. MCNULTY. We certainly agree that we do not want the effect of the penalty to be lost by the ability to be deducted. In fact, if it is a penalty.

Senator MCCAIN. That has happened in the past, that they have deducted the penalties from their taxes in other cases.

Mr. MCNULTY. Penalties are not deductible. Compensation, restitution to the government, would be. Congress has determined that compensatory damages would be deductible. So the question is whether or not it is that or it is a penalty.

It is our position when we go into these discussions.

Senator MCCAIN. Does it not matter whether they write it off or not?

Mr. MCNULTY. Of course it does.

Senator MCCAIN. Then how can you remain neutral on it and then make it relatively penalty-free?

Mr. MCNULTY. The term "neutral" does not mean it is penalty-free.

Senator MCCAIN. If they are able to write it off, what is the penalty?

Mr. MCNULTY. The term "neutral" means that it is going to be resolved. The question is how is it going to be resolved, not that we do not agree that they should not be able to get away and write off the payment. It is a question of how that is going to be determined. Is it going to be determined in the negotiations with the company, by the DOJ, or by the IRS, who has the expertise to determine whether or not it is appropriate.

Senator MCCAIN. It seems to me if you are going to punish somebody then they should pay the fine and do the time or not. I do not see how you can settle it with that kind of aspect of an agreement outstanding. I guess maybe we ought to have to pass some law that if you penalize somebody for wrongdoing and settle with them and absolve them of all criminal conduct with these payments or civil misconduct, that the taxpayers should not be picking up the bill.

Mr. MCNULTY. We agree. You will not need to do that because we are in full agreement with what you are saying. Again, the question is how do we get there? What process makes the most sense to achieve the policy that you are describing here today?

Senator MCCAIN. I do not think you get there.

Prior to entering into this settlement, did the DOJ find that other executives or members of the board know or should have known about then-CFO Michael Sears' illegal communications with Ms. Druyun?

Mr. MCNULTY. Senator, that was certainly a significant aspect of the investigation, to determine to what extent anyone else had knowledge that would be sufficient for purposes of a criminal charge. The fact is that in this investigation such knowledge was not determined to exist, and that is why no other charges were brought.

Senator MCCAIN. According to the Thompson Memo, as you mentioned, there is nine criteria. One of them is to make witnesses available. Did Boeing do so here?

Mr. MCNULTY. Yes, it did.

Senator MCCAIN. Did it disclose the complete results of its internal investigation?

Mr. MCNULTY. To the best of my knowledge they did, Senator.

Senator MCCAIN. Did they waive attorney-client privilege and work product protection?

Mr. MCNULTY. In order to make that report available, they had to, yes.

Senator MCCAIN. How did you come up with the $50 million amount in the criminal agreement and the $565 million in the civil agreement? In other words, what is the relationship between that amount and damages that the government actually incurred in these matters?

Mr. MCNULTY. That is very difficult to explain. What happens in this type of case is that the government seeks a sum of money that represents the fullest extent it can hope to gain or to negotiate. The company has a very different mind set, and there is an effort to go back and forth and try to explain figures that would be connected to loss.

The effort here is a sort of best faith that was put forward in order to try to determine what would be both punitive and compensatory in terms of government losses, while at the same time resolving the matter. So that is how $615 million was derived.

Senator MCCAIN. One more time. Boeing announced that it believed that it could deduct these payments. Does that not trouble you? They decided not to, but it could deduct these payments.

Mr. MCNULTY. That it could, in other words, that it was making the case.

Senator MCCAIN. Yes.

Mr. MCNULTY. That is fine if the company believed that. That does not necessarily dispose of that question. That is a question for the IRS to determine.

Senator MCCAIN. But it has happened in other cases where they have deducted the case of civil penalties. So the precedent has been set. That is, I am sure, why the CEO of Boeing announced that he could.

It is very troubling that we as the taxpayers end up footing the bill for a civil penalty that you impose on a corporation.

Mr. MCNULTY. But we do not, Senator.

Senator MCCAIN. If they can deduct it, do we not?

Mr. MCNULTY. But not because of something the DOJ does or does not do.

Senator MCCAIN. It is because the DOJ is silent.

Mr. MCNULTY. No, Senator. It is because at some point in a payment like this there is a compensatory part of the payment. That is just a fact. So long as there is a compensatory part of the payment, that is making the government whole with regards to its loss, then there is going to be a deductibility argument. That is not something the DOJ decided. That is the Federal tax law.

Now, the question is how much is compensatory, how much is punitive, and who determines that. The Department's position is that should be determined and it should be determined in a way that is absolutely consistent with all the facts and all the tax information of that taxpayer. But the IRS is in the best position to

know all of that tax information and to make the best assessment as to what is compensatory here and what is punitive here. We are not the tax experts as much as we are the civil enforcement experts, to try to get some resolution of the claim.

Senator MCCAIN. Under the criminal agreement, the government will forgo prosecuting Boeing on, among other matters, quote, "Boeing retention of a retired U.S. Air Force general officer and his activities while retained by Boeing relating to the tanker program or otherwise." Who is the Air Force general officer?

Mr. MCNULTY. We have not named that individual publicly. I would prefer not to name someone publicly who has for reasons of privacy not been disclosed.

Senator MCCAIN. Did this person discuss employment with Boeing while he was still with the Air National Guard?

Mr. MCNULTY. Senator, it is an ongoing matter.

Senator MCCAIN. I prefer to, because we are talking about whether people have violated the law or not. The information we have, e-mails here, which I would be glad to share with you, show clearly that this individual engaged in lobbying in violation of the law requiring that person to abstain from doing so for a period of time.

Mr. MCNULTY. It is a matter of ongoing criminal investigation, and I understand the importance of looking at it thoroughly. I just am reluctant to speak.

Senator MCCAIN. Is it still being looked at?

Mr. MCNULTY. Yes, sir, it is.

Senator MCCAIN. How could that be when you have reached a total, a final agreement?

Mr. MCNULTY. We still have the ability to pursue any matter of wrongdoing with regard to any individual and with regard even to the company. We are just limited by the Druyun matter and the EELV–NASA matters as they are defined in the scope of the agreement. But in terms of ongoing investigations, that is actually the purpose of the agreement, to get cooperation to do that.

Senator MCCAIN. My time has expired.

Senator Dayton.

Senator DAYTON. Thank you, Mr. Chairman.

Because of another commitment, I cannot stay. I do not have any questions of this witness. I do want to say, prefacing the appearance of the next witness, that I do not in any way condone the actions that occurred. I am glad the DOJ has prosecuted this matter to the maximum extent possible.

I have known Mr. McNerney for a number of years. He was the CEO of a great Minnesota company, 3M Corporation, which was throughout his tenure known for continuation of innovative production, employing thousands of Minnesotans and other Americans that performed that work with great integrity and honesty. I think it should be noted that, as far as the information I have, the misdeeds at Boeing preceded his taking this office, and I think for him to come here today and confront these issues directly is commendable. Again, I separate that entirely from the inexcusable misdeeds of others in that corporation that preceded his time here.

Thank you, Mr. Chairman. I yield back the balance of my time.

Senator MCCAIN. Thank you, Senator Dayton. I know that I speak for many members of this committee when we share your view of the integrity of the new management team at Boeing and the job that they are doing to make significant and fundamental beneficial changes, attributable to Mr. McNerney's leadership, and we share your view.

Senator Sessions.

Senator SESSIONS. Thank you, Senator McCain.

I would just join with Senator Dayton in saying that the new management team at Boeing represents a new day and is in place I guess in large part because of the problems that have occurred in the past, and that is good.

Let me ask you, Mr. McNulty, to get this straight. I was a Federal prosecutor for a number of years. There has always been this vagary about what can be deducted and what cannot be deducted in these cases.

First, when you say "write-off," is this a dollar-for-dollar write-off against profits? Or is it in effect the means that tax rate that they would pay? They would write off a third of it, I guess, so the 37.5 percent that they normally pay in profits on their corporate tax returns? Is that what we are talking about? Is it a 100-percent write-off of the $615 million, or would it be a third or 35 percent of that amount?

Mr. SCHIFFER. I should preface the answer, Senator, by noting that we stay tax neutral in part because of our specific lack of expertise on the tax laws.

Senator SESSIONS. Mr. Schiffer, I was reading your memos in the DOJ almost 20 years ago, so you ought to know. Tell us what you think?

Mr. SCHIFFER. First of all, we are talking about a deduction, not necessarily a dollar-for-dollar loss. Precisely one reason that we stay, in the DOJ at least, tax neutral is because the company may well know which portions are deductible and which are not, but the company would of course know its own tax situation.

We would have no way until the end of a company's tax year when the IRS would get into the act of knowing in fact what kind of loss carry-forwards the company would have, what the exact impact of any deduction would be. So that is something that ultimately gets worked out between the IRS and the company.

But again, as Mr. McNulty mentioned, only that portion which was regarded as compensation and therefore by definition, I should stress, it would be amounts on which taxes had already been paid by the company. In other words, to the extent that the company is simply paying back what it wrongfully obtained, and leaving aside penalties for a moment, those are amounts on which the company already paid taxes. So it really is an offset against that which they paid previously.

Senator SESSIONS. How long have you been at the DOJ?

Mr. SCHIFFER. Much too long, Senator, I am sure.

Senator SESSIONS. Come on, give me the number.

Mr. SCHIFFER. It is 43 years, sir. I am starting to wonder about my next promotion, where it is coming from.

Senator SESSIONS. That is worse than I thought. [Laughter.]

Now, so the $50 million, the criminal penalty, is not deductible, correct, and the other would be deductible, depending on what IRS concludes? My question is, this seems like it is a constant problem. Based on your experience, is it something that we can legislate? Is it a policy the DOJ could adopt that would deal with this? Or is it, as Mr. Schiffer suggests, just one of those things that, because of the nature of tax laws and the nature of different corporations' tax liability and so forth, may be impossible to right?

There has always been this discussion. I remember settlements, people arguing over whether it would be taxes, and the DOJ always took the position: Go see the IRS; they will tell you what taxes you owe.

Mr. MCNULTY. I would like to make two points. First, if we shifted this discussion or negotiation to the U.S. Attorneys, or to the DOJ, the question of how much the company was going to pay in a settlement would bring the tax issue actually into the picture, because now the company is going to have to try to negotiate an amount anticipating or dealing with the U.S. Attorney or the DOJ's assessment of what is going to be tax deductible or not. We would still have the figures being affected by that consideration.

Second, we would have of course different U.S. Attorneys taking different positions as to what the law would require or not require, and we would have kind of a patchwork quilt around the country of tax treatment of these matters.

Senator SESSIONS. Why would we not just make it so that all of this is not deductible? That would fix it, would it not?

It would take statutory special action to do that.

Mr. MCNULTY. That is a statutory issue, absolutely.

Senator SESSIONS. Why would we not do that? Why would we not just, Congress, as Senator McCain suggested, say that all of this cannot be deducted?

Mr. MCNULTY. I am not familiar at all with the policy considerations that go into the original decisions to make compensatory payments deductible or not. So I would not want to take a stab at that.

I do want to say, Senator, that the Government Accountability Office (GAO) looked at this matter, and I have referenced this in my testimony, looked at this very question not long ago, and determined that the DOJ process was not in error or not a problem. Instead what it said was, we have to make sure that we are providing an adequate amount of information to the IRS so that the IRS can make the proper assessment here and when the IRS is making it, they are doing it in a uniform way, so that we have the companies being treated the same under tax law, not based upon where they are in the country or who they are negotiating with, but rather they are getting an analysis from the IRS that is consistent.

Senator SESSIONS. I would have to agree. That is what I used to say when I was a United States Attorney. This is what the penalties are; you have to talk to the IRS about how much taxes you owe; I cannot enter into agreement with you that will set your tax liability; I do not have that authority; that is the authority of the IRS.

Is that basically the way you do these cases?

Mr. MCNULTY. That is right, and you do not have the information to know.

Senator SESSIONS. It just does leave a lot of uncertainty and it has always been there, and I am not sure we could not fix it.

I would just say this. With regard to the penalties that were imposed here, there were debarment actions taken that I know probably required EELVs to be transferred to Lockheed Martin in debarment for several years. Was that part of this penalty that the Boeing Corporation would have sustained, Mr. Schiffer?

Mr. SCHIFFER. Certainly the costs that were incurred in reallocating launches were elements of the claims we asserted, Senator.

Senator SESSIONS. I think it was about a billion dollars worth of work that was being done at that fabulous EELV facility in Alabama, that did not get done. I do not know how much that cost them on the bottom line. Would those be economic losses that the corporation sustained in addition to this $500 million, $600 million?

Mr. SCHIFFER. I am not sure I follow the question.

Senator SESSIONS. As I understood, there were some debarments that occurred. They had won competitions to produce certain EELV rocket launches and they were required to give those up and not be able to bid in the future for some period of time.

Mr. SCHIFFER. These units, the units associated with the rocket contracts, were suspended for a period of time. I cannot tell you an exact number of business they might have lost. But yes, those would be losses presumably.

Senator SESSIONS. Mr. Chairman, thank you for your leadership.

Chairman WARNER [presiding]. Senator McCain.

Senator MCCAIN. Mr. McNulty, thank you for being here.

Just a point of clarification. By its terms, the deferred prosecution agreement suspends the prosecution of the "Druyun matter," which includes the issue about the general officer. So that issue is currently pending only in the sense that DOJ can pick it up if Boeing violates the agreement. Is that true?

Mr. MCNULTY. I do not believe so, sir. It is under investigation and it is not prohibited from being so as a result of the deferred prosecution agreement.

Senator MCCAIN. My staff was told by Boeing's lawyers that the DOJ found that this general officer did not violate the 1-year cooling off period.

Mr. MCNULTY. I am not sure what the company has told the staff, but I will say that the matter is not closed. It may be that the company has some reason to believe that it is not going to result in a charge, and I do not want to give you the impression that it is, but I am just saying that is their impression.

Senator MCCAIN. The thing that troubled me most about this whole affair, Mr. McNulty, was the very heavy involvement of uniformed military personnel, Air Force officers, in this effort. I understand and appreciate the fact that civilian appointees are not only free, but in many ways obligated to advocate for their Service that they oversee and to do whatever they can to see it is best equipped. But when you see military officers engaged in some of the activities that I saw, it is very disturbing to me.

That is why I have some interest in this and other activities on the part of the uniformed personnel, including generals coming before the committee and volunteering statements which were not cleared by anybody, but they just felt compelled to do so, while advocating this tanker lease business. That is why I am interested in this issue.

I thank you, Mr. Chairman. I thank Mr. McNulty, Mr. Rosenberg, and Mr. Schiffer. We will try and get you promoted again. How many times have you been promoted in 40 years?

Mr. SCHIFFER. It has been a long time. I really cannot remember.

Senator MCCAIN. I thank you for your outstanding service to our country. We are grateful for you.

Chairman WARNER. Senator McCain, I might note, having had a modest career in the law myself, there is the term "career Justice public servant" and I think we see one over here. It does not make any difference; administrations come and go and there is a cadre in the DOJ that stays on, fortunately, dedicating their lives to careers of being civil servants and judging each case on its merits, politics be damned. I think there is one that sits there. Would that be correct?

Mr. MCNULTY. That is the strength of DOJ. There is a very thin political leadership and it really relies day-in and day-out on that 99 percent of the career folks, who really are the premier law firm in the world.

Mr. Chairman, I would like to just make one clarification in an answer I gave to Senator McCain earlier. He asked me about Boeing's waiver of attorney-client privilege, and I know that they made materials, everything we asked, available to us, but I want to be able to give you an accurate answer. I said yes and I am not sure that is correct. So I am going to draft a letter to you to answer that question.

[The information referred to follows:]

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

December 21, 2006

The Honorable John Warner
Chairman
Committee on Armed Services
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter is to clarify remarks of the Deputy Attorney General that were made during the August 1, 2006 hearing, entitled "Boeing Company Settlement Agreement" before the Senate Armed Services Committee. During the hearing the Deputy was asked by Senator McCain about Boeing's waiver of attorney-client privilege and the Deputy indicated he would like to give the Senator a more accurate answer for the record. The response follows.

Boeing did not completely or formally waive the attorney-client privilege and work product protection in connection with the investigations in the Eastern District of Virginia (EDVA), and the Central District of California (CDCA). However, Boeing did agree to a limited waiver in connection with the Company's internal investigation conducted by outside counsel of the Druyun matter, providing the entire investigation with an agreement that the materials would be protected under the grand jury secrecy provision of Rule 6(e) of the Federal Rules of Criminal Procedure. In connection with the Evolved Expendable Launch Vehicle (EELV) investigation, Boeing waived the privilege as to certain areas of the investigation, but not as to others, and worked with investigators and the U.S. Attorney's Office of the CDCA to provide documents and witnesses for interview.

In addition, enclosed is a response to your request for a discussion of the "nine basic criteria" of the Thompson Memorandum then in effect with supporting discussion of whether and to what extent they may have been applicable to the decision process on how to proceed in each investigation.

We hope this information is helpful. If we can be of further assistance, please do not hesitate to contact this office. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to the submission of this letter.

Sincerely,

James H. Clinger

James H. Clinger
Acting Assistant Attorney General

Enclosure

cc: The Honorable Carl Levin
Ranking Member

Senator MCCAIN. Thank you very much.

Chairman WARNER. Before you step down, gentlemen, I want to join my colleague, Senator McCain, in his observations about the conduct of certain military officers. I would like to put in today's record a letter of May 13, 2005, signed by myself and my distinguished ranking member, Carl Levin, reciting some of these incidents and how concerned we were about it.

It is all laid out in here, and perhaps you will have an opportunity to examine that letter in the context of your ongoing work.

Thank you very much, gentlemen. We will now receive the next panel.

[The information referred to follows:]

United States Senate
COMMITTEE ON ARMED SERVICES
WASHINGTON, DC 20510-6050

May 13, 2005

The Honorable Joseph Schmitz
Inspector General
Department of Defense
400 Army Navy Drive
Arlington, Virginia 22202

Dear Mr. Schmitz:

For the past 10 months the Committee has been reviewing documents relevant to the proposed Air Force lease of KC-767 tanker aircraft from The Boeing Company. We write to call your attention to certain e-mail messages from May 2002 to May 2003 that raise the question of whether a violation of the criminal conflict of interest statute, 18 U.S.C. 207(c), may have occurred in connection with the proposed lease of these aircraft to the Air Force. A list of these messages is attached.

As you know, 18 U.S.C. 207(c)(1) provides:

> [A]ny person who is an officer or employee . . . of the executive branch of the United States . . . who is referred to in paragraph (2) and who, within 1 year after the termination of such service or employment as such officer or employee, knowingly makes, with the intent to influence, any communication to or appearance before any officer or employee of the department or agency in which such person served within 1 year before such termination, on behalf of any other person (except the United States) in connection with any matter on which such person seeks official action by any officer or employee of such department or agency, shall be punished as provided in section 216 of this title.

Included in the prohibition is a person "employed in a position which is held by an active duty commissioned officer of the uniformed services who is serving in a grade or rank for which the pay grade . . . is pay grade O-7 or above" (18 U.S.C. 207 (c)(2)(iv)).

Major General Paul Weaver, USAF (Ret.) served as Director of the Air National Guard from 1998 to 2002. He retired on February 1, 2002, in the grade of major general (pay grade O-8). He would therefore appear to have been subject to the one-year prohibition of section 207(c) through January of 2003. Senate records show that he registered as a lobbyist for Boeing effective May 1, 2002, and was so registered throughout the period covered by the e-mail messages enclosed. These messages appear to indicate that General Weaver, within one year after his retirement, communicated with the Secretary of the Air Force and various adjutants general of the States on behalf of Boeing with the intent of influencing official action, i.e.,

approval of the tanker lease proposal. While some of the e-mail messages are dated more than one year after General Weaver's retirement, they appear to be part of an effort that began while General Weaver was subject to the one-year ban and continued thereafter.

We request that you investigate this matter and determine whether General Weaver violated the prohibition in section 207(c), as well as whether anyone else involved may have violated this statute or any other applicable conflict-of-interest statute, and, if so, whether referral to the Department of Justice or other disposition is appropriate. Please keep us informed of the progress of your investigation.

Sincerely,

Carl Levin
Ranking Member
Committee on Armed Services

John W. Warner
Chairman
Committee on Armed Services

LIST OF E-MAIL MESSAGES RELEVANT TO CHAIRMAN/RANKING MEMBER LETTER

1. Weaver to Secretary Roche, May 7, 2002, IGF--CD086--0182.

2. Weaver to Roche, May 19, 2002, subject: Visit by President, AGAUS.

3. Andrew Ellis to Darlene Druyun, September 18, 2002, subject: heads up [sic] (and Druyun reply, same date), IGD--CD155X--0249.

4. Andrew Ellis to Jim Albaugh, January 23, 2003, subject: call to roche on tankers [sic], TKR 006 0034.

5. Weaver to Roche, May 3, 2003, subject: Call from Jim Albaugh; Roche to Weaver, same date; Weaver to Roche, same date (and Roche reply, same date), 00001650 and 00001651.

6. Weaver to Roche, May 7, 2003, subject: 767 Lease; Roche to Weaver, same date and subject. IGT--CD086--0743.

7. Weaver to Roche, May 3, 2003, subject: Call from Jim Albaugh; Roche to Weaver, May 9, 2003, same subject. IGT--CD086--075_ (last number indistinct).

8. Weaver to Roche, May 16, 2003, subject: AGAUS Conference; and Roche to Weaver, same date and subject, 00001615.

Mr. MCNULTY. Thank you, Mr. Chairman, Senators.

Chairman WARNER. Mr. McNerney, we welcome you and thank you for the opportunity to have had two discussions with you. I note the presence of the former distinguished Judge Luttig of the Fourth Circuit, who has joined your company. While we certainly are sorry that he left the Federal judiciary, he did serve 15 distinguished years. This opportunity came along and the fact that Boeing reached out and found in its search an individual of his quality and standing certainly documents clearly the many steps that under your leadership have been taken to restore Boeing's hopefully, I say, rightful place in the industrial base of America as one

of our leading corporations, manufacturing products which are essential to our balance of payments. Certainly the aircraft that this company has turned out over the years has helped that, and also many military programs.

We thank you for coming today and the floor is yours.

STATEMENT OF W. JAMES McNERNEY, JR., CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, THE BOEING COMPANY

Mr. MCNERNEY. Thank you very much, Mr. Chairman and members of the committee. It is my privilege to represent the 155,000 men and women of Boeing. While I regret the circumstances that bring me here before you, I appreciate all the same the opportunity to testify.

I have been asked to address the recent global settlement of two high-profile investigations, which I will do. But in that context I hope also to discuss why, going forward, Congress and the taxpayers of this country can place their trust in Boeing. Companies doing business with the U.S. Government are expected to adhere to the highest legal and ethical standards. I acknowledge that Boeing did not live up to those expectations in the cases addressed by the settlement we are discussing here today.

We take full responsibility for the wrongful acts of the former employees who brought dishonor on a great company and caused harm to the U.S. Government and its taxpayers. Boeing is accountable for what occurred and we have cooperated with the government throughout this process.

This settlement is tough but fair. It has been widely reported as probably the largest monetary settlement of its kind, a sad distinction we must live with and learn from.

Chairman WARNER. Could I interrupt just to ask, what was the threshold date at which your statement, Boeing fully cooperated with the government? What is the threshold date of that measure of cooperation?

Mr. MCNERNEY. I do not have a specific date in mind, Mr. Chairman. We have attempted to cooperate throughout the process, and I was referring here to the settlement discussions.

Chairman WARNER. Would you amplify for the record then the stages at which Boeing did begin to cooperate in the investigation and the like?

Mr. MCNERNEY. I think there are antecedent investigations, the EELV, where the cooperation, as I have been informed, was full and proper.

Chairman WARNER. I suggest that you work on that for the record and have the benefit of your colleagues and the facts when you put it in our record.

Mr. MCNERNEY. Okay.

Chairman WARNER. Thank you.

Mr. MCNERNEY. I will do that. Thank you.

[The information referred to follows:]

1. Boeing's Cooperation with the Government in its Investigations. Senator Warner asked when the company began to cooperate in the government's investigations and requested amplification for the record. As Mr. McNerney testified, Boeing cooperated throughout the process. Because the Druyun investigation and the EELV investigation were initiated independently, it may be useful to respond further with respect to each.

In connection with the Druyun Matter, Boeing's cooperation began at the outset, when it took prompt action to disclose to the government the misconduct that it had found through its own investigation, and continued through successful prosecution of the responsible individuals and the global settlement.

More specifically, the company on its own initiative opened an internal investigation into the circumstances of Druyun's hiring in the summer of 2003. After the Inspector General of the Department of Defense subsequently opened an inquiry concerning the Tanker Lease Program, Druyun, and other matters, Boeing pledged its full cooperation. When, through its own investigatory efforts, the company discovered that Druyun and Sears had engaged in misconduct, the company immediately contacted the Department of Justice and the Air Force. On the same day that the company terminated the employment of Druyun and Sears for cause and publicly announced that action, Boeing met with government officials (the United States Attorney's Office for the Eastern District of Virginia, and agents of the FBI, DCIS and AFOSI, as well as the Air Force Contractor Responsibility Office) to disclose the results of its internal investigation, including the salient facts and critical documents that led to Druyun's and Sears' convictions.

Boeing's cooperation did not end with its initial presentation. In connection with the ensuing criminal investigation, the company produced interview memoranda and related information requested by the government without interposing privilege objections, provided documents exceeding the scope of the government's subpoenas, repeatedly came back to the government with additional information believed to be of potential relevance whether or not requested, thoroughly investigated collateral matters identified by the government, and made its employees readily available for interviews with the USAO and with other federal agents. In sum, Boeing did everything it could possibly do in terms of cooperation and voluntary disclosure.

With respect to the EELV Matter, Boeing cooperated with the Justice Department investigation that began in 2002. The company produced thousands of documents, submitted voluminous reports detailing the factual findings of its internal investigation, provided the Justice Department with dozens of witness interview memoranda, and made its employees available for follow-up interviews by the government investigators. Thereafter, the company regularly responded to factual inquiries by both the Air Force and the Justice Department, submitted lengthy white papers discussing the legal and factual issues, and provided updates to both agencies with respect to new issues that arose during the course of the investigation and related legal proceedings. Ultimately, the company entered into an Administrative Agreement with the Air Force that gives the government unprecedented access to the company's ethics and compliance program and internal investigations and further provides for an outside monitor to confirm the company's fulfillment of the agreement's terms. Under the terms of the global settlement, such oversight has been extended to the U.S. Attorneys in Alexandria, Virginia, and Los Angeles, California.

Boeing acknowledges that it made mistakes when it first investigated the EELV matter in 1999. At a minimum, it should have been more aggressive in determining the full extent of its employees' misconduct and more extensive in its disclosures to the government and to its competitor. The company subsequently waived privilege with respect to the 1999 investigation and disclosures, commissioned an independent review of its internal investigative procedures, and implemented significant changes in those procedures that are being monitored under the Air Force agreement.

Mr. MCNERNEY. Coupled with the loss of $1 billion worth of EELV launch vehicle business and the huge toll these matters have had on our reputation, the settlement serves as a stark reminder of the direct impact that unethical conduct can have on our bottom line.

Further, we recognize that the mistakes were ours and ours alone, and the problems that enabled those mistakes are ours to correct. Accordingly, we are not taking tax deductions for the $615 million in settlement charges that we have paid to the U.S. Government. Beyond the very real financial consequences of the settlement, I think it is important to note that the events themselves have caused an immense amount of introspection at Boeing. How could a company with a history of reliability and a self-image of unquestioned integrity have made these mistakes? This introspection set us on a course of building one of the most robust ethics and compliance programs in corporate America. That is the lasting legacy and silver lining of this dark cloud in our history.

Ultimately, our goal is to make ethics and compliance a clear competitive advantage for Boeing. Our people and their values, along with our leading-edge technology and products, are why our customers choose or choose not to do business with us. So we aspire to do more than just stay out of trouble. To do that, we are making ethics and compliance part of our leadership agenda and expect this will become a powerful discriminator for our company.

To strengthen our culture, we have been changing in three major ways. First, we are getting committed and getting aligned. For example, every employee each year personally recommits to ethical and compliant behavior three ways: by going through each year a thorough training regimen, re-signing each year the Boeing Code of Conduct, and each year participating in one of our ethics recommitment standdowns with his or her business or function.

Also, in November 2003 Boeing established a new organization, the Office of Internal Governance (OIG), which reports directly to me and has regular and routine visibility with our board of directors. OIG's role includes: one, acting as a strong check and balance for key functional disciplines. An example would be monitoring and tracking such things as potential conflicts of interest through our hiring, transfer, and proposal processes.

Two, providing significantly greater visibility into and oversight of specific ethics and compliance concerns and cases for our top leaders.

Three, consolidating in one organization our various investigative, audit, and oversight resources. This way we are able to identify potential problems and take corrective actions earlier.

Next, we are opening up the culture, and this is critical. We are creating a work environment that encourages people to talk about the tough issues and to make the right decisions when they find themselves at the crossroads between meeting a tough business commitment and doing the right thing. There simply can be no tradeoffs between Boeing's values and Boeing's performance. We want people to know it is okay to question what happens around them because that is what surfaces problems. Silence that ignores the misconduct of fellow workers is not acceptable.

Finally, we are driving ethics and compliance through our core leadership development model, not just off to the side of other things we do every day. At the end of the day, the character of an organization, its culture, comes down to the behavior of its leaders. I believe this is key. Ethics and compliance must be and must be seen to be a central part of the whole system of training and developing leaders and of the whole process of evaluating, paying, and promoting people.

When I joined the company a little more than a year ago, Boeing was already well along in addressing the weaknesses that a combination of internal and external reviewers had identified. But I wanted us to go even deeper, back to the basics of who we are, to mold the kind of leadership that we want to take Boeing into the future.

So first, we defined how we want leaders to behave both in terms of performance and values. We have six basic leadership attributes that we work off of: A leader will chart the course; set high expectations; inspire others; find a way; live Boeing values; and at the end of the day, deliver results.

Now we are modeling, teaching, and expecting these behaviors as we move toward measuring and rewarding them. Today we are familiarizing people with these attributes, helping them understand that "find a way" does not mean find any way. It means find a way within the Boeing value system or that setting high expectations does not mean that inappropriate or intimidating behavior is acceptable in any way.

Starting with the top of the company, we have also begun to directly measure and factor into the whole pay and promotion process the kind of behavior we want in our people.

Mr. Chairman and members of the committee, in my 14 months as the company's chairman, president, and CEO, I have made it my mission to understand and correct the root causes of what went wrong in years past, and I can attest that those former employees referred to in the settlement do not represent the people of Boeing, who are devoted to conducting their work ethically and in the best interests of our customers and our country.

Boeing is fully committed to operating at the highest levels and standards of ethics and compliance. I will continue to do everything in my power to ensure that the company never finds itself in a situation like this in the future.

Thank you very much.

[The prepared statement of Mr. McNerney follows:]

PREPARED STATEMENT BY W. JAMES MCNERNEY, JR.

Thank you, Mr. Chairman and members of the committee.

It is my privilege to represent the 155,000 men and women of Boeing. While I regret the circumstances that bring me before you, I appreciate all the same the opportunity to testify.

I have been asked to address the recent "global settlement" of two high-profile investigations—which I will do. But in that context, I hope also to discuss why, going forward, Congress and the taxpayers of this country can place their trust in Boeing.

Companies doing business with the U.S. Government are expected to adhere to the highest legal and ethical standards. I acknowledge that Boeing did not live up to those expectations in the cases addressed by the settlement we're discussing here today. We take full responsibility for the wrongful acts of the former employees who brought dishonor on a great company and caused harm to the U.S. Government and its taxpayers.

Boeing is accountable for what occurred. We have cooperated with the Government throughout this process.

This settlement is tough—but fair. It has been widely reported as probably the largest monetary settlement of its kind—a sad "distinction" we must live with and learn from. Coupled with the loss of $1 billion worth of Evolved Expendable Launch Vehicle business and the huge toll these matters have had on our reputation, the settlement serves as a stark reminder of the direct impact that unethical conduct can have on our bottom line.

Further, we recognize that the mistakes were ours and ours alone. The problems that enabled those mistakes are ours to correct. Accordingly, we are not taking tax deductions for the $615 million in settlement charges that we will pay to the U.S. Government.

Beyond the very real financial consequences of the settlement, I think it is important to note that the events, themselves, have caused an immense amount of introspection at Boeing. How could a company with a history of reliability and a self-image of unquestioned integrity have made these mistakes?

This introspection set us on a course of building one of the most robust ethics and compliance programs in corporate America. That is the lasting legacy—and silver lining—of this dark cloud in our history.

When I joined the company little more than a year ago, Boeing was already well along in addressing five areas of weakness that a combination of internal and external reviewers had identified:

- management engagement;
- law department investigations;
- hiring practices;
- procurement integrity; and
- our ethics program and associated training.

But I wanted us to go even deeper, back to the basics of who we are, to mold the kind of leadership that we want to take Boeing into the future.

Ultimately, our goal is to make ethics and compliance a clear competitive advantage. We aspire to do more than stay out of trouble. We are making ethics and compliance part of our leadership agenda and expect this will become a powerful discriminator for our company. After all, our customers depend on our people even more than on our products and technologies.

To strengthen our culture, we have been changing in three major ways. We are:

1. Getting committed and aligned;
2. Opening up the culture; and
3. Driving ethics and compliance through our core leadership model, not just off to the side of other things we do every day.

To get us committed and aligned:

- Every employee, each year, recommits to acting ethically in two ways: by signing the Boeing Code of Conduct; and by participating in one of our Ethics Recommitment stand-downs with his or her business or function.
- Also, in November 2003, Boeing created the Office of Internal Governance (OIG), which reports directly to me and has regular visibility with our board of directors. OIG's role includes:
  1. Acting as a strong check and balance for key functional disciplines. An example would be monitoring and tracking such things as potential conflicts of interest through out hiring, transfer and proposal process.
  2. Providing significantly greater visibility into—and oversight of—specific ethics and compliance concerns and cases for our top leaders.
  3. Consolidating, in one organization, our various investigative, audit and oversight sources. This way, we are able to identify potential problems earlier and take corrective action earlier.
- In addition, we have been fortunate to attract an individual with sterling credentials and a peerless reputation for integrity—Judge Michael Luttig, formerly of the U.S. Court of Appeals for the Fourth Circuit—to lead our legal department as senior vice president and general counsel.

On the second point: To open up the culture, we are creating a work environment that encourages people to talk about the tough issues and to make the right decisions when they find themselves at the crossroads between meeting a tough business commitment and doing the right thing. There simply can be no tradeoffs between Boeing's values and Boeing's performance. We want people to know that it's OK to question what happens around them, because that's what surfaces problems early. Silence that ignores the misconduct of fellow workers is not acceptable.

That commitment starts at the top with leadership. At the end of the day, the character of an organization—its culture—comes down to the behavior of its leaders. I believe this is key: Ethics and compliance must be—and must be seen to be—a central part of the whole system of training and developing leaders and of the whole process of evaluating, paying and promoting people.

So, first, we defined how we want people to behave in the form of six leadership attributes: Chart the course, set high expectations, inspire others, find a way, live the Boeing values, and deliver results. Now we are modeling, teaching and expecting these behaviors, as we move toward measuring and rewarding them.

Today, we are familiarizing people with the attributes—helping them understand that "find a way" doesn't mean "find any way;" it means "find a way within the Boeing value system;" or that "setting high expectations" doesn't mean that abusive or intimidating behavior is condoned in any way.

Starting with executives, we have also begun to directly measure and factor into the whole pay and promotion process the kind of behavior we want in our people.

Mr. Chairman and members of the committee, in my 14 months as the company's chairman, president, and Chief Executive Officer, I have made it my mission to understand the root causes of what went wrong in years past. I can attest that those former employees referred to in the settlement do not represent the people of Boeing, who are devoted to conducting their work ethically and in the best interests of our customers and our country.

Boeing is fully committed to operating at the highest standards of ethics and compliance. I will continue to do everything in my power to ensure that the company never finds itself in a situation like this in the future.

Chairman WARNER. Thank you very much.

Now, I listened carefully and it may well be that you covered this, but I would like to focus on it. We have learned through experience in our Federal Government that problems happen, and we have instituted a whistleblower protection act. Actually, it is a Federal statute. Carefully in there is protection for any retaliation or reprisal. I did not hear as crisply as I would like to what you have as a component of this overall and very impressive program you laid out, that tried and I think tested concept.

Mr. MCNERNEY. We try to make as broad a set of provisions and mechanics available to our people who want to bring forward problems that they have identified in the company. Just as background, we get 12,000 inquiries a year into our ethics hotline, so to speak, which can be reached either via phone or via the web. Most of these are inquiries about issues, how to do the right thing, information to help them do their jobs better. Some are serious matters.

Chairman WARNER. That 12,000 is internal?

Mr. MCNERNEY. Internal.

Chairman WARNER. Internal to the company.

Mr. MCNERNEY. This is Boeing people often asking questions, trying to figure out how to do the right thing.

Chairman WARNER. That has been in place how long?

Mr. MCNERNEY. That has been in place 2 years, I believe, at least since 2003.

[The information referred to follows:]

It should be noted that Boeing's ethics hotline was originally instituted more than 10 years ago as part of Boeing's participation in the Defense Industry Initiative on Business Ethics and Conduct.

Mr. MCNERNEY. But the point is that some of these are serious matters, occasionally anonymous. One of the mechanisms we have that directly bears on your question, Mr. Chairman, is we have a tracking system that we implement after someone comes forward. They are often concerned about some kind of retaliation or intimidation post the disclosure. We have an actual tracking system

where we work with people, regularly check in with them, and ask them in their view are they experiencing any kind of retaliation. We track for a long time. Everybody in the company knows we do that. So that has been very helpful to get at that issue.

Chairman WARNER. Could you address the protection of any reprisal against them or adverse?

Mr. MCNERNEY. That is a punishable offense in and of itself in our company. Anybody caught even looking like they are performing some kind of reprisal against somebody, it is a very serious matter, and that is an offense in and of itself and we deal with it.

Chairman WARNER. Is that laid out in this plan as a part of it?

Mr. MCNERNEY. Yes, it is.

Chairman WARNER. Are you able to supply that to the committee?

Mr. MCNERNEY. Yes.

Chairman WARNER. I think it would be helpful if it were made a part of the record. Thank you.

Mr. MCNERNEY. Yes.

[The information referred to follows:]

Boeing has numerous policies in place to encourage employees to come forward with concerns about possible wrongdoing and to protect employees who raise such concerns in good faith. A number of corporate policies and procedures state expressly that retaliation will not be tolerated. (For example, POL-2 "Ethical Business Conduct," PRO-3 "Ethics and Business Conduct Program," POL-5 "Equal Employment Opportunity," and PRO-4332 "Workplace Harassment.") In addition, Boeing's Code of Conduct, signed annually by each employee, cites Boeing's policy against retaliation, and the internal Ethics and Business Compliance web site contains a page directed at managers entitled, "Prohibition on Retaliation" (Enclosure A).

In December 2004, Boeing implemented a tracking process to further ensure that employees do not suffer retaliation. Under that process, documented in Business Process Instruction (BPI) 3751, employees who allege potentially serious misconduct have the option of having their career tracked by a unit within Boeing's Human Resources organization to ensure that they do not suffer retaliation. That unit then conducts follow up interviews with the reporting employee every six months for a minimum of three years to determine whether the employee believes that he or she has suffered retaliation. Any allegation of retaliation made through that process would trigger a separate inquiry and discipline up to and including discharge if the allegation is substantiated. (Enclosure B is a copy of BPI-3751.) Employees also can bring complaints about retaliation through the company Ethics Line, to the company ethics advisors directly, or to the Human Resources organization.

Chairman WARNER. Senator Reed.

Senator REED. Thank you very much, Mr. Chairman.

Welcome, Mr. McNerney. I have not had the privilege of meeting you, but Senator Dayton's personal commendation is quite impressive and I wish you well on your leadership of a great company.

One of the things that intrigues me is I am sure if we flash back about 4 or 5 years ago the leaders of Boeing would point to their very strong ethics policy, their procedures, et cetera, and it did not work. I wonder if you might shed some light on why you think it did not work and why this approach that you are adopting will in fact work?

Mr. MCNERNEY. I think that back then there were a number of sincere leaders that felt that the company was on the right path. As you look back on it, I think it was not as clear to all of our employees in a very explicit way the values we expected of them. So

you cannot just deal with ethics as a stump speech. It has to get into the fabric of the company in every way, and that is what we have tried to do differently here. It is part of pay, it is part of promotion, it is part of our Leadership Development Center outside of St. Louis. It is part of values statements that we sign up for. It is embedded in everything. It is part of our leadership assessment of people.

So it is not any one thing. It is in everything, combined with some strong leadership from the top in terms of leading it and modeling it and displaying it, there is no one thing you hang your hat on. You embed it in everything. That is what has to happen in my experience in leading large organizations.

Senator REED. Is this a topic, ethics, that is periodically reviewed by the board of directors in a detailed way, so that they are also involved in this process?

Mr. MCNERNEY. Yes. The OIG, led by Bonnie Soodik to my right here, routinely shows up. It is part of the board agenda. There is a report. There is time for questions and answers. On top of that, in every audit committee meeting cases are brought forth that are discussed. We have a hotline that comes in through our board of directors that gathers some of these inquiries or accusations.

So it is very visible to our board of directors at the case level, and we think that is important.

Senator REED. As I mentioned in my questioning of the Assistant Attorney General, this agreement expires in 2 years, so the precise legal requirement to continue this program will disappear. But how can you ensure that it is permanent?

Mr. MCNERNEY. I think what we are doing now makes us a stronger company. This is not a matter of we are either competitive or we are an ethical company. The fact is the same kind of open culture that a company has that fosters a good ethical program is also good business. It is a free forum of ideas. The best ideas are the ones that make it, not hierarchically determined ideas. In the same fashion, ethics is something that should be discussed irrespective of the hierarchy and dealt with irrespective of the hierarchy.

So I am bound and determined to make our pursuit of all the mechanics and cultural change that we are driving for, make it a fundamental discriminator for us on the positive side. So we are going to keep building this program regardless of any legal requirement.

Senator REED. You point out that you are trying to develop a culture in which ethics factors into compensation, into the mix of values that you treasure in the company. How do you measure that in a practical way? I know it is a complicated question.

Mr. MCNERNEY. We tried to make it simple, because it is complicated. I think we have striven to make it something that is easily understandable and is directly part of the measurement. We started with the top of the company. We took those six leadership attributes I described and embedded in each of them is an element of ethics and compliance, as well as one of them which explicitly deals with it. I tried to point out that embedded in each of the others there is a piece of it.

We assess our people. I did that with my team last year and they did it with theirs. Now we are going to roll it down through the company.

So there are two reasons why you get certain kinds of bonuses, which are significant pieces of their compensation. One is performance against objectives and the other is this leadership assessment. They will both bear on it. Until you do that, people are not convinced, in some cases, you are serious about all this.

Senator REED. Thank you very much.

Mr. MCNERNEY. You are welcome.

Senator REED. Thank you, Mr. Chairman.

Chairman WARNER. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. McNerney, was Senator Rudman and his team's work helpful to you?

Mr. MCNERNEY. Excuse me?

Senator MCCAIN. Senator Rudman's?

Mr. MCNERNEY. Yes, it was helpful to us.

Senator MCCAIN. Last week you stated that Boeing would "not write off" these payments despite that it concluded that it could do so. On what basis did you conclude that most of the payments payable to the government under the agreement are tax deductible?

Mr. MCNERNEY. You are never certain. We had outside counsel who offered a view that $565 million was deductible, and that was the input that I had.

Senator MCCAIN. So that was an analysis from outside informants?

Mr. MCNERNEY. Yes.

Senator MCCAIN. First of all, I would like to thank you for your stewardship of this wonderful corporation that fell onto some hard times, and we look forward to working with you.

I believe that we are about to face a serious crunch in defense spending. We are looking at unfunded repair and replacement costs for the Army which are I think $17 billion. We are looking at already cuts being made in the appropriations process in defense spending, looking at increased funding requirements for a number of weapons systems as they mature.

No matter the individual feelings of the members of this committee, we think that history shows that there is probably going to be reductions in defense spending and budgets, as opposed to what we have enjoyed in years past. This makes the argument for procurement reform even more compelling. I think that we are going to reform procurement one way or the other. I do not think we can continue the way we are, given the premise that I just stated.

If we are really going to seriously reform procurement, we are going to have to have a partnership with the defense industry. I think we are very powerful here in the Senate, in Congress, and in the executive branch, but I am not sure how much we really achieve unless we work together with the corporations that do most of the defense production in this Nation.

I would like you to start thinking about it. The chairman and I, Senator Reed and others, all feel that we are going to have to address this issue, and I believe that, given your position and your record, that you can help us a great deal as we embark on this ef-

fort, facing what I believe may be a real crisis in our ability to fund this Nation's defense requirements and national security requirements.

Mr. MCNERNEY. We would be glad to participate in that debate, because I think we share goals here.

Senator MCCAIN. Thank you.

Chairman WARNER. First I would say, Senator McCain, I thank you. You have been on the cutting edge of all the initiatives of recent here on this question of reforming our procurement process, and I look forward to the next Congress and working with you on that important subject.

Senator Sessions.

Senator SESSIONS. Thank you, Mr. Chairman.

I would like to say that I do agree with Senator McCain that there seems to be some inertia in this procurement process, that contracts just seem to grow. We are going to have a tight time. It is just going to be tighter, and we have a lot of very expensive programs out there. I think every defense contractor has to know that they are going to be expected to perform on time, on budget, and we are going to be looking for ways to do things better at less expense than maybe the initial expectation by some would be.

I just would want to say that I am aware that Boeing Company did lose some substantial work in addition to the $600 million plus in fines and penalties you paid and it impacted your facility in Alabama. I am glad that it does appear that Lockheed and Boeing have reached an accord on that EELV project, which may well have saved a plant that might otherwise have been closed, primarily as a result of these penalties and debarments that you got hit with.

I think it is clear to anyone that the company has paid a substantial penalty and substantial losses. I do think perhaps we should consider, Mr. Chairman, how to handle these matters that are categorized as compensatory payments. Apparently the tax code must not be exactly clear, but apparently if they are truly compensatory and not penalties they become deductible by any defendant that pleads guilty. Really we could in Congress clarify that. We could just say, bam, it is going to be this way.

But I can say in somewhat defense of Mr. McNulty and his team, I remember back when I was a prosecutor 20 years ago the position of the DOJ always was that the IRS will decide how much taxes you pay, this is what the fine is. They would try to negotiate: can you make this tax deductible? That is not part of our discussion.

Maybe it is time for us to confront that. I am not sure why it needs to be so vague. Mr. McNerney, would you have a comment? Obviously you had advice that indicated you may could deduct it. You chose not to out of a commitment, I guess, to demonstrating to the world Boeing's determination to reach higher and further than it has before. Do you have any thoughts about that?

Mr. MCNERNEY. I only have thoughts about our situation. I think you fairly characterized it. We wanted to do the right thing. We did not think the taxpayers should bear the brunt of our wrongdoing.

Senator SESSIONS. One thing, when you know it, Mr. Chairman, you know it. The government knows it is going to be deductible or the government knows it is not going to be deductible. The defendant company knows it is not going to be or is going to be, and all

that can enter into reaching a fair and just penalty. I think it might be better if we could clarify.

I have heard excellent things about your leadership. I was with a lawyer recently who defended a big case and he was telling me that these kind of training programs are good. He even suggested we in Congress ought to do it, that if you do not have a good training program you are far more susceptible to legitimate criticism than if some lower official violated a clear, unequivocal policy and teaching of the company. It seems to me that probably few companies in America at this point are more committed to teaching to the lowest level of your company the highest standards of ethics, and I salute you for that.

Thank you, Mr. Chairman.

Chairman WARNER. Thank you, Senator Sessions.

I have one other question. Do you have anything?

Senator REED. No, I do not, Mr. Chairman.

Chairman WARNER. The criminal settlement agreement contains language standard in such settlements to the effect that Boeing undertakes not to commit any of the certain Federal criminal offenses during the term of the agreement. However, the agreement also provides that, for purposes of determining compliance with the agreement, only criminal conduct by Boeing employees at the level of executive management will be imputed to the company, although the company is required to conduct a significant ethics and compliance program for all employees.

Why was this restriction on liability included, and how many Boeing employees are at the level of executive management?

Mr. MCNERNEY. This refers to about 1,800 executive level employees in the company. I think it is my understanding that one of the reasons the settlement centered on that group is that is where the wrongdoing occurred and that was the source of the wrongdoing in one of the cases. So I think it settled that way.

That does not provide immunity, by the way, for wrongdoing by others at the company. I think it just refers to the potential opening up of the original charges.

[The information referred to follows:]

The question refers to paragraph 4(f) of the agreement with the U.S. Attorneys and, in responding, it is important to distinguish between what this provision does and does not do. Paragraph 4(f) is addressed solely to the circumstances in which the commission of an offense in the future by a Boeing employee could trigger the reopening of the Druyun Matter, and permit the government to prosecute the company on Druyun-related charges (or seek to impose an additional penalty of up to $10 million). The provision does not immunize or otherwise protect anyone – the company or its employees regardless of rank – from criminal liability for future offenses. Furthermore, as a government contractor, Boeing would always be subject to potential suspension or debarment were an employee at any level to be indicted or convicted of an offense bearing upon the company's present responsibility as a government contractor.

The limitation on circumstances in which the global settlement could be reopened and Druyun-related charges pursued is neither unreasonable nor unprecedented.

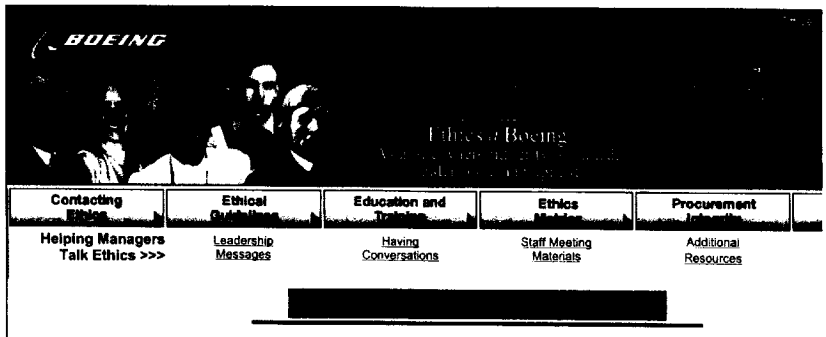
One of the goals of the global settlement was practical finality. A settlement that could be reopened based upon any misconduct by any individual among Boeing's 155,000 employees would be inconsistent with finality. Another goal, addressed through the requirement that Boeing maintain its enhanced ethics and compliance program and improved investigation processes, was to reduce the risks of such misconduct or, in any event, to encourage proactive company action to detect and report it. It is fully consistent with that purpose to restrict the trigger for reopening the Druyun matter to those situations in which the remedial measures required by the settlement agreement have arguably proven ineffective – i.e., when it is believed that senior management engaged in serious criminal misconduct and the company failed to timely detect and report it.

Presumably, the same rationale underlies similar provisions negotiated in other contexts. For example, in *United States v. America Online, Inc.*, the deferred prosecution agreement provides that the deferred charges will not be reinstated absent future "Federal Crimes," defined to include "financial fraud related to AOL's business activities committed by AOL officers or directors at or above the level of Senior Vice President." In the global settlement here, the designation of executive management includes company officers but is much broader, encompassing more than 1,800 Boeing officers and employees.

Chairman WARNER. I tell you what. I am going to leave this question here and you could collect it and look at it and perhaps amplify it for the record. I would also ask my chief of staff that that question go to the DOJ also, so that they can have an opportunity to put this in the record, because this is an issue that is being raised by a number following this important case.

[The information referred to follows:]

The Boeing Company also notes that the Druyun matter involved misconduct at the executive management level.



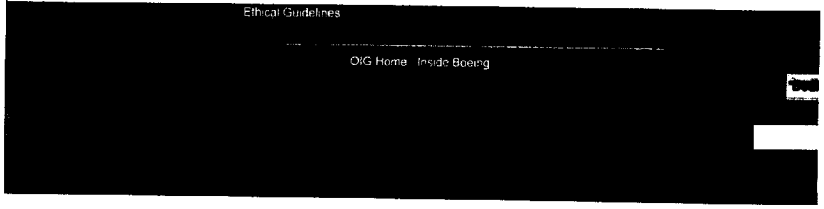
The term "Whistleblower" has gained common usage to describe someone who reports a significant violation of law or ethics t the government or some other oversight body. Federal and state statutes create protections for various classes of public and p who "blow the whistle" in specific contexts. Perhaps the most notable of these whistleblower protections is that afforded under Oxley legislation. The SOX anti-retaliation provisions prohibit retaliation against a reporter of financial fraud. Unlike many whis protections, SOX covers contractors, subcontractors, and agents in addition to officers and employees. The specific protection whistleblowers vary based on the applicable statute, and can vary significantly. Boeing uses the term "Reportant" to describe p report potential legal and ethical violations. The term "Reportant" is used to avoid the negative connotations that can be assoc "Whistleblower".

The single most important thing to remember is that Boeing policy prohibits retaliation against a Reportant for having reported regardless of whether the Reportant falls within a statutory definition of a "whistleblower" and regardless of whether the matter turns out to have been an issue. Regardless of whether a specific statute provides whistleblower protection, Boeing, as a polic retaliation. There shall be no retaliation against persons who in good faith report a matter they believe to be a violation of law c

Retaliation is an adverse action taken against the Reportant because of the reporting of the issue. The most obvious form of re termination, but the concept is in fact far broader, including actual or threatened retaliation: e.g. disciplinary action, suspension transfer, demotion, removal of work statement or responsibility, sudden shift to negative performance reviews, harassment, fai raises, move to less desirable work location, terms, benefits or privileges -- or threats to take any of these kinds of retaliatory a can be direct and obvious or it can be subtle.

Managers should keep in mind that an employee who is a Reportant may well be nervous about retaliation and is likely to inter actions in a negative light, even though the manager has no retaliatory intent. For example, if an employee has recently report ethical issue, and the manager happens to be incredible busy with a special project, the employee may well think that the man speaking to the employee because the manager is angry with the employee, when in fact the manager is just focused on some

The fact that an employee under your management is a Reportant does not mean that you are relieved of your obligation to m employee. The prohibition on retaliation prohibits actions taken because of the employee having reported the potentially signifi Normal management decisions based on employee performance and business needs are not retaliation and such normal man decisions should be made. However, the fact that an employee is a Reportant should be discussed with Law and an HR profes employment action is taken to avoid even an appearance of retaliation. For example, if an employee has had performance pro years and the manager has documented these performance issues, Law and HR would likely advise the manager to proceed v action arising from the performance issues. However, if the manager has not been documenting the performance issues, HR a advise the manager take a different approach toward commencing corrective action with respect to a Reportant to avoid the ap retaliation.



BPI-3751
Issue Date
December 17, 2004

Process to Follow Up with Reportants

Purpose/Summary

The purpose of the instruction is to describe the process for follow up by Global Diversity and Employee Rights to determine whether retaliation has occurred against employees who bring forth potentially significant allegations as outlined in PRO-6419..

Supersedes

None

Applies To

All Boeing

Roles Affected

Global Diversity and Employee Rights, Receiving Organizations

Maintained By

World Headquarters Global Diversity and Employee Rights

Authority Reference

Procedure PRO-6419, "Mandatory Referral of Certain Matters Requiring Legal Investigation to the Boeing Law Department"

Approved By

Rick Stephens
Senior Vice President, Internal Services

A. Scope

1. Receiving Organizations must refer to the Law Department Potentially Significant Allegations as defined in PRO-6419.

2. Each Receiving Organization also shall notify Global Diversity and Employee Rights of the Reportant of each Potentially Significant Allegation which that Receiving Organization refers to the Law Department, or in the case of Law, which the Law Department receives from a source other than a Receiving Organization.

3. The Global Diversity and Employee Rights organization shall follow up with Reportants, and address where necessary, retaliation against those who raise Potentially Significant Allegations. The follow up process will not identify the Reportant to anyone other than those who have a need to know for follow up purposes, e.g. an authorized HR professional.

B. Definitions

The definitions of the terms used in this process instruction are for purposes of this process instruction only and have no effect on the meaning of the same or similar terms used in other documents.

1. **Potentially Significant Allegation:** An accusation or report that involves a suspected violation of law or policy which, if confirmed, could cause substantial harm to the business or reputation of the Boeing Company (see PRO-6419, "Mandatory Referral of Certain Matters Requiring Legal Investigation to the Boeing Law Department").

2. **Receiving Organization:** Ethics, Law, Security, HR, Finance, Audit, Safety, Health & Environmental Affairs, Quality, etc.

3. **Reportant:** A person who in good faith reports what he or she reasonably believes to be a Potentially Significant Allegation to (a) company management, (b) an external government or regulatory agency, or (c) a Receiving Organization.

4. **Retaliation:** Whether a particular action constitutes "retaliation," shall be determined by Global Diversity and Employee Rights, in consultation with the Law Department where appropriate, based on the specific facts of the situation. Generally, retaliation is an adverse action (e.g., denial of a promotion opportunity, denial of a salary increase, layoff selection, harassment, or corrective action such as termination) against a specific

employee that is caused as a result of a person alleging a Potentially Significant Allegation.

C. Requirements and Process Steps

1. Notification of Potentially Significant Allegations

Role (s): Receiving Organizations

Each receiving organization, upon receiving a Potentially Significant Allegation (as defined by PRO-6419) from an individual, shall forward that allegation to the Boeing Law Department. In addition, receiving organizations shall forward to Global Diversity and Employee Rights the individual's name, BEMS ID, and a brief description of the Potentially Significant Allegation forwarded to the Boeing Law Department.

2. Maintain List of Reportants

Roles (s): Global Diversity and Employee Rights

Global Diversity and Employee Rights shall maintain a list of the names and BEMS IDs of individuals referring Potentially Significant Allegations. The names of individual Reportants shall not be disclosed to anyone other than those who have a need to know for follow up purposes, e.g. an authorized HR professional, OIG or Law Department.

3. Conduct Follow Up Interviews

Role (s): Global Diversity and Employee Rights

Subject to the consent of the Reportant, Global Diversity and Employee Rights shall conduct follow up interviews with the Reportant every six months after the initial Potentially Significant Allegation for a minimum of three (3) years. If a Reportant elects not to be followed up with, his/her name shall be deleted from the list.

4. Investigate Allegations of Retaliation

Role (s): Global Diversity and Employee Rights

If, during the course of an interview, a Reportant raises a claim of retaliation, the allegation shall be investigated by Global Diversity and Employee Rights in accordance with investigation guidelines and processes currently in effect.

5. Employee Corrective Action

Role (s): Global Diversity and Employee Rights, Business Unit HR, and Employee Corrective Action Focals

If a retaliation allegation is substantiated, the individual (s) responsible for the retaliation will be subject to appropriate corrective action per PRO – 1909 (Administration of Employee Corrective Action).

6. **Quarterly Reports to the Office of Internal Governance**

Role (s): Global Diversity and Employee Rights

Global Diversity and Employee Rights shall provide quarterly status reports to the Office of Internal Governance (OIG) and meet with OIG leadership as necessary and appropriate to discuss the follow up process.

7. **Final Follow Up Interview**

Role (s): Global Diversity and Employee Rights

After three (3) full years from the last report of a Potentially Significant Allegation and subject to the consent of the Reportant, Global Diversity and Employee Rights shall conduct a final interview with the Reportant to address any retaliation concerns.

8. **Audit the Reportant Follow Up Process**

Role (s): Office of Internal Governance (OIG) and Audit Focal

The Office of Internal Governance (OIG) will designate Audit to perform a review of the Reportant Follow Up Process on an annual basis to ensure compliance.

D. **Additional References**

POL-2, "Ethical Business Conduct Policy

PRO- 3, "Ethics and Business Conduct Program"

Boeing Code of Conduct

Chairman WARNER. We have our colleague from Missouri, Senator Talent.

Senator TALENT. Thank you, Mr. Chairman.

I appreciate your testimony, Mr. McNerney, and your attitude toward this whole issue. I could not agree more that if we are going to do what we need to do to fund America's military we are going

to have to work closely with the major defense contractors in making the dollars stretch and we are going to have to have relationships of trust. It seems to me that you are building in that direction on behalf of a great company that, notwithstanding this incident, Mr. Chairman, I think has had a very strong record on balance over the years of efficient delivery.

I just think of these programs that are the mainstay of naval aviation, Mr. Chairman, and so many other fine platforms that this company has produced. It really is the best work force producing military aircraft in the world.

If I understood your testimony, let me sum it up and you tell me if this is right, that you and your team are inculcating at Boeing the idea that, look, if you are working on a project and you get a good business result, but you do it the wrong way, that is not a good business result. Similarly, if you get what would normally be thought of as a bad business result, but you did it the right way, that is a good business result.

In other words, that preserving the reputation and the integrity of the company is more important than the business bottom line result in a particular case. Would you agree? Is that an accurate summary of what you are saying? Maybe if you want to just reflect a little bit, because you have a history before Boeing, obviously, on just your general approach and maybe how your past experiences bore on how you approach this issue.

Mr. MCNERNEY. I think the essence of what you are saying is how you do things is just as important, if not more important, than what you do. Obviously, you want a company where you both perform and do it right. As I pointed out in response to Senator Reed's comments, if it does not count in the way people are paid and promoted eventually, people think you do not mean it.

So you have to measure it, which leads to the other issue of bringing it into the actual evaluation process. I think that is learning I have taken from other situations. You have to have an open culture that questions things, that makes self-questioning alright, that makes the strength of ideas more important than the hierarchical source of them. You have to measure things and get them into the fabric of what people are concerned about every day. If you do not do that, you do not have an effective ethics program. That is what we strive to do.

Senator TALENT. I appreciate that. It is like a whole lot of these kinds of initiatives. If the support is not there at the top, everybody realizes it, no matter what people may say. So I appreciate very much your testimony and your attitude.

That is really all I have, Mr. Chairman. Thank you.

Chairman WARNER. I would like to just make an observation. This has been an unusual hearing. I am privileged to be in this committee for 28 years now and we have never had a hearing quite like this one. My colleague, Senator McCain, and I, together with others, we weighed very carefully what was our objective in having it and what did we hope to have adduced at the hearing. I believe that, certainly speaking for myself, those expectations were reached today, because I felt we were not here to further inflict any adverse publicity or punishment or however people wish to judge the actions of Congress as to the private sector. It was a constructive

thought on the part of us to have this hearing to show how a company which had literally sunk to its knees from a lofty height is now making its way back up under your leadership. I presume the board and others who have a deep, abiding respect for this company and the need to restore it, not just for their own self-interest but for the national interest to have Boeing viewed as the premier among the premier of our industrial base. I think we have achieved that today.

If I could just gratuitously give one little bit of advice, I look back on my own career. I was fortunate enough to go to two schools. One was my father's old school, Washington and Lee University, founded by George Washington and later General Lee was president in the aftermath of the tragic Civil War; and the University of Virginia, founded by Jefferson.

I am deeply affected every day of my life by many of the things that I learned at those two institutions, among them the honor code. As I have tried to put together my humble career, that has been a guiding light and I am sure that it has spared me some grief along the way that I have witnessed others suffer.

All this to say to you, I would hope that you would find the opportunity to visit one or more of the preeminent business schools in America, where the young industrial leaders to be are anxiously learning and receiving the guidance from their elders, and imbue in them what you have learned and what you are trying to achieve in the hopes that the coming generation of industrial leaders in our Nation will have the benefit of the learning that you can provide. I just add that by way of a personal thing, out of recognition for coming to get to know you and the sincerity with which you approach your task.

Mr. MCNERNEY. Thank you.

Chairman WARNER. Thank all who are in attendance today. The hearing is concluded.

[Questions for the record with answers supplied follow:]

QUESTIONS SUBMITTED BY SENATOR JOHN WARNER

IMPUTATION OF CONDUCT

1. Senator WARNER. Mr. McNulty and Mr. McNerney, the criminal settlement agreement contains language standard in such settlements to the effect that Boeing undertakes not to commit any of certain Federal criminal offenses during the term of the agreement. However, the agreement also provides that, for purposes of determining compliance with the agreement, only criminal conduct by Boeing employees at the level of executive management will be imputed to the company, although the company is required to conduct a significant ethics and compliance program for all employees. Why was this restriction on liability included?

Mr. MCNULTY. Boeing argued that conduct by lower level employees, unknown and unapproved by executive management, should not trigger the draconian remedy of prosecution of the company under the deferred prosecution agreement. The United States Attorney's Offices for the EDVA and CDCA accepted that argument, but insisted that it was important for all Boeing employees to participate in ethics and compliance training to create the proper ethical environment in the company.

Mr. MCNERNEY. It is important to note at the outset that the agreement does nothing to restrict the government's right to prosecute the company or any individual employee (regardless of level) for the commission of any Federal offense. One of the goals of the global settlement was practical finality. A settlement that could be reopened based upon any misconduct by any individual among Boeing's 155,000 employees would be inconsistent with finality. Another goal, addressed through the requirement that Boeing maintain its enhanced ethics and compliance program and improved investigation processes, was to reduce the risks of such misconduct or, in

any event, to encourage proactive company action to detect and report it. It is fully consistent with those goals to restrict the trigger for possibly reopening the Druyun matter to those situations in which the remedial measures required by the settlement agreement have arguably proven ineffective—i.e., where it is believed that senior management engaged in serious criminal misconduct and the company failed to timely detect and report it.

2. Senator WARNER. Mr. McNulty and Mr. McNerney, how many Boeing employees are at this level?

Mr. MCNULTY. Approximately 1,900 Boeing employees are in executive management.

Mr. MCNERNEY. As of August 7, 2006, there were 1,991 officers and employees at this level.

3. Senator WARNER. Mr. McNulty, please provide the analysis supporting the Department of Justice's (DOJ) consideration of the Thompson Memo guidelines as used in determining the none-prosecution agreement in this case.

Mr. MCNULTY. Based on the factors outlined in the Department's Principles of Federal Prosecution of Business Organizations, the United States Attorney's Offices in the EDVA and CDCA reached the decision to enter into an agreement with Boeing not to seek criminal charges against the company. Those factors included Boeing's timely and voluntary cooperation, particularly in the Druyun matter; its willingness to continue to cooperate in the investigations; the company's policies and procedures in place at the time of the conduct; the remedial actions taken by Boeing, including efforts to improve and make more effective its corporate compliance program; its termination of wrongdoers; and the adequacy of other remedies, including the civil settlement.

QUESTIONS SUBMITTED BY SENATOR JOHN MCCAIN

CHIEF FINANCIAL OFFICER MICHAEL SEARS

4. Senator MCCAIN. Mr. McNulty, prior to entering into this global settlement, did the DOJ find that other executives or members of the board contemporaneously knew (or should have known) about then Chief Financial Officer (CFO) Michael Sears' illegal communications with Ms. Druyun?

Mr. MCNULTY. As outlined in the statement of facts filed in the U.S. District Court in the Eastern District of Virginia on November 15, 2004, at the time of Michael Sears' plea, senior management of Boeing was aware that Michael Sears sought to hire Darleen Druyun as a Deputy in Boeing's Integrated Defense System Missile Defense Systems located in Washington, DC. However, there was no evidence developed in the investigation, or cooperation of Michael Sears, that senior management other than Michael Sears was aware that Darleen Druyun had not disqualified herself from acting on Boeing matters prior to her negotiations with Michael Sears for employment by Boeing.

THE THOMPSON MEMO

5. Senator MCCAIN. Mr. McNulty, under the Thompson Memo, the prosecutor gauges the extent of a company's cooperation by considering several factors. One of those factors requires the prosecutor to consider whether the business organization "[w]aived attorney-client privilege and work-product protection". How were waiver issues handled regarding information needed for the DOJ to conduct its independent investigation, leading up to the agreement?

Mr. MCNULTY. Boeing did not completely or formally waive the attorney client privilege and work product protection in connection with the two investigations in the EDVA and CDCA. However, Boeing did agree to a limited waiver as to the investigation conducted by outside counsel of the Druyun matter, providing the entire investigation with an agreement that the materials would be protected under the grand jury secrecy provision of rule 6(e) of the Federal Rules of Criminal Procedure. In connection with the Evolved Expendable Launch Vehicle (EELV) investigation, Boeing did not waive the privilege but worked with investigators and the U.S. Attorney's Office of the CDCA to provide documents and witnesses for interview.

6. Senator MCCAIN. Mr. McNulty, how are waiver issues handled under the agreement regarding information that the DOJ and the Special Compliance Officer may need to assure that Boeing is abiding by the agreement, going forward?

Mr. MCNULTY. The Criminal Agreement provides in paragraph 7 that Boeing is required to report the status of ongoing legal investigations, as that is defined, both to the United States Air Force (USAF) under the Interim Administrative Agreement (IAA) and to the U.S. Attorney's Offices if an investigation involves a defined offense. Neither the IAA or the Criminal Agreement requires Boeing to waive attorney client privilege in providing those reports.

7. Senator MCCAIN. Mr. McNulty, I understand that under the Thompson Memo, among the factors that guide the Department's prosecution of a business organization, is evidence of "pervasive wrongdoing within the corporation". Did the DOJ find that there was "pervasive wrongdoing" within Boeing during the relevant period?

Mr. MCNULTY. The two criminal investigations did not find pervasive wrongdoing as set forth in the Principles of Federal Prosecution of Business Organizations. In the case of the hiring of Darleen Druyun, while the guilty Boeing employee, Michael Sears, was in a senior position, other senior management was not aware of his illegal conduct. When the illegal conduct was discovered, Sears was promptly terminated for cause by Boeing. In the case of the EELV investigation, the guilty employees were at a relatively low level in the corporation. Their conduct was not condoned by senior management.

INTERNAL REVENUE SERVICE INVESTIGATIONS

8. Senator MCCAIN. Mr. McNulty, in your written testimony, you state that, rather than negotiate beforehand the tax treatment of its civil settlements with the settlor, the Department works after-the-fact with the Internal Revenue Service (IRS) to "facilitate follow-on investigations of the tax ramifications of our larger fraud settlements." You also cite "initiat[ing] meetings with [the IRS] to facilitate a systematic sharing policy that can expand this process into other enforcement areas [with the DOJ]." What exactly does these mean? Please describe these measures more thoroughly.

Mr. MCNULTY. Since 2003, the DOJ has cooperated with a compliance project established by the IRS to focus on the deductibility of payments made in settlements involving fraud, primarily those resolving liability under the False Claims Act (FCA). This cooperation has consisted of personnel in the DOJ Civil Division promptly informing IRS of any FCA settlement that exceeds $10 million and providing the IRS with information and documents from such settlements that may be pertinent to the determination of tax liability. In addition, personnel from the Department have conducted formal in-depth training of IRS personnel in the area of FCA liability and our attorneys often engage in discussions with IRS managers and agents to discuss the issues attendant to these settlements.

9. Senator MCCAIN. Mr. McNulty, how exactly do these measures help assure that, after the DOJ enters into one of its "tax neutral" settlements, the IRS properly characterizes and treats payments required under the settlement, for tax purposes?

Mr. MCNULTY. After these settlements are achieved by the Department and the IRS initiates its review, a technical advisor within the IRS calls designated personnel within the Department to identify the appropriate DOJ attorneys to contact for in-depth information about the matter. Department attorneys then provide information that may support the various components of the settlement amount, such as restitution, fines, penalties, and multiple damages under the False Claims Act. This information may include correspondence or presentations submitted to the Department by the settling party that reveal an awareness that a settlement consists of amounts over and above restitution. It may also consist of correspondence or presentations made by the Department to the settling party revealing similar information, and internal records revealing the actual disposition of amounts received by the Department in those settlements. Simply put, to the extent permitted by law and within parameters governing the preservation of our various privileges, the Department strives to provide the IRS with any and all information that will effect our mutual goal of assuring the proper tax treatment of these settlements.

10. Senator MCCAIN. Mr. McNulty, under the agreement, which covers a 2-year period, Boeing agrees not to commit any crimes related to stealing other companies' sensitive procurement information or otherwise violate the laws governing Federal bribery, graft, and conflict of interest. But, here, the agreement contains a stipulation that provides that, if a non-executive level Boeing employee commits the covered offense, that it's not a violation of the agreement by Boeing. Has such a provision ever been included in a deferred prosecution agreement, or non-prosecution

agreement, in the past? If so, please identify those agreements and describe those provisions.

Mr. MCNULTY. Yes, the deferred prosecution agreement between the U.S. Attorney's Office for the EDVA and AOL which was entered December 14, 2004. That agreement defined Federal crimes which would violate the agreement as certain offenses similar to the offenses that were deferred, and required that certain of those offenses would have to be committed by AOL officers or directors at or above the level of senior vice president to violate the deferred prosecution agreement.

11. Senator MCCAIN. Mr. McNulty, under this provision, what if a Boeing executive knew or should have known about the fact that the non-executive employee committed a covered offense?

Mr. MCNULTY. While this is a hypothetical question, the outcome of which would turn on the facts of such a case, an "Executive Management" employee under the agreement, who knew of covered criminal conduct by a non-executive management employee and did not report the crime, could be in violation of the agreement. The Responsible Corporate Officer Doctrine would result in criminal liability for the "Executive Management" employee who did not report or prevent the criminal conduct of the lower level corporate employee. This criminal liability of the "Executive Management" employee would violate the agreement.

12. Senator MCCAIN. Mr. McNulty, would this be a violation of the agreement, or not? If not, why doesn't the agreement cover circumstances where Boeing's executives knew or should have known about the offense committed by the non-executive employee? In other words, please explain the rationale behind this provision.

Mr. MCNULTY. See answer to question 11.

13. Senator MCCAIN. Mr. McNulty, under the criminal agreement, the Government will forgo prosecuting Boeing on, among other matters, "Boeing's retention of a retired USAF General Officer and his activities while retained by Boeing relating to the tanker program or otherwise." What is the current status of any investigation arising from the activities of this individual, as to this individual personally?

Mr. MCNULTY. This is the subject of an ongoing criminal investigation.

14. Senator MCCAIN. Mr. McNulty, what is the current status of any investigation arising from the activities of this individual, as to the company?

Mr. MCNULTY. See answer to question 13.

15. Senator MCCAIN. Mr. McNulty, if there are no investigations pending arising from the activities of this individual, please describe the circumstances surrounding Boeing's retaining him.

Mr. MCNULTY. See answer for question 13.

16. Senator MCCAIN. Mr. McNulty, if there are no investigations pending arising from the activities of this individual, did this individual ever discuss employment with Boeing while he still was with Air National Guard?

Mr. MCNULTY. See answer for question 13.

17. Senator MCCAIN. Mr. McNulty, what "activities while retained by Boeing relating to the tanker program or otherwise" is the agreement referring to?

Mr. MCNULTY. See answer to question 13.

18. Senator MCCAIN. Mr. McNulty, what did you find regarding "Boeing's retention of this USAF General Officer and his activities while retained by Boeing relating to the tanker program"?

Mr. MCNULTY. See answer to question 13.

GLOBAL SETTLEMENT AGREEMENT

19. Senator MCCAIN. Mr. McNerney, last week you stated that Boeing wouldn't "write-off" payments that it was required to make under the global settlement agreement, despite that it concluded that it could do so. On what legal basis did Boeing conclude that most, if not all, of the payments payable to the Government under the agreement were tax deductible?

Mr. MCNERNEY. With respect to the $615 million payment, our conclusion, based upon the advice of outside experts, was that the $565 million payment under the Civil Settlement Agreement was not a non-deductible "fine or similar penalty" with-

in the meaning of Internal Revenue Code Section 162(t), but rather qualified as a payment of deductible compensatory damages. That determination was based on the underlying facts and an analysis of the relevant provisions of the Internal Revenue Code and of the U.S. Treasury regulations, legislative history, pertinent court decisions, published rulings of the IRS, and such other authorities as were considered relevant.

20. Senator MCCAIN. Mr. McNerney, under the deferred prosecution agreement, the Government will forgo prosecuting Boeing on, among other matters, "Boeing's retention of a retired USAF General Officer and his activities while retained by Boeing relating to the tanker program or otherwise." Please describe the circumstances surrounding "Boeing's retention" of him?

Mr. MCNERNEY. I am advised that the referenced USAF General Officer retired effective on February 1, 2002, having commenced terminal leave in November 2001. On May 2, 2002, he was retained for a 6-month term as a Boeing consultant. His consultancy was renewed in November 2002 and in subsequent years. (He is no longer a Boeing consultant.)

21. Senator MCCAIN. Mr. McNerney, when did discussions between Boeing and General Weaver about this begin?

Mr. MCNERNEY. I am advised that the discussions between Boeing and the retired General Officer began in April 2002. We have not ascertained the precise date.

22. Senator MCCAIN. Mr. McNerney, while this General Officer was still with the USAF, did anyone from Boeing talk to this General Officer about possibly working for Boeing as either an employee or independent contractor and what was discussed?

Mr. MCNERNEY. We are not aware of any discussions between Boeing and the retired General Officer, prior to his retirement, concerning possible employment by or retention as a consultant for the company.

TANKER PROGRAM

23. Senator MCCAIN. Mr. McNerney, what "activities while retained by Boeing relating to the tanker program or otherwise" is the agreement referring to?

Mr. MCNERNEY. For the purpose of defining matters that were investigated and for which a decision not to prosecute Boeing was made, the referenced language in the agreement refers to the consultant services performed on Boeing's behalf by the retired General Officer and any other activities in which he may have engaged during the period of his consultancy. At the time the retired General Officer was retained, his primary focus was to engage with State Adjutants General (TAGs) regarding the KC–767 Tanker program. After his retention, he provided consultant services, including attending TAG events, participating in Boeing strategy sessions, and attending meetings on Capitol Hill.

24. Senator MCCAIN. Mr. McNerney, did any executive or member of Boeing's board know that then CFO Michael Sears was negotiating with Darleen Druyun for a job, while she was negotiating with Boeing on the tanker program?

Mr. MCNERNEY. To the best of our knowledge after extensive inquiry, the answer is no. The company's internal investigation, which included interviews of the members of senior management, developed no evidence showing that anyone, other than Sears, was aware that Druyun had not disqualified herself from USAF matters involving Boeing at the time he and she discussed possible employment. As you may recall, Mr. McNulty testified at the hearing with respect to the government's investigation:

> "[T]hat was certainly a significant aspect of the investigation, to determine to what extent anyone else had knowledge that would be sufficient for purposes of a criminal charge. The fact is that in this investigation such knowledge was not determined to exist, and that's why no other charges were brought."

QUESTIONS SUBMITTED BY SENATOR LINDSEY O. GRAHAM

UNITED STATES TRADE REPRESENTATIVE SETTLEMENT

25. Senator GRAHAM. Mr. McNerney, your predecessors pushed hard for United States Trade Representative (USTR) to file a World Trade Organization (WTO) case

against the European Union (EU) regarding subsidies to Airbus. You have been widely quoted as wanting a negotiated settlement. Are you working with USTR to negotiate a settlement? If so, what progress has been made to date?

Mr. MCNERNEY. The Boeing Company's goal is to address the market distortions resulting from European government subsidies to Airbus. These subsidies, particularly launch aid (at least $15 billion in no- or low-interest loans, repayment of which is dependent on the success of a particular airplane model under development), shift the commercial and financial risk of aircraft development from Airbus to European governments. As such, the commercial aircraft playing field is not level, and the cost to Boeing, the American aerospace industry, and American workers of having to compete with the European governments has been high. The Boeing Company welcomes competition. Airbus, however, is a mature company, with a full fleet of aircraft and strong market share that, in our view, should stand on its own and not be receiving European government subsidies.

Ideally, the U.S. and EU could resolve this dispute through a negotiated solution that establishes rules that would apply on both sides of the Atlantic. We have worked with the administration to achieve such a solution from the beginning. Indeed, the administration endeavored to negotiate a solution well before it filed its WTO case. In January 2005, the terms of reference for a negotiated solution were agreed with the EU, which provided a potentially strong basis for further talks. Unfortunately, those terms of reference did not hold during negotiations and the administration, with Boeing's support, filed the pending WTO case.

We understand that the administration continues to explore whether a negotiated solution is achievable that would, in fact, level the playing field and ensure fair, commercial competition. Such a negotiated solution remains elusive today. We welcome the administration's continued efforts in this regard; but what is critical is that the subsidies be eliminated. If that cannot be achieved through negotiation, then the Boeing Company fully supports the United States pursuing the WTO case to conclusion.

SETTLEMENT AGREEMENT

26. Senator GRAHAM. Mr. McNerney, it is my understanding that the DOJ settlement restricts the definition and reach of corporate wrongdoing to your senior executives. Under the terms of this agreement, if any other employee is found guilty of stealing proprietary information, the settlement terms are not triggered. Do you believe this a correct interpretation of the terms negotiated?

Mr. MCNERNEY. The settlement agreement with the DOJ provides that Boeing agrees not to commit specified Federal crimes during the term of the agreement. Commission of any such crime would constitute a breach of the agreement. As defined in the agreement, the specified Federal crimes are limited, among other things, to those committed by employees at the level of executive management, such that only specified crimes committed by employees at that level would trigger the settlement terms. It is important to note, however, that the agreement expressly preserves the right of the government to prosecute any future crimes committed by Boeing that could otherwise be prosecuted absent the agreement (regardless, for example, of the level of the employee involved). Neither Boeing nor any employee would be protected from prosecution for the commission of any such crimes.

QUESTIONS SUBMITTED BY SENATOR HILLARY RODHAM CLINTON

INSPECTOR GENERAL'S REPORT ON THE TANKER DEAL

27. Senator CLINTON. Mr. McNulty, in reaching its settlement with Boeing, did the DOJ take into consideration the Department of Defense (DOD) Inspector General's (IG) report on the tanker deal, and if so, can you tell me why so much of the text—literally dozens of pages in total—have been redacted?

Mr. MCNULTY. We did review the May 13, 2005, Report of the Inspector General on Management Accountability Review of the Boeing KC–767A Tanker Program. The DOJ did not prepare the report and is not responsible for the redactions.

28. Senator CLINTON. Mr. McNulty, do you think the redacted sections should be made public?

Mr. MCNULTY. That is a decision for the DOD, Office of IG.

29. Senator CLINTON. Mr. McNulty, is anyone in the DOD or at the White House, or for that matter in Congress, being protected by the redactions?

Mr. MCNULTY. The content of the redactions is a question for the DOD, Office of IG which prepared the report. Without commenting on the specific content of the redactions, which is a matter for DOD to address, I can certainly say that the DOJ has been determined to seek a full and complete resolution of all aspects of this incident. We believe that the $615 million recovery reflects the scope of our investigation and vindicates the public interest.

30. Senator CLINTON. Mr. McNulty, would you agree with me that because of the irregularities on this matter that the public has a right to know this information?

Mr. MCNULTY. The determination as to the material to be released in the DOD, Office of IG's report is more properly directed to DOD since the DOJ did not prepare the report.

31. Senator CLINTON. Mr. McNulty, would you support an effort to get all the facts on the table?

Mr. MCNULTY. See answer to question 30.

[Whereupon, at 4:36 p.m., the committee adjourned.]