

**A REPORT TO THE
CHAIRMAN AND BOARD OF DIRECTORS OF
THE BOEING COMPANY
CONCERNING THE COMPANY'S ETHICS PROGRAM AND ITS
RULES AND PROCEDURES FOR THE TREATMENT OF
COMPETITORS' PROPRIETARY INFORMATION**

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INTRODUCTION

In early 2003, the Department of the Air Force (“Air Force”) began an inquiry into an incident involving The Boeing Company’s (“Boeing”) possession and alleged use of its competitors’ proprietary information in the course of a United States Government (“USG”)¹ procurement. As a consequence of that investigation, on July 24, 2003, the Air Force issued Notices of Suspension to three Boeing programs: the Launch Systems Program, the Launch Services Program, and the Delta Program. The suspensions barred these three Boeing units from federal government contracting, and from receiving any benefits offered by federal government assistance programs. Boeing did not contest the suspensions, but rather undertook (in the company’s words) to “regain the confidence of its customers.”

On July 14, 2003, on the instructions of the company’s Board of Directors, Boeing engaged Warren B. Rudman of the law firm Paul, Weiss, Rifkind, Wharton & Garrison LLP, and a former United States Senator from New Hampshire, to conduct an independent and in-depth review of Boeing’s policies concerning the treatment and handling of its competitors’ proprietary information. Boeing also asked that, in the course of considering that issue, the review address the structure and organization of Boeing’s ethics and compliance programs, and the ethics “culture” at Boeing – *i.e.*, the company’s overall approach to its ethics and legal obligations.

This Report contains the results of our review. It includes findings in the areas covered by the review, and makes recommendations regarding new policies and

¹ A list of acronyms and abbreviations used in this Report appears at the end of this volume.

procedures based on those findings. The Report is divided into six major sections: an overview of our investigation; a brief review of Boeing's rapid growth since the mid-1990s and its involvement in the incidents that gave rise to the Air Force suspensions; a description of relevant aspects of Boeing's existing corporate structure, policies and procedures; a description of Boeing's ethics program; our findings; and our recommendations.

This Report is being provided to Boeing's Chairman and Chief Executive Officer ("CEO"), with a copy to the company's Senior Vice President and General Counsel ("General Counsel").

EXECUTIVE SUMMARY

We were asked to undertake a review of Boeing's ethics and compliance programs, with particular emphasis on the company's policies and procedures regarding procurement integrity and the handling of other companies' proprietary information. We were also asked to report generally on the "ethics culture" within Boeing, including the structure and organization of Boeing's ethics and compliance programs generally, and the extent to which those programs are effective in guiding the company's day-to-day business operations.

The impetus for this review was a series of significant incidents in which Boeing employees allegedly had improper possession of a competitor's proprietary information. In two of these incidents, the employees were directly involved in the support of proposals to the federal government for major defense contracts. The Air Force suspensions described in the introduction to this Report followed directly from one of those incidents, including the manner in which Boeing handled the investigation and

disclosure of the events in question. Another incident resulted in Boeing's withdrawal as a competitor for an important component of the nation's missile defense system. A third incident has raised additional questions about Boeing's ethics and compliance programs. Although we did not undertake to evaluate or verify the factual allegations or legal conclusions that have been made regarding the events in question, our understanding of these incidents is based on reports by various entities (such as the General Accounting Office), documents produced in judicial proceedings, press accounts, and other documents.

Our review was conducted during the period July through October 2003. The review entailed a comprehensive examination of the documents most directly relevant to Boeing's ethics and compliance programs, including: (1) Boeing's policy and procedure documents relating to procurement integrity, marketing, competition-sensitive and third-party proprietary information, and related matters; (2) Boeing's ethics guidelines and procedures; (3) Boeing's ethics and procurement integrity training programs; and (4) additional materials relating to Boeing's history, its governance and its overall corporate structure. We interviewed a broad range of Boeing employees at five different Boeing facilities, and we interviewed numerous other employees by telephone. We conducted in-depth interviews at our Washington, D.C. offices with senior company officers, including the CEO, the Executive Vice President and Chief Administration Officer, the President of the company's Integrated Defense Systems division, the Senior Vice President and General Counsel, the Vice President for Ethics and Business Conduct, and the Vice President for Contracts and Pricing.

In order to understand Boeing's ethics and compliance programs, and to put those programs into context, we found it useful to understand the company's recent history. Between 1995 and 2000, Boeing acquired Rockwell, merged with McDonnell Douglas, and then acquired Hughes Space and Communications. Each of these transactions required Boeing to integrate within its corporate organization and day-to-day operations a company that was itself a major defense contractor, with its own traditions, values, practices and procedures. These transactions resulted in a substantial transformation of Boeing as a company. In 1995, Boeing's principal business was the manufacture of commercial aircraft and related services, and less than \$6 billion of Boeing's revenue was generated by other activities in that year. During the first *half* of 2003, \$13 billion in revenue – over half of the company's total revenue for the period – was from business units unrelated to the company's commercial aircraft business.

Boeing's integration of three large defense contractors has understandably required substantial time and energy to establish a consistent set of ethics and compliance policies and procedures. It is also notable that two of the three incidents involving Boeing's improper possession of a competitor's proprietary information noted above began at one of the "heritage" companies. Nonetheless, we remained mindful (as has the company's senior management) that one of the incidents in question occurred at Boeing, and that the manner in which Boeing addressed at least one of the incidents after it came to light has also been subject to criticism.

We also found it useful to examine Boeing's overall organization and structure, with an emphasis on the company's Law Department and Ethics organization. Boeing's corporate structure can be characterized as a series of relatively independent

business units that are bound together by, and report to, a relatively small central corporate organization. The Boeing corporate philosophy is that each of the business units “owns” its problems as well as its successes, and this is reflected in the reporting structures within the company.

Boeing’s Ethics organization reflects the decentralized organization of the company itself. There are relatively few “corporate” ethics officials at Boeing; a majority of the ethics professionals are employees of, and have reporting responsibility to, the business unit to which they are assigned. This principle of decentralization does not apply to all of the company’s functional areas, however. For example, although some attorneys in Boeing’s Law Department are assigned to assist individual business units, and in many ways operate as integral parts of those organizations, every Boeing attorney reports up a central chain of command to the General Counsel at Boeing’s World Headquarters.

Given Boeing’s recent history, its size and its corporate structure, two elements of its ethics program are of particular importance: (1) a clear and strong message must be conveyed from senior management that ethical conduct is expected in all Boeing activities, and must be combined with forceful oversight and monitoring of compliance policies and activities; and (2) a clear and open channel of communications must be maintained between the various business units and senior corporate management, so that issues that transcend the interests of the individual units – such as a potential violation of federal procurement laws – can be addressed quickly and effectively. In these two respects, and others we discuss below, Boeing’s Ethics program could be strengthened.

This conclusion should not be understood to imply that ethics and compliance issues at Boeing have been ignored, or that its programs in these areas are fundamentally flawed. On the contrary, at the end of our review we were left with the impression of a company that takes ethics and compliance issues very seriously. For example:

- Boeing has adopted, instituted and disseminated to its employees policies and procedures establishing the high level of ethical conduct expected of all company employees, as well as the legal and ethical principles that must be followed in many situations – including the requirements of the federal Procurement Integrity Act regarding the treatment of a competitor’s proprietary information.
- Boeing has an extensive Ethics program, and commits substantial personnel and resources to ethics and compliance matters. In addition to a central Ethics hotline available to all employees, Ethics personnel are physically dispersed throughout the Company. The Ethics personnel receive detailed training, and have access to an array of resources within the company (including the Law, Security, Audit and human resources organizations) to which they can direct inquiries and to which they can refer matters for investigation.
- Boeing has established a mandatory training program for all employees that addresses ethics questions and the importance of maintaining the company’s integrity in its business dealings. In addition, the company has specific training programs that address the legal requirements associated with the treatment of third-party proprietary data during government procurement activities.

In general, these programs are robust, and confirm that the company pays significant attention to ethics and compliance matters.

We also found that the company takes seriously the need to reassess its ethics and compliance programs on an ongoing basis, and to make continuous improvements as necessary. The steps the company has already taken include, among other things, an Ethics Recommitment Day for all employees of the company’s Integrated Defense Systems (“IDS”) unit; a new procedure for the investigation of alleged receipt or

improper handling of a competitor's proprietary information; revisions to the company's core policies and procedures regarding the handling of competitors' proprietary information; establishment of a Compliance Review Board to oversee compliance policies and practices within IDS; and active consideration of screening procedures to review the placement of former employees of competitors in potentially sensitive positions.

In sum, despite the problems that have occurred, we believe that it would be both unfair and incorrect to conclude that the company treats ethics and compliance matters lightly, or otherwise administers those programs in a cavalier fashion. Moreover, we believe that the three incidents involving Boeing's possession of its competitor's proprietary information described in the Report were grounded in the isolated acts of a few individual employees, and do not fairly reflect Boeing's ethics program or culture as a whole. On the contrary, our sense is that Boeing is committed to minimizing the likelihood of future violations, and to having in place reporting and investigation mechanisms that will result in the expeditious resolution of any incidents that may occur in the future.

That said, we believe that Boeing's ethics and compliance programs has had some areas of weakness. Although recent changes in the company's ethics and compliance programs have substantially addressed some of these weaknesses, we believe that additional action is required in some areas, as described at length in our Report. The overall weaknesses we have identified are as follows:

1. Engagement by the company's senior management in the development and implementation of the ethics and compliance programs has been insufficient in terms of organization and regularity;

2. The ethics program has had weaknesses in its internal profile, its structure, and its level of resources (including personnel resources);
3. The level of central command and control over internal investigations of alleged violations of law (including procurement integrity law) has been insufficient;
4. The company's internal training, monitoring, and oversight in the area of procurement integrity and handling of third-party proprietary data has not been as strong as its written procedures, policies, and guidelines; and
5. The company's policies and programs directed at procurement integrity and handling of third-party proprietary data have placed insufficient emphasis on (1) legal constraints other than the Procurement Integrity Act and (2) the issues raised by hiring and placement of persons who have worked for competitors.

We have crafted 16 recommendations that we believe will address these weaknesses, and substantially strengthen Boeing's ethics and compliance programs. In some instances, these recommendations have been partially adopted already, or are currently under active consideration within the company. Our recommendations fall into four broad categories: (1) structural recommendations, with particular focus on the organization and stature of Boeing's ethics organization and the company's core ethics message to employees; (2) Boeing's hiring and training procedures; (3) procedures regarding the staffing of procurement-related activities and the manner in which Boeing responds to problems that may arise in the future; and (4) Boeing's ongoing oversight and review of its ethics and compliance programs.

Structural recommendations. The three recommendations directed to structural issues focus on the dynamics of the Ethics organization within the corporate structure, but they also address the few concerns that did come to light during our review regarding the company's "ethics culture." We have sought to formulate recommendations that, on the whole, will emphasize the importance the company places on ethics issues, and enhance the awareness of ethics matters throughout the company.

Our expectation is that adoption of these recommendations will result in a clearer channel for communication of important ethics and compliance issues up a central chain of command to senior corporate executives, so that serious matters that affect the company as a whole can and will be addressed in an effective and timely manner.

Recommendation 1

Management, at the most senior corporate and business unit levels, should place additional emphasis on the importance of ethics and compliance and should do so in a manner that reaches employees at all levels.

Recommendation 2

All Ethics personnel and activities should be consolidated into a single functional department within the World Headquarters operation. Ethics Advisors assigned to the company's various business units should report directly up through the Ethics Office, with "dotted line" reporting/support responsibility within the Boeing "matrix" to management of the relevant business unit. The head of the Ethics Office should have periodic access to the CEO. Overall, we believe that the visibility of the Ethics Office within the company should be elevated. We leave it to the company to determine how that is best accomplished.

Recommendation 3

Boeing should: (1) increase the number of Ethics Advisors assigned to the various business units; (2) over time, strive to replace part-time Ethics positions with full-time positions; and (3) undertake to ensure that Ethics is seen as a long-term career opportunity within the company.

Hiring and training recommendations. The recommendations addressed to hiring and training matters are directed to the observation that there have been insufficient opportunities to remind employees of their obligations relating to ethical conduct, procurement integrity, and the possession and use of third-party documents. The company should build into the hiring and training processes additional opportunities to remind employees of their obligations in these areas. Training relating to ethics and compliance issues should also be conducted in the most effective manner possible –

which, in our view, means a strong emphasis on in-person, group-based training that incorporates “real-world,” practical problems.

Recommendation 4

All new employees should, as soon after the date of hire as possible, receive specific, in-person counselling (in an individual or group setting) concerning Boeing’s Ethics program from an appropriate Ethics Advisor or other similarly qualified individual. Included in this counselling should be information specifically focused on the laws and company policies governing the unauthorized possession and/or use of competition sensitive/proprietary documents or trade secrets of other companies.

In addition, as a condition of hire, each new employee should be required to sign a certification that he or she: (1) does not possess any proprietary documents (either hard copy or electronic); (2) will not attempt to obtain any such materials or information except in accordance with relevant law and established Boeing procedures; and (3) will not obtain or reveal any other companies’ proprietary information while a Boeing employee.

Recommendation 5

The Boeing Leadership Center should prepare modules for all levels of managers and executives that provide an overview of the Boeing Ethics program and raise ethics issues for discussion.

Recommendation 6

Training materials – whether in the context of the Leadership Center or those available to all employees – that are addressed to ethics and compliance matters should include “real world” examples.

Recommendation 7

Boeing’s ethics and procurement integrity training – including initial new employee briefings, discussions at the time of forming a new proposal or similar team, and refresher courses – should emphasize group discussion rather than individual on-line training.

Recommendation 8

An “all hands” event such as Ethics Recommitment Day should be repeated, adjusting the precise content, duration and frequency as deemed appropriate.

Recommendations regarding staffing and investigations. This set of recommendations focuses on the procurement process, including staffing and management oversight of the proposal preparation teams, and procedures for responding to possible third-party document violations. The goals here are (1) to prevent employees, to the extent possible, from being placed in situations that might create an appearance of impropriety, or that might lead to improper conduct; and (2) to ensure that, in the event a violation of rules regarding competitors’ proprietary information nonetheless may occur, procedures are in place to address the matter in a thorough and timely fashion.

Recommendation 9

Each new Boeing employee who worked for a competitor within the past three years should be “tracked” for a specified period of time after that employment, to ensure that the employee and Boeing are not placed in a potentially compromising position. A “flag” should be attached to the employee’s personnel file that is accessible to his business unit management, the Ethics organization, the Law Department and HR, so that changes in the employee’s assignments can be assessed to ensure that the assignment is appropriate given the employment history.

Recommendation 10

Boeing should establish substantive policies that prevent employees recently employed by competitors from being placed in positions that could create an appearance of impropriety.

Recommendation 11

Before an employee can begin work on a Capture, Proposal or Blue Team, that employee should be required to certify that she/he has completed procurement integrity training, including training regarding the handling of competitor’s confidential information, within the past 90 days and that she/he will comply with all applicable laws and Boeing policies and procedures.

Recommendation 12

Boeing should establish procedures (such as a certification process or structured legal review) to confirm compliance with legal and ethics rules following completion, and prior to submission, of a proposal to the federal government in a competitive procurement.

Recommendation 13

The recently announced Compliance Review Board in the Integrated Defense Systems unit should establish a mechanism to ensure prompt reporting of CRB activities to Boeing's corporate headquarters. It is essential that, however the CRB is composed, there be a mechanism for immediate reporting to the General Counsel and VP-Ethics on matters of concern.

Recommendation 14

Responsibility for ensuring the thorough, accurate and expeditious investigation and resolution of all incidents involving the unauthorized possession or use of third-party or USG competition sensitive/proprietary information should rest with senior levels of the Boeing General Counsel's Office.

Recommendations regarding internal oversight. Our final two recommendations focus on the need to assess, on an ongoing basis, the effectiveness of the various new policies and procedures being adopted by Boeing.

Recommendation 15

At appropriate intervals, Boeing's Audit group should conduct an assessment of the effectiveness of the various new policies and procedures adopted to address procurement integrity issues in general and issues relating to possession and use of third-party documents in particular. Such an inquiry should include an examination of, *inter alia*: (1) general compliance with laws and policies governing third-party documents; (2) compliance with relevant training and certification policies; (3) compliance with "cooling-off" periods for ex-employees of competitors; and (4) the effectiveness of new company procedures for addressing potential third-party document violations.

Recommendation 16

The Ethics program, including its interaction with the business units and with other functional organizations within Boeing, should be subject to ongoing scrutiny, examination and, possibly, further reorganization.

* * *

A detailed discussion of each of the foregoing observations, findings and recommendations is addressed in detail in the body of our Report.

BACKGROUND, FINDINGS AND RECOMMENDATIONS

I. OVERVIEW OF OUR INVESTIGATION

To complete our undertaking, we performed an extensive review of both the overall corporate structure of Boeing and, in particular, the company's Ethics and Business Conduct ("Ethics") program and the manner in which it operates within that overall structure. We conducted in-person and telephone interviews with Boeing personnel at all levels, from the CEO to line-level employees, across Boeing's various business and support units. We have also reviewed documents and web pages relating to Boeing's Ethics program and policies on competitors' proprietary information and procurement integrity. Our review was conducted during the period July through October 2003.

Although the impetus for this review was to evaluate Boeing's policies and practices regarding the handling of competitors' proprietary information in the context of federal procurement contracts, our mandate was not so limited. As part of our review, we were also charged with assessing the company's overall Ethics program, and the ethics culture at Boeing. Thus, although our primary focus was on the treatment of competitors' proprietary information, we examined this issue in the broader context of the organization and management of the relevant aspects of Boeing's ethics and compliance programs.

We have also examined Boeing's recent independent efforts to strengthen the company's policies and procedures relating to the treatment of competitors'

proprietary information and its ethics and compliance programs. While these activities are ongoing, we believe that this Report captures the essence of the Ethics program that was in place at the outset of our investigation, as well as the changes that recently have been implemented or currently are under consideration.

A detailed description of our review follows.

A. Document Review

We reviewed documents relating to procurement integrity, the handling of proprietary data, and the structure and organization of Boeing's Ethics program generally, including thousands of pages of electronic and print documents relating to Boeing policies and procedures, to employee training, and other matters within the purview of our inquiry.

1. POLs and PROs

We examined all of the company's policy and procedure documents, referred to at Boeing as POL and PRO documents respectively, that relate to the company's Ethics program and procurement integrity policies. We also reviewed many POL and PRO documents relating to Boeing's corporate organization, corporate governance, and delegations of authority. We paid particular attention to PRO-70,² which sets out procedures relating to the federal Procurement Integrity Act ("PIA"),³ including the requirements of that statute regarding the handling of competitors' proprietary information.

² A copy of PRO-70 is included in the Appendix at Tab 1.

³ 41 U.S.C. § 423. A copy of the PIA is included in the Appendix at Tab 2.

2. Boeing Intranet

We examined a variety of materials available on Boeing's intranet, including an extensive array of ethics materials. This intranet system, which is available to all Boeing employees, serves as a primary conduit for the dissemination of information on all topics from Boeing World Headquarters ("WHQ") and management. The intranet also hosts the Ethics training programs, such as the ethics training modules discussed below (which are the main ethics training regimen required of all Boeing employees).

The Boeing intranet Ethics page also contains a link to the Law Department's "e-Legal" system, which provides basic information on legal issues for all Boeing employees. We reviewed the training topics within the e-Legal system that were relevant to our undertaking.

3. Ethics Training

We reviewed all of the available training material offered by Boeing on the subjects of procurement integrity and the handling of competitors' information. In addition, we reviewed much of the training material given to Ethics Advisors (the individuals assigned to the various business and support units who are responsible for ethics matters) and other Ethics personnel, as well as the training packages utilized in the Ethics Recommitment Day ("Recommitment Day") activities conducted by the Integrated Defense Systems ("IDS") business unit in July 2003.

The company's primary tool for ongoing ethics training is a series of modules hosted on the company's intranet Ethics website. We reviewed the first two of these modules, which all Boeing employees should by now have completed. In addition to the current ethics training modules, we have reviewed other ethics training programs

that are hosted on the Boeing intranet, including the “Ethical Decision-Making” course, the “Ten Minute Trainers,” and the introductory ethics course for new employees.

4. Heritage Company Documents

Our review included many of the policies and practices relating to ethics and procurement integrity issues that were in place at the so-called “heritage companies” (Rockwell, McDonnell Douglas Corporation, and Hughes) at the time those companies were acquired by or merged with Boeing. This review included McDonnell Douglas’ Policy 10, which addressed information integrity violations, as well as that company’s “Always Take the High Road” program materials, which formed the basis for McDonnell Douglas’ thematic, values-based approach to ethics.

5. Industry Standards

In addition to Boeing documents, we have examined the written ethics policies and procedures of certain other companies in the aerospace and defense industries, as well as best practices documents published by organizations such as the Defense Industry Initiative, the Ethics Resource Center, and the Ethics Officers Association. Information concerning other companies’ policies was derived from a variety of sources, including published ethics policies. Information on best practices was obtained from a review of the relevant publications of leading ethics organizations.

While these sources provided some perspective for our inquiry, the more challenging issues presently confronting Boeing are not addressed in any particular depth in these documents. It is noteworthy, for example, that these materials do not provide standards or guidelines with respect to the recruitment, hiring and placement of employees of competitors. Thus, to some extent, recent events have forced Boeing to

address difficult issues without the benefit of industry consensus or other norms or standards.

B. Site Visits

Attorneys on our investigative team interviewed employees at a number of Boeing facilities within its IDS business unit. We chose to focus on IDS for two reasons. First, this is where the principal events involving competitors' information and procurement integrity issues that led to the Air Force suspensions occurred. Second, the opportunities for problems involving competitors' information and procurement integrity issues appear to be greater at IDS than at other Boeing divisions, both because of IDS' relative size and because of its intensive involvement in highly competitive USG contracting activities. For example, the Boeing Commercial Airplanes ("BCA") unit does considerably less business directly with USG customers, and the nature of the competitive environment in which BCA operates – in which there is only one major competitor (Airbus) and very little movement of employees between the two companies – does not appear to create as many opportunities for this type of incident. (As we discuss in greater detail below, this is not to say that BCA or other business units that do not have day-to-day involvement in federal procurements are, or should be, unconcerned with these issues.)

The site visits and interviews took place at IDS facilities in Seal Beach, Huntington Beach, El Segundo, and Anaheim, California, and St. Louis, Missouri. This gave us the opportunity to examine a variety of IDS business units. We also visited the Boeing Leadership Center near St. Louis to obtain information concerning the ethics training that is given to Boeing managers and executives at this training facility.

We selected a cross-section of different employee functions and responsibility levels. Our interviewees included representatives from Boeing organizations covering ethics, law, finance, audit, business development, engineering, supplier management and human resources. We spoke on-site with employees up to the rank of senior vice president. This cross-section was intended to ensure that we would obtain the greatest possible variety of perspectives in the limited time available for our review. We conducted a total of 53 on-site employee interviews: 37 interviews in Southern California, and 16 interviews in St. Louis.

In addition to the employees that we selected for interviews, we also spoke in person, by telephone or through written correspondence with employees who asked for an opportunity to meet with us. All but one of our in-person interviews was conducted with the individual employee alone in a private room with two or more attorneys from our investigative team.⁴ To encourage complete and candid answers, employees were assured that no statements in our Report would be attributed to a specific individual.

Employees were questioned regarding a wide range of topics, including: (1) personal background and responsibilities; (2) ethics training modules; (3) the role and functions of Ethics Advisors and Ethics Line personnel; (4) Recommitment Day; (5) cultural differences between Boeing and the heritage companies; (6) pressure to win competitive contracts; (7) knowledge of incidents involving competitors' information; and (8) hiring of employees from competitors. Employees were also asked what

⁴ The one exception involved a senior executive who is responsible for many highly classified projects, who asked that a member of the Boeing Law Department be present to ensure against the inadvertent disclosure of classified information.

recommendations they would make to senior management. The typical interview lasted approximately one hour, although a number were longer.

C. Additional Interviews

In addition to our on-site interviews, we conducted a series of telephone interviews with Boeing employees throughout the company. The phone interviews were intended to give us preliminary background information and to provide greater exposure to personnel outside of the IDS business unit.

Our telephone interviews involved employees in IDS, BCA, Phantom Works, Air Traffic Management (“ATM”) and WHQ. The interviewees included individuals serving in a wide variety of functional and business roles at the company, including Ethics, the Law Department, Security, Audit, and Business Development. The telephone interviews covered topics similar to those covered in the on-site interviews. The employees involved were given the same assurances regarding nonattribution of their comments as were given to the employees we interviewed on-site.

We also asked certain Boeing senior executives to meet with us individually at the Paul, Weiss offices in Washington, D.C. for more extensive discussions. These interviews included the Executive Vice President and Chief Administration Officer, the General Counsel, the Vice President for Ethics and Business Conduct (“VP-Ethics”), and senior executives in the areas of Contracts & Pricing (“C&P”) and the People Organization (the name given by Boeing to its human resources (“HR”) department). We met on two occasions with the Chairman and CEO of the company.

On the whole, we believe that the Boeing employees we interviewed – on-site, by telephone, and in Washington, D.C. – were open and honest in their responses to our questions. It is clear that employees – at all levels – are loyal to Boeing, which is especially notable since the majority of the employees with whom we spoke had been hired originally by Rockwell, McDonnell Douglas or Hughes, and thus were Boeing employees only by virtue of a corporate merger or acquisition. Most employees, however, were not reluctant to criticize Boeing when they felt that criticism was warranted. They freely discussed their views of the company’s shortcomings, and offered improvements in Boeing’s ethics policies, programs and culture.

D. Executive and Board Briefing

We briefed senior company management on our preliminary findings and recommendations during the first two weeks of October 2003. On October 20, 2003, we provided an oral summary of our findings and recommendations to the company’s Board of Directors. As a result of comments from the Board and senior management, certain minor details of our recommendations were modified to ensure that they could be readily understood and implemented. The substance of the recommendations did not change. We did not change any of our findings as a result of these discussions.

We also provided a draft of our Report to the General Counsel for a factual review. As a result of that review, clarifications were made to our descriptions of certain factual matters, but we did not change our findings or recommendations as a result of that review.

E. Laws Relevant to Handling Proprietary Data

In order to put Boeing's Ethics program into context, we considered the principal statutes that govern Boeing's conduct.

Two federal statutes – the Procurement Integrity Act and the Economic Espionage Act (“EEA”)⁵ – are of particular relevance to Boeing's handling of competitors' sensitive information. In addition to these subject-specific statutes, Boeing's Ethics program has been influenced by certain Federal Sentencing Guidelines (“FSG”)⁶ that govern the penalties that may be imposed on a corporation that is convicted of criminal activity under federal law. Although far from the only federal requirements affecting Boeing's operations in the areas of procurement integrity and handling competitors' data, these statutes and their implementing regulations shape a substantial portion of the company's policies and procedures in these areas. We found that a general understanding of these statutes, as well as state trade secret laws, is helpful to an assessment of Boeing's ethics and compliance programs relating to procurement integrity and the treatment of competitors' information.⁷

⁵ 18 U.S.C. §§ 1831-1839.

⁶ 18 U.S.C. app. § 8A1.2

⁷ The summaries in the text are intended only as a brief overview of these statutes and should not be relied upon as a complete description of the relevant statutory provisions. The full text of the PIA and EEA are included for reference in the Appendix at Tab 2.

(a) Procurement Integrity Act

The PIA⁸ regulates two primary issues relating to the award of federal government procurement contracts. First, the PIA prohibits any private party from knowingly obtaining “contractor bid or proposal information or source selection information” before the award of the federal procurement contract to which the information relates. Second, the PIA requires the disclosure by a federal official of any offer of non-federal employment by a bidder or offeror involved in a federal procurement, and prohibits a former federal agency official from accepting compensation from a contractor for a period of one year after involvement in certain decisions favoring that contractor. The prohibitions on disclosing and obtaining information described above apply only to competitive procurement contracts. The employment restrictions apply to any federal procurement activity.

For purposes of the PIA, the term “contractor bid or proposal information” refers to information that: (1) is submitted to a federal agency “as part of or in connection with a bid or proposal to enter into a federal agency procurement contract, if that information has not been previously made available to the public or disclosed publicly;” and (2) falls into any of several categories, including cost or pricing data, proprietary technical information, or information marked by the contractor as “contractor bid or proposal information.”

⁸ The PIA was originally enacted as part of the Office of Federal Procurement Policy Act Amendments of 1988, Pub. L. No. 100-679, § 6, 102 Stat. 4063 (Nov. 17, 1988), and substantially revised by the Clinger-Cohen Act of 1996, Pub. L. No. 104-106, § 4304, 110 Stat. 659 (Feb. 10, 1996).

The term “source selection information” refers to information prepared for use by a federal agency to evaluate bids or proposals in a federal agency procurement process where that information has not been previously made available to the public or disclosed publicly. Such information includes proposed costs and prices, source selection or evaluation plans, rankings, reports and evaluations of selection panels, or any other information marked “source selection information.” Although reasonable efforts must be made by the appropriate federal agency to mark “source selection information” as such, the information described above will be considered “source selection information” whether or not it is marked. The PIA does not prohibit the disclosure by a contractor of its own bid or proposal information.

Violations of the PIA are punishable by significant civil and administrative penalties. Civil fines include a penalty of up to \$50,000 for an individual or \$500,000 for an organization, plus twice the amount of the benefit that the individual or organization offered or received for the prohibited conduct. A violation may also result in cancellation of a federal contract, and suspension or debarment from participation in federal procurement activity. In certain circumstances, a violation of the PIA provisions regarding the treatment of contractor bid proposal or source selection information may result in criminal penalties, including fines and imprisonment.

(b) Economic Espionage Act

The EEA applies to the theft of trade secrets either for financial gain or for the benefit of a foreign government, and prohibits the unauthorized copying, distribution, receipt, purchase, or possession of such information. The EEA also prohibits attempts or conspiracy to commit any of these activities. Although some courts have interpreted the

EEA narrowly, on its face it is substantially broader than many state trade secret laws, such as the Uniform Trade Secrets Act (“UTSA”).⁹ The EEA criminalizes the unauthorized appropriation or receipt of trade secrets by “fraud, artifice or deception,” or the receipt or possession of such information knowing it to have been stolen or obtained without authorization. The EEA definition of “trade secret” applies to a broad variety of information, including financial, business, and commercial information.

Violations of the relevant portions of the EEA are punishable by imprisonment or, for offenses committed by a corporation, fines of up to \$5 million (there are no civil penalties for violations of the EEA). The violator must also forfeit any proceeds gained from the violation, and may face confiscation of personal property used to commit the crime.¹⁰

(c) Uniform Trade Secrets Act

The UTSA is a model law relating to the protection of trade secrets that has been adopted by 40 states and the District of Columbia. The UTSA provides for civil liability for anyone who wrongfully obtains or possesses the trade secrets of another. Unlike the EEA, the UTSA does not provide for criminal penalties.

(d) Federal Sentencing Guidelines

The FSG contain a list of factors that are considered whenever a corporation is subject to sentencing by a federal court. Because these factors address the policies and procedures in place at the time that the crime was committed, the FSG provide guidance as to the fundamental elements of a satisfactory compliance program.

⁹ Unif. Trade Secrets Act § 1(2), 14 U.L.A. 438 (1996).

¹⁰ See 18 U.S.C. § 1834.

The FSG provide a list of seven elements indicating an effective compliance program, including:

- (1) compliance standards and procedures (*e.g.*, a code of ethics) capable of reducing the risk of criminal behavior;
- (2) oversight of those standards and procedures by high-level personnel (*e.g.*, a senior ethics officer);
- (3) exercising due care not to delegate authority to individuals with a propensity to engage in illegal activity;
- (4) effective communication of standards and procedures to all employees (*e.g.*, regular ethics training);
- (5) auditing, monitoring, and reporting systems and mechanisms (*e.g.*, an ethics “hotline”);
- (6) consistent enforcement of standards and procedures through appropriate disciplinary mechanisms; and
- (7) appropriate response after detection of a violation, including any necessary compliance program modifications.

The Boeing Ethics program has been heavily influenced by the FSG, as have the ethics programs of other major corporations in America. As a consequence, many of Boeing’s ethics policy and procedure documents are tailored to address the federal laws and regulations that these policies and procedures are intended to implement.

II. BOEING’S RECENT PAST

Although this Report is intended to describe the state of ethics at Boeing in 2003, it is useful to have some understanding of how Boeing reached its current position, and the sequence of events that triggered the Air Force suspensions. Most importantly, Boeing as a company has undergone a substantial transformation during the past decade. As recently as eight years ago, Boeing was a commercial aviation giant with a relatively small defense business. Boeing is now one of the nation’s leading defense contractors, whose commercial aviation sales account for less than half of the company’s

revenues. The high-profile incidents that drew Boeing's ethical conduct into question, which we also describe in this section of our Report, occurred during a time of dramatic change in the company's size, focus and organization.

A. Mergers and Acquisitions in the 1990s

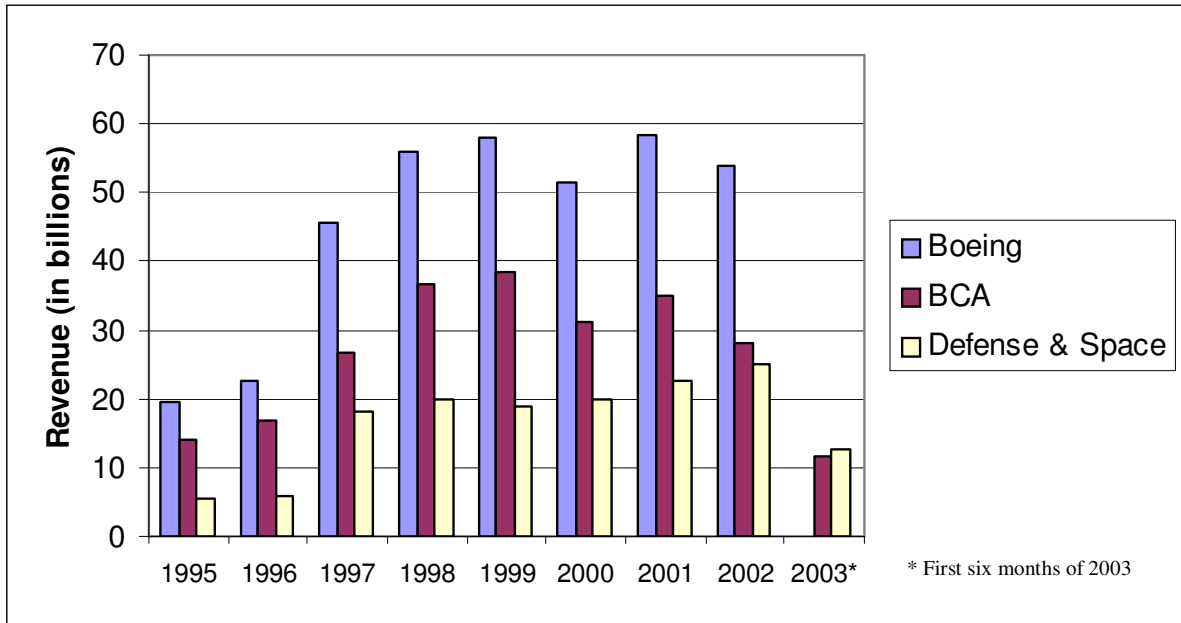
In 1995, Boeing's commercial aircraft operations were conducted through the Boeing Commercial Airplane Group, which engaged in the development, production and marketing of commercial jet airplanes and related support services to the commercial airline industry on a worldwide basis. The defense and space operations, conducted through Boeing Defense & Space Group, encompassed development and production of military aircraft and space and missile systems. During the mid-1990s, while commercial aircraft operations were conducted by Boeing itself, many of the space and defense projects were conducted through joint ventures or similar teaming arrangements. A number of the major defense contracts that Boeing had were large, long-term military aircraft contracts (such as the AWACS program). In 1995, Boeing's commercial aircraft operations generated \$14 billion in revenue, while the company's defense, space and communications operations generated \$5.5 billion. In 1995, Boeing employed approximately 105,000 people worldwide.

On December 6, 1996, Boeing acquired Rockwell, a leading aerospace and defense company, and established Boeing North America, Inc. This acquisition brought NASA space shuttle projects to Boeing, as well as other programs involving Global Positioning System satellites, ICBM systems, tactical missiles, sensors, and the B1-B bomber. The following year, on August 1, 1997, Boeing concluded its merger with McDonnell Douglas Corporation. As a result of these developments, Boeing's emphasis

on its defense business, and its engagement in a substantial number of competitive USG procurements as a prime contractor, increased substantially.

On October 6, 2000, Boeing acquired Hughes Space and Communications (“Hughes”). The acquisition also included Hughes Electron Dynamics (a supplier of electronic components for satellites), Spectrolab (a provider of solar cells and panels for satellites), and a share of HLR Laboratories (a research center). From this acquisition emerged a new Boeing business unit, Boeing Satellite Systems (“BSS”). BSS incorporated Boeing’s space-based communications, reconnaissance, surveillance and imaging systems, and commercial communications satellite businesses.

As a consequence of these transaction, Boeing’s defense-related revenues in 2000 had nearly quadrupled from 1995 levels, although Boeing’s revenue from commercial airplanes still outpaced revenues from other business. Revenue from commercial aircraft that year was \$31 billion. Revenue from military aircraft and missiles was approximately \$12 billion, while space and communications added \$8 billion. During this timeframe, Boeing’s workforce increased to 239,000 employees.



In recent years, the share of Boeing’s revenues from commercial airplanes relative to defense and other businesses has declined. In 2002, revenue from the commercial airplane operations was just over \$28 billion, while revenue from military aircraft and missile systems was \$14 billion, and space and communications revenue was \$11 billion. During the first six months of 2003, commercial aircraft revenue was \$11.5 billion, and other revenues – mostly defense-related – were \$13 billion. The workforce during this period reached its current level of approximately 165,000 employees.

As a consequence of these mergers and acquisitions, Boeing has expanded well beyond the commercial aircraft market and relatively small defense-related business, and has emerged as a major defense contractor. Recently, to name two notable examples, Boeing was awarded the prime contract for the Army’s Future Combat Systems (“FCS”) program and, until the recent suspensions, had received a major portion of the Air Force’s expendable launch vehicle procurement. In a very short time, Boeing has developed into

a major defense systems integrator, with a focus on organizing its own internal resources and those of other companies to pursue large, highly competitive defense contracts.

B. Incidents Relating to Procurement Integrity and Competitors' Proprietary Information

During the period from the late 1990s to the present, significant incidents relating to procurement integrity and, specifically, to the handling of competitors' proprietary information occurred at Boeing and its heritage companies. The critical events that led to these incidents in some instances occurred prior to or during the mergers and acquisitions described above; in these cases, Boeing "inherited" problems that had originated at another company, including the episode that ultimately precipitated the recent Air Force suspension. However, one important incident did occur at Boeing. Moreover, the manner in which Boeing reacted to one of these incidents in particular, once it was brought to light, has been drawn into question by the Air Force and others.

Our consideration of these incidents focused not on the impact that the alleged wrongdoing may have had on any individual procurement, but instead on the relationship, if any, of these episodes to Boeing's ethics and compliance programs. Within this contextual framework, we provide the following summaries of these incidents, which were derived from a variety of sources. With respect to the facts involved in the Evolved Expendable Launch Vehicle ("EELV") matter, we relied on documents produced in judicial proceedings, information provided by the company and by the Air Force, as well as various news reports. In the case of the facts surrounding the Exoatmospheric Kill Vehicle ("EKV") matter, we relied primarily on information contained in the United States General Accounting Office's letter to Representative

Howard L. Berman, dated January 27, 2003, which was prepared in response to a Congressional inquiry into the events surrounding Boeing's withdrawal from the EKV selection process. Reports of the third major incident, involving an executive at Hughes (later acquired by Boeing) also has received public attention, primarily as the result of judicial proceedings. We emphasize that we have accepted at face value the accounts of these incidents on which we have relied. We have made no attempt to reinvestigate these matters, or to verify the validity of any of the facts or conclusions contained in the sources from which these descriptions were derived.

1. EELV

The EELV program is an Air Force-funded project to develop a next-generation of spacecraft launch vehicles for military payloads. In January 1997, prior to its merger with Boeing in August of that year, McDonnell Douglas hired an engineer to work in its EELV program then underway in Cape Canaveral, Florida. The engineer had previously worked as a manager on Lockheed Martin's proposal for an earlier phase of the EELV program. Upon moving to McDonnell Douglas, this engineer allegedly brought hundreds of Lockheed Martin documents, many of which were marked as restricted or competition-sensitive.

The engineer made several trips to McDonnell Douglas facilities in southern California, where work on the EELV proposal also was underway. On one or more of these trips, he reportedly shared Lockheed Martin competition-sensitive documents with at least two other individuals involved in Boeing's EELV program, including his supervisor and an individual involved in strategic planning and market analysis for the project. According to reports, the engineer also spoke with members of

the California-based team charged with determining the best way for the company to win the procurement.

In October 1998, following the Boeing-McDonnell Douglas merger, the Air Force awarded 19 out of its 28 scheduled EELV launches to Boeing, and the remaining 9 launches to Lockheed Martin. In June 1999, a Boeing employee reported overhearing a statement by one of the employees involved to the effect that the former Lockheed Martin engineer had been hired in exchange for information regarding Lockheed Martin's EELV proposal. This report prompted an internal investigation headed by the Boeing Law Department. Following a six-week investigation, Boeing returned a number of documents to Lockheed Martin, terminated two of the employees involved, and reprimanded the third (who retired shortly thereafter).

In July 2000, the two employees who had been terminated as a result of this incident filed wrongful-termination suits against the company. Boeing's efforts to respond to initial discovery requests in that litigation uncovered approximately two boxes of additional Lockheed Martin documents that the former Lockheed Martin employee had brought with him to McDonnell Douglas and which had not previously been uncovered and returned to Lockheed Martin. Then, in April 2003, as a result of a grand jury subpoena and an investigation by the United States Attorney for the Central District of California, Boeing located approximately 11 more boxes of Lockheed Martin documents. These documents were returned to Lockheed Martin in April 2003. Overall, the documents involved in this incident totalled over 25,000 pages of Lockheed Martin information.

In response to this incident (including the manner in which Boeing investigated and made disclosures regarding the matter), in July 2003, the Air Force withdrew the award to Boeing of seven previously awarded satellite launch contracts, and disqualified Boeing from three West Coast launches. The Air Force also instituted the suspensions described at the outset of this Report.

2. EKV

Boeing was one of two competitors for the EKV program, which was an element of the national missile defense system. In July 1998, during a site visit at a Boeing facility in Downey, California, a group of Army officials left behind a lengthy document containing confidential data on a proposal prepared by Raytheon, the other competitor for the EKV contract. The document was marked “unclassified competition sensitive” on each page, and it also bore markings indicating that the document had been prepared for submission to the USG.

A member of the Boeing EKV team is said to have found the document and, according to reports, gave it to her supervisor who passed the data to another manager on the team and also prepared a summary of the information. Allegedly, a copy of the document was anonymously slid under the locked door of the office of the Boeing team assigned to assess Raytheon’s program, and some of that team began to use the information. Another member of this team reported the matter to Boeing Ethics, which initiated an investigation.

As a result of this incident, Boeing withdrew from the EKV competition. There were also discussions within the government about debarring Boeing from future competitions unless the company agreed to compensate the Army and the Ballistic

Missile Defense Organization for costs resulting from the lost competition. Estimates of those costs ranged as high as \$400 million. Although these sanctions were considered, they ultimately were not imposed and Boeing's withdrawal from the EKV competition was accepted by the USG.

3. The Hughes Incident

Hughes hired a former employee of Lockheed Martin in September 2000. The employee rose within the ranks, eventually becoming Director of Regional and National Operations within the Hughes (now BSS) business development group. Prior to his departure from Lockheed Martin, the employee downloaded allegedly proprietary data from that company's computers, which he subsequently transferred to his computer at Hughes.

Shortly after moving to Hughes, the employee is reported to have distributed several of these documents by e-mail to a small number of his colleagues. One of the employees who received the documents reported the matter to Boeing Ethics, which initiated an investigation. The former Lockheed Martin employee was terminated in May 2001 after the final investigation into the allegations was concluded by Boeing's Law and Security Departments.

4. Other Incidents

In light of the publicity surrounding some of these incidents and the recent programs at Boeing designed to highlight the consequences of using a competitor's proprietary information, Boeing's Law Department and Ethics personnel have received scores of reports and inquiries from concerned employees regarding procurement integrity and proprietary data. In the vast majority of cases, we have been told, the

resulting investigation has revealed that the documents in question were publicly available (*e.g.*, the information was available on the competitor’s website or from their publicly available sources), trivial (*e.g.*, information was found in an employee’s garage from a company he worked for 30 years ago), or permitted to be in Boeing’s possession (*e.g.*, pursuant to a proprietary information or nondisclosure agreement with a company with which Boeing had teamed on a procurement). A few incidents remain under investigation, either by Boeing’s Law Department or outside counsel. We understand that these matters have been reported to the Air Force.

III. THE BOEING ORGANIZATION

In order to review the role of Boeing’s Ethics program, it was necessary to understand Boeing’s corporate organization, including the manner in which the Ethics program fits within that structure.

A. Boeing’s Corporate Structure

1. General Overview

Boeing’s corporate structure is complex, and can best be understood as a group of interrelated businesses that report to and are serviced by a common central headquarters.¹¹

At the top of the company’s management is the Office of the Chairman. The members of the Office of the Chairman consists of the Chairman and CEO, the Chief Financial Officer, the Chief People (human resources) and Administration Officer, and

¹¹ For a broad overview of Boeing’s corporate structure, see the diagram in the Appendix at Tab 3.

the Chief Technology Officer. The Office of the Chairman is responsible for the overall operation of the Company and implementing the policies set by the Board of Directors.

The Strategy Council is the primary executive forum that considers major company strategic and policy issues, including mergers and acquisitions, financial, personnel and labor matters, and other significant issues that affect the company as a whole. The Strategy Council has nine members, including the Chairman and CEO, the Chief Financial Officer, the Chief People and Administration Officer, three senior executives from Boeing's two largest business units (BCA and IDS), the General Counsel, the Senior Vice President for Washington, D.C. Operations, and the Senior Vice President for Communications.

The Executive Council is composed of 29 senior executives, including all members of the Strategy Council plus the other Senior Vice Presidents of the company. This Council reviews strategy and operations and makes decisions on new initiatives. The Council also supports the Office of the Chairman in reviewing activities with the potential for significant impact on the company. The Executive Council members are also members of the Ethics and Business Conduct Committee, whose functions are supported by the VP-Ethics.

At the base of the company's central management structure are the Boeing Process Councils, which oversee specific policies or functions on a company-wide basis. These include, for example, a Business Development Council, a People (HR) Council, and a Contracts & Pricing Council. Membership on these councils includes relevant executives from the various business units. As we discuss below, one of these Process Councils covers ethics matters, and is chaired by the VP-Ethics.

Outside of the core corporate management functions encompassed in the Office of the Chairman, the Councils and the Process Councils, Boeing's organizational structure consists of various business and functional units. The central business unit is WHQ, which houses the leaders of many of Boeing's major functional groups, such as the Law and HR Departments, and certain infrastructure functions, such as information technology. Although central to the company's governance, WHQ is relatively small in size, reflecting the company's decentralized corporate and management structure.

By far, the two largest Boeing business units are BCA and IDS. As noted above, BCA is a world leader in the development, production and sale of commercial jet aircraft. BCA is headquartered in the Seattle area, but has sales and service personnel worldwide. The vast majority of BCA sales are to airlines and other private concerns, and BCA does relatively little contracting with the federal government. BCA has approximately 55,000 employees and generated revenues of approximately \$11.5 billion through the first six months of 2003.

IDS was created in 2002 through a merger of Boeing's Aircraft & Missile and Space & Communications divisions. These divisions, in turn, were the product of the late-1990s mergers and acquisitions involving McDonnell Douglas, Rockwell, and Hughes. A large majority of IDS's business is with the federal government, either directly as a prime contract (such as the lead systems integrator) or indirectly as a subcontractor. IDS has approximately 75,000 employees and had revenues of nearly \$13 billion through the first six months of 2003.

Three other operational business units exist within the company – Boeing Capital, Connexion by Boeing, and ATM. Boeing Capital is the financial services arm of

the company and provides financing for the sale and lease of large capital equipment. Connexion and ATM are emerging business units. Connexion offers high-speed, two-way Internet connections to passengers on commercial airliners and executive jets. ATM's stated goal is to create a new model for air traffic management in the United States and around the world.

Boeing's Phantom Works is an enterprise-wide, cross-disciplinary group of scientists and engineers responsible for creating leading edge solutions to technical problems and for developing new ideas throughout Boeing's operations. Phantom Works is characterized as the research and development engine that drives innovative and affordable technologies and processes throughout the rest of the company. A significant percentage of Phantom Works' projects are funded by Boeing, but customer projects (particularly with USG agencies) also provide funding. Phantom Works is significant for present purposes because it illustrates the extent to which Boeing business units other than IDS can become involved in highly competitive government procurements. Boeing's successful proposal for the FCS contract, for example, was managed by Phantom Works.

The Shared Services Group ("SSG") is a multi-service supplier for the other units within Boeing. It provides administrative services such as security, transportation, and certain elements of the hiring process. SSG's goal is to provide these services in a more cost-effective and uniform way than would be possible if each of the business units handled such matters independently. SSG personnel are located throughout Boeing's sites, and utilization of SSG services by a business unit results in a direct charge against the budget of that business unit. Of particular note for present

purposes is SSG's involvement in the HR process. SSG's responsibilities for hiring employees include: (1) collection and review of résumés; (2) maintaining an employee's pre-hire personnel records; and (3) generating and maintaining the employee application forms that serve as the primary source of information about the background and job history of an employment candidate.

2. Functional Groups

In addition to the business units, Boeing has several functional organizations that engage in company-wide activities. These functional units service each of the business units, and include the Boeing organizations with the most direct impact on ethics and compliance matters.

(a) The Law Department

The Boeing Law Department is the primary resource within the company for all legal services. The Law Department also coordinates the utilization of outside counsel on behalf of the company, including the determination to seek outside assistance to investigate alleged violations of law by Boeing employees.

Attorneys from the Law Department are assigned either to a particular business unit or program, or to a functional group within the Law Department. These functional groups include litigation, labor and employment, and environmental matters.

Attorneys assigned to support a program or business unit are referred to within the Law Department as "program attorneys." These program attorneys provide advice and assistance on the substantive business matters relating to their assigned programs, such as interpreting regulatory requirements or supporting contract negotiations. They report directly to the Vice President & Assistant General Counsel

(“AGC”) for their business unit. Although these AGCs are considered to be part of the business unit that they support, they report to, and are supervised by, the General Counsel.

Attorneys assigned to functional groups (litigation, labor, etc.) are responsible for addressing inquiries and problems relating to their area of expertise throughout the company. The Law Department’s litigation attorneys, in addition to taking the lead on all litigation matters concerning the company and coordinating the use of outside counsel, are responsible for conducting investigations into allegations of illegal conduct by Boeing employees (unless referred to outside counsel). The attorneys assigned to functional groups each report through a chain of command to the AGC in charge of that function; these functional AGCs report directly to the company’s General Counsel.

(b) Ethics and Business Conduct

The Ethics Office is charged with developing and implementing Boeing’s ethics policies and procedures across the enterprise, and with communicating the company’s ethics policies to each employee through outreach and education. Ethics personnel also receive reports of ethics violations and initiate investigations if appropriate, drawing upon the resources of other functional groups (such as Security, Audit or the Law Department). On an organizational basis, the Ethics Office resides within the Office of the General Counsel, and the officer in charge of the Ethics Office, the VP-Ethics, reports directly to the General Counsel. Ethics is a decentralized functional organization; although the General Counsel and VP-Ethics are both part of the WHQ organization, most Ethics personnel are employees of the individual business units

to which they are assigned. (The structure and function of the Ethics organization are discussed in greater detail below.)

(c) People (HR)

Boeing's HR department, known as "People," is responsible for creating and implementing the company's labor and employment policies and practices. The head of People is the company's Executive Vice President and Chief Administration Officer, and a member of the Office of the Chairman and of the company's Strategy and Executive Councils.

During the hiring process, People personnel located in each business unit work with their counterparts in SSG. People at the WHQ level is responsible for establishing hiring policy, while HR personnel assigned to the business units are tasked, in coordination with the business unit's hiring manager, with setting candidate requirements prior to the posting of a job opening. SSG then undertakes to identify qualified candidates, either within Boeing or outside the company.

People is also responsible for operation of the Boeing Leadership Center, which, as noted above, is a training facility at which Boeing conducts educational and leadership training programs for management at all levels. Approximately 45,000 Boeing employees, including almost all current managers, have received some type of training at the Leadership Center.

(d) Internal Audit

The Corporate Audit department ("Audit"), which reports through the company's Finance group to the Chief Financial Officer, is responsible for planning and conducting internal reviews of the company's processes and procedures, both financial

and otherwise. Audit conducts these reviews on a quarterly or as-needed basis. The audit plans for the annual reviews are formulated each year, with audit target selection based on the likelihood of problems in a particular business unit.

Approximately 20-25 audits are conducted each quarter, 40% of which address financial matters, 30% compliance issues, and approximately 30% operational matters. Audit resources are split among the business units, with approximately 35% of audits taking place in IDS, 30% in BCA and 35% throughout the rest of the company.

Audit plays a key role in the Ethics program's annual Compliance Assessment Process, in which each of the business units self-assesses its compliance with legal and ethics standards in a variety of subject areas. Audit takes the results of these surveys, identifies high risk areas (in cooperation with management), and reviews them for accuracy and completeness during the fourth quarter of each calendar year. The results of this audit, with recommended changes in policies and procedures as appropriate, are then presented to senior management.

(e) Contracts and Pricing

The C&P department is responsible both for setting prices as part of proposals or contract negotiations and for administration of contracts once they have been won by the company. These two functions are separated within the C&P unit. The pricing function is intimately involved in the preparation of proposals, including the analysis of Boeing's costs to be used in setting proposal prices, negotiating contract terms, and modifying Boeing's standard contract language. The contract administration function interfaces with customers to ensure contract compliance and maintains customer contract-related communications. The C&P function is headed by WHQ staff, but C&P

personnel are embedded within the various business units throughout the company to support new proposals as well as ongoing business operations. C&P is the group within Boeing that has primary responsibilities for developing and implementing policies and training related to procurement integrity issues.

(f) Security

The Security and Fire Prevention department (“Security”) is responsible for investigating alleged violations of a wide variety of company policies, including assault, dishonesty and fraud, drugs and weapons violations, property damage, and compromise of data. Security at Boeing is headed by the company’s Chief Security Officer and the organization is part of SSG.

Boeing’s Security group employs 60 investigators, half of whom are full-time investigators. The remainder are part-time security managers with some investigative responsibilities. Investigators generally have a law enforcement or military background. Although all of the investigative personnel within Boeing’s Security group report to the Chief Security Officer, the guards and normal duty Security personnel at some facilities report, instead, to the local site manager. Security personnel are regularly called upon to assist in investigations being performed by other functional groups.

3. The Matrix Organization

Most of the components within the Boeing organization are organized in a matrix. The matrix organization structure is so named because it creates management responsibility in multiple directions. Most employees within Boeing have at least two management chains to which they are responsible. The first management chain is the functional group, within which the employee’s job classification resides. Engineers, for

instance, have reporting responsibility up the Boeing Engineering management chain, which is under the direction of a senior executive for engineering.

At the same time, employees typically have reporting responsibilities to the business units and, more specifically, the managers of the programs to which they are assigned. The program managers have day-to-day responsibilities over the employee's work, but would not be responsible, for example, for the employee's professional training, career track, or, in some cases, program assignments. Those matters would be the responsibility of the employee's functional area.¹²

A third dimension to the matrix organization is "site management." Each Boeing facility has a designated site manager, who is responsible for duties such as property management, security, and building maintenance. Although the actual work in each of these functional areas is generally performed by SSG employees, the responsibility for ensuring that a facility runs properly rests with the site manager.

In the Boeing matrix, the functional specialists that are assigned to the business units do not always report on significant matters directly to the heads of their functional groups at WHQ – that is, to the executives responsible for ensuring uniform practices on a company-wide basis. Correspondingly, the functional executive at WHQ does not always have direct, day-to-day authority over the individuals in his functional organization who are assigned to the various business units.

¹² Although the majority of employees at Boeing have functional reporting responsibility to a functional senior executive, certain employees, such as business development and program management staff, report solely through management chains to the heads of the major business units.

As discussed in greater detail below, this is notably true for many Ethics personnel, most of whom are assigned to specific programs and sites, and report to the management of that business unit. Moreover, Ethics Advisors (discussed below) often are assigned to support a particular set of programs and/or sites, with the Advisor having responsibility for employees across a number of different program areas at a particular site, as well as for employees in other locations around the country who are part of the Advisor's program assignment. At facilities housing multiple programs, this can lead to an overlap of Ethics Advisors for any given employee, and a complicated chain-of-command for the Ethics Advisor in question. By contrast, attorneys in the Law Department are assigned in many cases to support particular programs or sites, but they all report directly up the Law Department chain of command to the General Counsel.

B. Internal Investigations

Allegations of wrongdoing are investigated by different organizations within Boeing, depending on the type of behavior involved and, to some extent, the resources that are available. Allegations involving theft of company property, for example, would typically involve a coordinated effort between the Security organization and Ethics, along with HR in the event that corrective action is to be taken against an employee.¹³ The following section summarizes the investigative duties of various functional groups at Boeing.

¹³ The responsibilities for investigating different types of allegations are set forth in the investigation responsibility matrix included in the Appendix at Tab 4.

1. Boeing Organizations with Investigative Duties

A number of different organizations within Boeing have investigative capabilities and functions, many of which bear on the issues relating to the handling of a competitor's sensitive information. These organizations include:

- The Law Department, which performs investigations involving alleged violations of law and in other areas when an investigation is to be performed under attorney-client privilege. Such investigations may involve, for example, issues arising under the export and import laws, the Foreign Corrupt Practices Act, or government procurement laws.
- The Ethics organization, which manages investigations of violations of Boeing's ethics policies, drawing upon investigators from other functional organizations as appropriate. Such violations may include improper time charging, insider trading, conflicts of interest, or misuse of company resources.
- The Security Department, which investigates allegations of misconduct including fraud, assault, theft, and sabotage. In addition to these traditional law enforcement areas, Security personnel may be called upon to assist other functional groups, such as Ethics, in conducting investigations in other areas.
- Audit, which is available to provide support to other functional groups, including Law and Ethics. Audit personnel involved in investigations often perform analyses of financial issues and review internal control procedures.
- HR, which investigates violations of company personnel rules, such as attendance issues, unfair disciplining or evaluations, and inappropriate language. Because allegations reported to Ethics Advisors frequently involve such issues, HR investigators are often brought in to assist with ethics investigations.
- EEO investigators (part of the Boeing Office of Global Diversity), who respond to allegations of discrimination and harassment. Among the issues covered by such investigations are alleged racism or gender bias, age discrimination, and sexual harassment.

These groups sometimes share information concerning ongoing investigations with members of other investigative groups. For instance, Ethics and the

Law Department have regular communications, both at the corporate level and at the business unit level, to keep each other informed as to the progress of investigations that may have relevance for the other organization. The regularity and scope of these communications appear to vary among business units, however.

2. Databases for Tracking Investigations

Each group performing investigative tasks appears to use a separate and distinct database system for tracking ongoing investigations within its own department. The Law Department, for instance, uses a closed-access, proprietary system, which provides a regularly updated snapshot of where each investigation stands. Ethics employs a similar computerized tracking system. Although these systems are generally available to members of the relevant organization with a need to gain access to them, the systems are not generally accessible by personnel from outside the specific department that employs the tracking system.

In addition to the potential difficulties presented by their separate tracking systems, further challenges are presented by the manner in which data is aggregated and reported. Within the Ethics tracking system, for instance, the broad category of “information integrity” is used to describe a variety of potential information-related violations, including the misuse of employee personnel records and the unlawful possession of competitors’ proprietary information during a government procurement process. Although the detailed records associated with each incident report indicate the precise nature of the allegations, the metrics that are used to classify incidents for internal reporting purposes are unable to distinguish between these two very different types of information integrity problems.

C. The Boeing Approach to Competitive Procurement

1. The IDS Teams

Much of the work in IDS is performed pursuant to USG contracts, often following a competitive procurement process. When preparing to participate in a procurement, several groups or “teams” are formed, each of which is assigned a task. These teams are known as Capture Teams, Proposal Teams, Blue Teams, and a Program Office. Although the composition of these teams is likely to vary based on the nature of the particular procurement (and not every procurement will require formation of each of those teams), they are the basic components of Boeing’s approach to competitive government contracting.

The Capture Team is generally the first team to be established. Its primary mission is to coordinate the overall process of winning, or “capturing,” the government contract. Thus, it engages in some oversight of the activities of other procurement-related teams. The Capture Team is charged with evaluating the procurement to determine whether and how Boeing is likely to win the contract, as well as to begin pooling the resources necessary to do so. The Capture Team is a multi-functional group, with support from a variety of business units and functional employees.

Proposal Teams are responsible for creating and assembling the company’s formal submission, including all financial and technical elements (whether generated by Boeing or by proposed subcontractors). The Proposal Team is also responsible for doing a final analysis of early cost and pricing estimates, to ensure that the proposal has a realistic chance of success at the bid price. The Proposal Team also

handles other pre-award activities, such as preparing a final offer and responding to customer inquiries.

Blue Teams identify the likely strategies, technical demands and cost/price parameters of a likely competitor's proposal. The Blue Team's central task is to create a model of a key competitor's anticipated proposal. The Blue Team advises the Boeing Capture and Proposal Teams on how they can maximize the chances of Boeing winning the contract by compiling the most favorable bid package.

The Program Office is responsible for overseeing the day-to-day operations of a project once a contract has been awarded. The Program Office is involved in identifying staffing needs and in monitoring Boeing's performance under the contract. Program Offices are the last of these groups to be created with respect to a particular procurement.

2. Competitive Assessment Activities

Throughout the Boeing organization, groups of employees are assigned the ongoing task of gathering information about the methods, prices, strategies and technical approaches of Boeing's competitors and the broader competitive environment that the company faces. These functions are referred to within Boeing as "competitive assessment." The competitive assessment groups reside within the business development divisions of the major business units, but they provide information upon request throughout the company. Competitive assessment groups are called upon to produce regular reports, which update information on competitors and market conditions. They also frequently create special reports and analyses upon request.

The analysts that perform competitive assessment functions within Boeing uniformly stated during our interviews that their focus in information-gathering is public sources, including the Internet, industry trade publications, and trade show literature. The information is combined with the extensive historical data that Boeing possesses (*e.g.*, data on cost and technical capabilities) to generate a competitive assessments. Human intelligence, particularly of the sort gathered from people outside of the Boeing organization, is rarely sought or used, although customers (especially in the commercial areas of the business) do occasionally volunteer information about Boeing's competitors. In addition, Boeing policy does permit competitive assessment personnel to interview former employees of competitors, provided that such interviewees are advised not to provide any trade secrets or other proprietary information gained while in the employ of the competitor.

Competitive assessment groups also track trends within the industry that might affect competitors, such as commodity and currency prices. The analysts with whom we spoke indicated that they have to be prepared to explain the basis of every piece of information they use in their reports, and no proprietary data or restricted information from outside sources is ever knowingly incorporated into their analyses. Furthermore, because of the nature of the activity, these analysts expressed a heightened awareness of the problems created by misusing proprietary information. The employees within the competitive assessment groups often receive additional training on ethics and proprietary information issues to maintain their heightened awareness of these matters.

According to the competitive assessment team members interviewed, most Boeing employees that might have a need for a competitive assessment are aware that the

teams are a central collection point for information on competitors. Despite this awareness, these interviewees stated that rarely, if ever, are proprietary documents brought to them, and when it does happen, the team members are very familiar with the proper procedures to be followed. Several employees were able to recount instances in which they had declined to accept or use documents or information presented to them (usually by a customer) either because of doubts about the proprietary nature of the information or the legality of Boeing's possessing it.

3. Focus Programs

During the business acquisition process, certain programs may be designated as "focus programs" (also known as "must-win" projects), which indicates that these contracts are viewed as critical to Boeing's ongoing business strategy.

Members of a Capture or Proposal Team typically feel considerable pressure to win focus program contracts, due to the effect that losing this type of competition can have on the company, the business unit and individual employees. Despite the intense pressure to win such competitions, however, all of the managers that were interviewed stated that they did not perceive a policy that these contracts should be won at all costs. These managers recognized that the consequences of committing ethical violations in order to win a contract could backfire and cost the company more than is gained, as happened with EELV and EKV.

The majority of IDS interviewees stated that they do not worry about large-scale lay-offs resulting from contract competition losses, even for focus programs. Although such lay-offs happened with some frequency in the past, the perception is that the remaining defense contractors are sufficiently busy that employees working on a

proposal effort that does not win a contract award are generally absorbed by other programs within Boeing.

IV. BOEING'S ETHICS AND BUSINESS CONDUCT PROGRAM

A. Boeing's Ethics Organization

Boeing's POL-1¹⁴ sets out the delegations of authority within the Boeing organization. This policy document determines where, within the Boeing hierarchy, a particular business or functional unit looks for supervision, budgeting, and other oversight and administrative activities. POL-1 delegates responsibility for developing and maintaining the company's ethics policies and programs to the VP-Ethics. For budgeting, reporting and other administrative purposes the Ethics Office resides within the Law Department.

1. Ethics Personnel

The Ethics function within Boeing, like the company itself, has a decentralized organizational structure. As reflected by the budget data discussed below, the central functional unit at WHQ is relatively small, and most Ethics resources are distributed among the business units. Importantly, the Ethics officials for a particular business unit or program report directly to the business head of that unit or program, with a separate, functional reporting line to the Ethics Office at WHQ.

(a) The Vice President for Ethics and Business Conduct

The VP-Ethics is the chief Ethics officer within the Boeing organization and is responsible, along with his staff and other responsible senior policy-makers, for

¹⁴ A copy of POL-1 is included in the Appendix at Tab 5.

devising and implementing Boeing's Ethics program, as well as monitoring compliance with the company's ethics policies and practices.

Boeing's current executive-level organization puts the VP-Ethics in a direct reporting relationship to the company's General Counsel. In the parlance of Boeing's organizational structure, the VP-Ethics has a "hard line" relationship to the General Counsel, with a "dotted line" relationship to the Chairman and CEO. As part of the hard line relationship, the VP-Ethics is responsible to the General Counsel for budgeting and performance reviews. The VP-Ethics does not sit on the company's Executive Council, nor is he a member of the Ethics and Business Conduct Committee ("EBC Committee") (although he does serve as secretary for this Committee). The organizational policies preserve access to the Chairman on matters of importance.

(b) The EBC Committee and the Ethics Process Council

Pursuant to Boeing's POL-2,¹⁵ the EBC Committee is responsible for making major policy decisions concerning the company's Ethics program, as well as for monitoring Boeing's overall compliance with the company's standards of ethical conduct. As noted above, the composition of the EBC Committee is the same as that of the Executive Council. It does not appear that, under current practice, the Executive Council formally reconvenes as the EBC Committee. Rather, important ethics matters that require senior management attention are brought to the attention of the Executive Committee as necessary, typically by the General Counsel with support from the VP-Ethics.

¹⁵ A copy of POL-2 has been included in the Appendix at Tab 6.

Within the Ethics organization itself, the Ethics Process Council (“EPC”) provides leadership on ethics and business conduct issues on a company-wide basis, including setting and reviewing policies and practices, monitoring ongoing ethics issues, and overseeing compliance with Boeing’s ethics policies and legal responsibilities. One of the guiding principles behind the EPC is to provide a consistent and integrated message on ethics issues throughout the company’s various business units. The EPC consists of the VP-Ethics, along with the Vice President for Ethics at IDS, and all of the senior Ethics personnel (discussed below) assigned throughout the company.

The EPC meets on a monthly basis. At these meetings, the EPC addresses policy assessments, analyzes the metrics used to track the company’s performance on ethics issues, discusses ethics cases and investigations, and considers potential changes to the company’s ethics guidelines and policies.

(c) Senior Ethics Personnel in the Business Units

Various senior Ethics personnel are assigned to manage the Ethics programs within the business units. At IDS, for historical reasons, the Ethics program is run by a Vice President. Two Ethics Directors report to him, each having responsibility for a group of IDS sites aggregated on a geographical basis between “IDS East” and “IDS West.”

At BCA, the senior Ethics official is a Director, who reports (for functional purposes) to BCA’s AGC. The ethics element of the AGC’s duties is mostly administrative, with the day-to-day operation of the Ethics program within BCA overseen by the Ethics Director.

The Ethics programs at the other business units – Boeing Capital, ATM, and Connexion – are run by either an Ethics Executive or Director. The program at Phantom Works is under the direction of a Senior Manager.

All of the Ethics personnel within the business units report to the heads of those business units, with “dotted line” reporting up to the VP-Ethics. The business unit leaders thus have direct authority over the performance reviews and budgets of their respective Ethics personnel.

(d) Ethics Advisors

Ethics Advisors are the “front-line ground troops” of the Ethics program. They are responsible for providing a daily interface between Boeing’s Ethics program and other company employees. Ethics Advisors receive training on ethics issues, although this training generally does not address procurement integrity issues specifically. Ethics Advisors sometimes take part in leading ethics training for other employees.

Ethics Advisors serve as the primary focal point (along with the Ethics Line, discussed below) for employees to report possible ethical violations. Much of an Ethics Advisor’s time is devoted to receiving inquiries regarding potential problems, and either responding in person or coordinating assistance from the relevant functional groups within Boeing, such as Security, Law or Audit.

Ethics Advisors typically are assigned a mix of program and site responsibilities. Ethics Advisors typically have responsibility for 4,000-5,000 employees, and sometimes as many as 10,000-15,000 employees. Despite the scope of this responsibility, Ethics Advisors generally have minimal administrative support. Also,

because of the program- and location-specific tasking, Ethics Advisors frequently have responsibility for employees who are part of their assigned program but are located elsewhere. However, those distant program employees may have direct access to another Ethics Advisor who is responsible for the site at which that employee is located. In this way, the Ethics Advisor system provides some redundancy and overlap.¹⁶

Due to the heightened awareness resulting from the EELV incident and IDS Recommitment Day, inquiries to the Ethics Advisors have increased significantly in recent months, especially in the areas of procurement integrity and handling competitors' proprietary information. For example, some Ethics Advisors reported that they experienced a dramatic increase in the number of monthly inquiries on these subjects.¹⁷ Even before this recent increase in their caseloads, however, Ethics Advisors reported that it was difficult to find time for outreach activities on a regular basis.

A number of Boeing facilities are serviced by part-time Ethics Advisors, whose responsibilities include other functional areas, such as HR. Part-time Ethics Advisors are generally posted to sites that are considered too small to warrant a full-time position; but our interviews suggest that some locations with significant numbers of employees are also served by part-time Ethics Advisors. Part-time Ethics Advisors

¹⁶ Employees are generally requested to report ethics concerns to their local (site) Ethics Advisor, as that Ethics Advisor is usually in a better position to conduct any local follow-up.

¹⁷ The Ethics data collection system does not permit precision here, because it does not categorize data below the level of "information integrity," which covers not only misuse of third-party proprietary information, but also mishandling of Boeing proprietary or sensitive information, such as personnel records.

sometimes have additional support staff assigned to them as a consequence of their other functional duties.

Although the formal training available within Boeing for Ethics personnel (beyond introductory level training) is somewhat limited, Ethics Advisors are expected to engage in ongoing professional development. They are encouraged to complete additional training courses offered by professional organizations and universities and to attend meetings of professional organizations, such as the Ethics Officer Association's annual conference, in order to stay current on best practices and current thinking within the field.

Ethics Advisor positions generally are sought after, with hundreds of applicants applying for each Ethics Advisor position that becomes available. Nonetheless, a number of Ethics Advisors were of the view that their status and administrative support were inadequate, and that, to the extent they were "players" within business management, this was more the result of personal effort than the institutional structure or stature of the Ethics function. These views were generally consistent with the results of our interviews with employees in other functional areas. A number of Ethics Advisors also expressed the view that the company should place more emphasis on Ethics as a valued career path. The current staff of Ethics Advisors appears to be nearly evenly divided between those who characterized themselves as career Ethics professionals and those for whom the Ethics Advisor position is part of a "rotation" program.

Finally, Ethics Focals are employees that, on a part-time basis, support the Ethics program at Boeing sites that do not have a resident Ethics Advisor. Ethics Focals

refer employee questions or concerns to the appropriate Ethics Advisor, ensure employee access to ethics training materials, and coordinate implementation of the Ethics training and awareness programs at their assigned site.

(e) WHQ Ethics Personnel

The Ethics Office at WHQ houses the personnel who operate the Ethics “hotline” and an Ethics Operations Manager who oversees various aspects of the Ethics program. The Ethics Line is a dedicated toll-free phone number that employees can use to report ethics violations or to make inquiries regarding the company’s ethics policies. Calls that come into the Ethics Line are not identified by either caller ID or other mechanism, although employees are free to identify themselves if they wish. During non-business hours, a recording system is used; a caller can leave a message, which will be returned promptly by an Ethics Line operator or the appropriate Ethics Advisor.

Ethics Line operators are stationed in St. Louis, Seattle, and Seal Beach, California. The Ethics Line number is listed on posters located throughout Boeing facilities, as well as in every issue of the company newsletter and on identification badge extenders that many employees wear. The Ethics Line is one of the most visible elements of the Ethics program for rank and file employees.

The Ethics Line is staffed by a small group of operators who have training in how to handle the sensitive and sometimes emotional calls they receive. In addition, the Ethics Line operators are able to take the same training courses as Ethics Advisors, as well as continuing education programs offered outside the company. There are six Ethics Line operators stationed around the country, and calls are routed to these operators based on the area code from which the call is made.

The Ethics Operations Manager is in charge of certain centralized operations of the Ethics program, including the Ethics Line and the ethics portion of the Compliance Assessment Process. The Ethics Operations Manager is part of the WHQ Ethics Office and reports directly to the VP-Ethics. The Ethics Operations Manager does not have oversight responsibility for any of the Ethics Advisors operating in the business units.

(f) Ethics Budget Allocations

Across the Boeing enterprise, approximately \$7.6 million was budgeted for the Ethics program for 2003. Of this amount, approximately \$2.7 million was budgeted for the WHQ Ethics Office, and the remainder was budgeted by the business units for their Ethics personnel and activities. Actual expenditures in 2003 are projected to be about \$1.7 million over budget, company-wide.

The budget allocation for the WHQ Ethics Office is assessed to the business units as part of their annual corporate overhead, along with other enterprise-wide services such as Law, Audit, and SSG. By contrast, the business units are directly responsible for the salaries and program expenditures (aside from special ethics training) for the Ethics personnel working within their business units. The Ethics budget and personnel breakdown among the business units, in terms of cost and personnel, is as follows:

Ethics and Business Conduct Program					
Budget and Headcount by Business Unit - Fiscal Year 2003					
As of October 16, 2003					
Business Unit	Annual Budget*	Year-end Estimate as of 10-16-03	Headcount		
			Total	Full-time	Part-time
WHQ	\$2,735,000.00	\$3,283,764.00	12	12	
IDS	\$3,200,000.00	\$4,300,000.00	35	19	16
BCA	\$1,300,000.00	\$1,300,000.00	22	10	12
PW	\$50,000.00	\$50,000.00	1		1
SSG	\$150,000.00	\$150,000.00	1	1	
ATM	\$70,000.00	\$70,000.00	1		1
CBB	\$50,000.00	\$50,000.00	1		1
BCC	\$25,000.00	\$25,000.00	1		1
Total	\$7,580,000.00	\$9,228,764.00	74	42	32

*** Annual budget does not include employee time associated with Ethics training and meetings**

2. Ethics Training Programs

(a) General Ethics Training

Ethics training at Boeing is designed by the WHQ Ethics staff.

Responsibility for administering the training to individual employees generally falls to the Ethics Advisor responsible for that employee’s site or program and to the employee’s manager. In the last few years, ethics training at Boeing has undergone significant revisions; the current employee training program bears little resemblance to the material in use at the time of the merger with McDonnell Douglas.

Each new employee at Boeing receives a copy of the company’s “Ethical Business Conduct Guidelines” (“Guidelines”).¹⁸ The Guidelines set forth a number of the company’s core policies and procedures on ethics matters. The document opens with POL-2, which states in part:

¹⁸ A copy of the Guidelines is available in the Appendix at Tab 7.

Boeing will conduct its business fairly, impartially, in an ethical and proper manner, and in full compliance with all laws and regulations. In conducting its business, integrity must underlie all company relationships, including those with customers, suppliers, and communities and among employees. The highest standards of ethical business conduct are required of Boeing employees in performance of their company responsibilities. Employees will not engage in conduct or activity that may raise questions as to the company's honesty, impartiality, or reputation or otherwise cause embarrassment to the company. Conduct that is prohibited under Boeing policy may not be accomplished on an employee's behalf by anyone outside the company.

All new Boeing employees are also required to watch a short video that introduces the Boeing Ethics program and briefly describes some of the company's ethics policies. A new version of this video featuring the Chairman and CEO, the General Counsel and the VP-Ethics was released in September 2003. For the first time, procurement integrity and the use of competitors' proprietary information received particular attention in this new-employee video, consuming approximately half of the four-minute-and-fifteen-second running-time.

All new Boeing employees are also required to complete a web-based training program that includes hypothetical questions involving conflict of interest issues and accepting business courtesies. This program also identifies for new employees the resources within the company available for addressing ethics issues, such as the names and phone numbers of Ethics personnel to whom questions or suspected violations may be directed. Finally, the program shows new employees where to look for the company's ethics policies concerning specific situations not addressed in the training materials.

This introductory program focuses more on conveying to employees the ethics values of Boeing than on specific rules or expected conduct for a variety of situations. The program does not address the use of third-party proprietary information.

All Boeing employees are also required to complete regular ethics refresher training, which is designed by WHQ Ethics personnel for use by employees across the company's various business units. This computer-based training is intended to be reviewed in discussion groups, but can be taken by individual employees who are unable to attend the regular training sessions. Responsibility for ensuring that each employee receives his or her mandated training is, in most instances, the dual responsibility of the employee's manager and the Ethics Advisor at the employee's site.

Prior to 2003, the ethics refresher training consisted of an annual half-day program, featuring a series of case-studies that focused on a specific ethics topic, such as kick-backs or misuse of company resources. In early 2003, Boeing moved to shorter computer-based courses to be taken three times per year.

Each session of the new ethics refresher training takes about 20 minutes to complete (excluding discussion time) and covers a broad range of ethics topics. The guiding principle behind this new refresher training is that it is more important to develop the skill of ethical decision-making than to address every ethics rule in the Boeing policy manuals. As a result, the content of the modules tends to be somewhat abstract and philosophical.

Overall, reaction to the new ethics training modules has been mixed, with a large number of the employees and managers we interviewed suggesting that the new modules are insufficiently linked to actual rules and policies and to the kinds of everyday

ethics issues faced by Boeing employees. The prior ethics training, which focused on case studies, was generally thought to instill a greater level of awareness of Boeing's ethics policies. Other employees noted, however, that the new approach was effective in generating discussion in group settings, and that employees were more likely to think about ethics as a result of this training.

As noted above, although the new ethics modules are computer-based, the Ethics Office still encourages business managers to conduct the on-line training in discussion groups. We found significant variation in the extent to which managers in different programs encouraged or required their employees to participate in discussion groups. In some business segments, employees were left to their own devices to complete the modules on an individual basis as time permitted. Other managers required employees to participate in group discussions. In some instances, and particularly for more senior managers, the group's Ethics Advisor would be asked to lead the discussion group. Managers who required group participation generally expressed the view that this exercise reinforced the importance of ethics and led to a greater awareness of ethics issues among employees. In instances where particular employees were unable to participate in the group sessions, those individuals would be required to complete the training on their own or as part of a make-up group session, if available.

With regard to training of Ethics personnel, the two and one-half day Boeing Ethics Advisors Training ("BEAT") program is taken by Ethics Advisors and the Ethics Line operators to familiarize themselves with the company's ethics policies and practices and to learn the basic skills needed to perform their functions. BEAT covers training on handling inquiries, including protecting the confidentiality and anonymity of

employees that make inquiries or reports, and initiating investigations. Substantively, the course covers many of the major issues confronted by Ethics personnel, including misuse of company resources, conflict of interest, and business courtesies. However, BEAT does not address procurement integrity issues in general or use of third-party competitive data in particular.

(b) Procurement Integrity Training Courses

In addition to ethics training, employees (including outside contractors hired to assist on particular matters) are required to take training in the legal requirements relating to procurement integrity. Procurement integrity training is not administered by Ethics, but rather by C&P, with central coordination coming from the WHQ C&P staff.

The basic procurement integrity training is a web-based multimedia program taken by employees as they begin their involvement in government procurement activities. The program follows the progress of a hypothetical proposal process from start to finish. During the course of the proposal's development, the trainee is presented with a variety of procurement integrity issues and is called upon to guide the main character in choosing from several possible courses of action. The trainee's responses to these questions are tracked throughout the training course, and the consequences of those responses are discussed at the end of the program.

The training program provides a realistic look at the ways in which procurement integrity issues may arise in the context of a proposal process. These include: (1) an outside consultant's offer to give a Proposal Team member a competitor's proprietary information; (2) the discovery of such information on a company fax machine; (3) and an offer of assistance from an ex-government employee who was

directly involved in the government's efforts in the proposal process. At each of these decision points, the trainee is given guidance through the use of short case studies addressing the relevant topics. The texts of the PIA and the EEA also are available in the on-line course materials.

The Procurement Integrity Refresher Course is a much less involved web-based program, which contains a description of the prohibitions in the PIA. The course discusses penalties for violations of the PIA and whom to contact in the event an employee discovers a PIA violation. There is also a brief overview of proprietary information agreements in the context of proposal preparation. All Boeing employees involved in USG procurement activities must take this course at least once every three years. The course does not cover relevant areas of the law other than the PIA (such as the EEA).

A procurement integrity briefing is required to be given when a Proposal Team is formed. At the initiation of the Proposal Team, a kickoff meeting is held to familiarize team members with the program requirements and team strategy. As part of this meeting, an ethics briefing is conducted, during which team members are given an overview of procurement integrity law. This Proposal Team briefing is normally given by the Proposal Team's C&P manager.

As an alternative to this standard Proposal Team ethics briefing (particularly for larger programs), Proposal Team members may be given a more detailed "Awareness Briefing" on procurement integrity issues. The Awareness Briefing describes the text of the PIA, as well as several scenarios based on real-life procurement integrity problems. The Awareness Briefing provides a short summary of the facts of

each incident and lessons based on the outcomes, both positive and negative, resulting from employees' actions in the matter. Currently, Boeing employees who join Proposal Teams after their formation are not required to receive, and generally do not receive, this type of procurement integrity briefing.

(c) Other Procurement Integrity Training Materials

As described earlier, a number of organizations exist within Boeing to gather information about competitors and the competitive environment in which Boeing operates. Although these efforts are expressly directed at obtaining only information that is available in the public domain, the nature of these activities has created a heightened awareness of the potential for procurement integrity or EEA/trade secret violations within these competitive assessment groups. As a result, employees engaged in competitive assessment activities generally are required to complete additional training focused on the EEA and trade secrets laws that has not traditionally been included in other training programs at Boeing.

This training focuses on acceptable sources of information about competitors (such as news reports or public financial disclosures made to regulators) and unacceptable information sources (such as proprietary third-party documents or the knowledge of former competitors' employees that would be classified as a trade secret under the UTSA). The training also instructs competitive assessment employees to seek guidance from the Law Department in the event that they come into possession of questionable information.

Additional material on procurement integrity is available in IDS' Global Business Acquisition Program ("GBAP"), which functions as a Proposal Team "boot

camp” designed to create a team mentality prior to beginning work on certain proposals. Participants are given a briefing on ethical issues, including procurement integrity. The briefing focuses specifically on the handling of competitors’ information.

Further information is available in a reference document entitled “Guide to Compliance with the Procurement Integrity Law and Use of Competitor Data,” which provides a basic introduction to the PIA, including a series of common questions and answers. Developed by IDS’ predecessor business unit in the wake of the EKV incident in 1998, the guidelines discuss appropriate sources of information for Blue Teams and require that only publicly available information be used to assemble the team’s competitive assessment.¹⁹

Finally, the Law Department provides a course, designed by the Legal Resources Network, that covers procurement integrity issues. As with some of the other training material on procurement integrity issues, this course tends to focus on the letter of the PIA, without providing examples of conduct that would violate the law.

3. Compliance Management Oversight Process (“CMOP”)

Boeing’s CMOP program is a multi-layered effort to monitor the effectiveness of the company’s compliance mechanisms and develop corrective actions as necessary. While not technically part of the Ethics program, CMOP does address a number of compliance risk areas, including procurement integrity law. The CMOP involves identification of risk areas, assignment of responsibility for those risk areas to executives, and an annual self-assessment on compliance issues.

¹⁹ A copy of the Guide and the original memorandum introducing it in 1998 are included in the Appendix at Tab 8.

(a) Compliance Risk Areas (“CRAs”)

The first step in the CMOP program is the identification of compliance risk areas, known as CRAs, where violations of law or policy are most likely to occur in the course of Boeing’s business. The CRAs are identified on an annual basis by means of consultation among the VP-Ethics, the General Counsel, the Corporate Auditor, and the Corporate Controller. Although CRAs may change on an annual basis due to changes in the risk environment faced by the company, there is often substantial overlap from one year to the next. Procurement integrity has sometimes appeared on the CRA list. However, until this year, the risk area has been rather narrowly defined as compliance with the PIA. The company is presently considering expanding this risk area to cover other risks associated with procurement integrity and the handling of third-party proprietary data.

(b) Process Councils

Process Councils, such as the EPC described above, focus on improvement of business performance by ensuring that best practices are shared throughout the enterprise. The membership of Process Councils consists of senior executives in the functions related to the Process Council’s subject area, and each Council is led by a senior executive who typically is a member of the Boeing Executive Council.

Once CRAs have been identified for a given year, they are aligned with the subject matter expertise of the Process Councils, and the leader of a specific Process Council becomes the “Responsible Executive” for the corresponding CRA. That sponsor

must then ensure that his Process Council has developed a means of addressing the CRA, as well as evaluating compliance and educating employees on the risk area.

(c) Compliance Assessment Process (“CAP”)

The CAP program is an annual self-assessment of Boeing’s performance in identified areas of compliance risk (*i.e.*, the CRAs). Each year, the “Responsible Executives” select senior managers within the business units to oversee the CAP process. These senior managers in turn select business unit personnel to complete extensive questionnaires, in which the business unit’s risk and compliance levels are considered and reported within the identified risk areas. The results of the CAP questionnaires are then combined to generate business unit and company-wide compliance assessment reports.

(d) Controls Self-Assessment

In addition, Boeing holds periodic company-wide meetings, known as controls self-assessments (“CSA”), to consider individual risk areas. For example, Boeing held a CSA in August 2003, at which functional leaders from throughout the company were invited to a day-long review of the company’s internal controls relating to procurement integrity. To our knowledge, this CSA was the first one to address procurement integrity issues.

B. The Culture of Ethics at Boeing

We make general findings regarding Boeing’s “ethics culture” in a subsequent section of this Report. It is appropriate here, however, to note specific issues we encountered in the course of our investigation.

1. Differences in Culture Among IDS Locations

Numerous interviewees noted that substantial differences in corporate culture still exist among the various Boeing locations, despite several years' effort to create a single, coherent corporate identity. In particular, a number of employees emphasized perceived differences between the IDS facilities in St. Louis and those in southern California. The St. Louis facilities are heritage McDonnell Douglas, and concentrate in large part on long-term defense programs, such as the F-15 fighter jet. The St. Louis facilities were described as more "military" in attitude, with a more formal approach to supervision and chains of command. St. Louis employees indicated that they were more likely to establish roots in the community and with the company and to remain with Boeing for a substantial portion of their careers.

The southern California facilities include heritage McDonnell Douglas facilities, as well as heritage Rockwell and Hughes operations. These facilities were characterized as more fluid and innovative, with a research and design, rather than a production, mentality. Southern California employees were also described as being more likely than their counterparts elsewhere in the company to move among competitors during their careers. Despite this perception, however, a large number of employees that we interviewed in southern California indicated that they had been with Boeing (through employment at Rockwell, McDonnell Douglas, or Hughes) for more than 10 years, with several employees having more than 25 years with one of the heritage companies.

2. Employee Fear of Retaliation

By and large, the Boeing employees that we interviewed had no fear that the company would retaliate against them if they reported ethical misconduct or other

violation of company policy. Most interviewees noted that Boeing has made a substantial effort to create an environment of openness, where individuals feel free to voice their concerns. Some employees specifically noted that this effort has improved employee attitudes towards reporting violations.

Despite this general sentiment, a few individuals did express the view that fear of retaliation still exists within Boeing, particularly at certain Southern California locations. Although these employees recognized that such retaliation would be contrary to Boeing policy, they expressed continued concern that individual managers could act in subtle, difficult-to-prove ways – such as by giving bad performance reviews – against employees who reported ethics violations.

3. Employee Surveys

Although we were able to interview only a limited number of Boeing employees, Boeing has conducted internal surveys of its employees, and the survey results are, by and large, consistent with our observations.

During the second quarter of each year, Boeing conducts an employee survey to measure employee attitudes on a wide variety of issues, including personal job satisfaction and overall opinion of the company. The survey also addresses a number of questions relating to ethics issues, such as the level of fear of retaliation for reporting violations of company policies. The survey questions have remained consistent over the recent past and are similar to questions asked at a number of other companies. This consistency and similarity permits comparisons both with Boeing's past results and, to some extent, broader industry results.

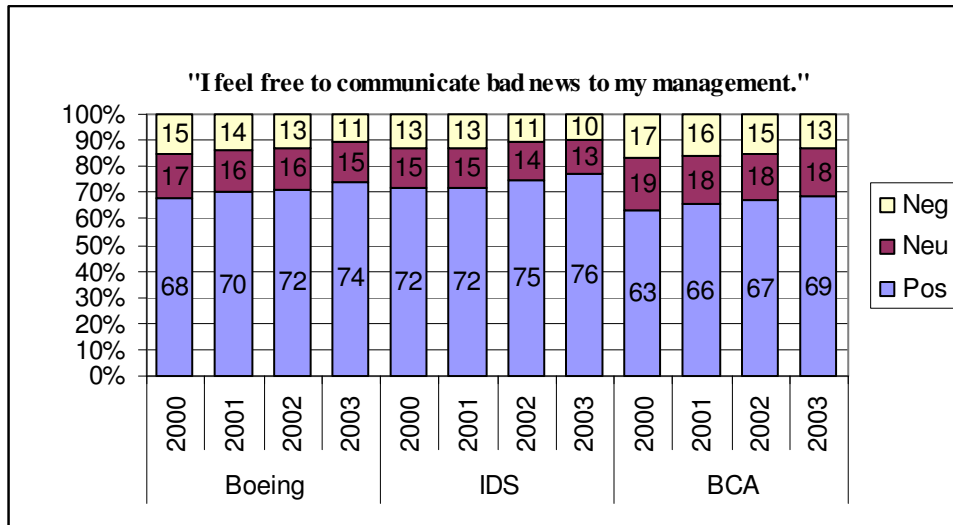
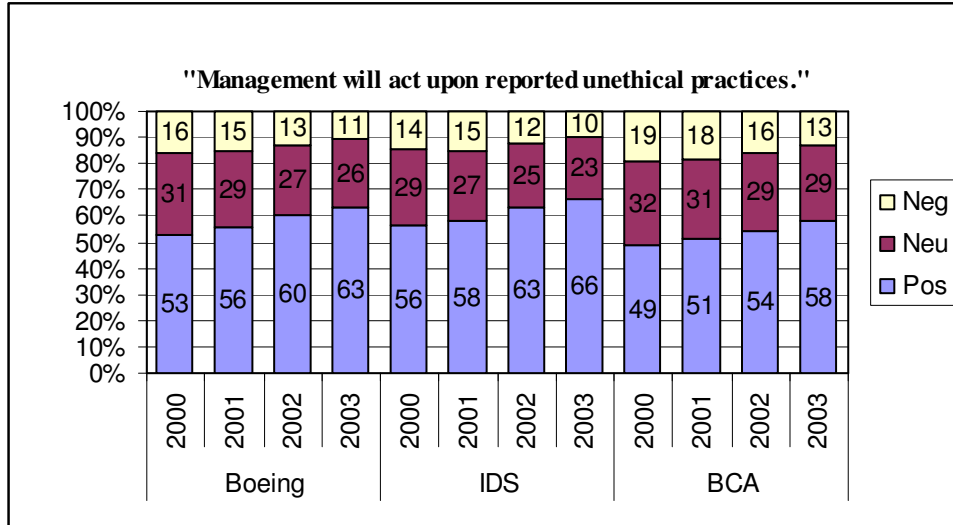
Results from these surveys are compiled both on a company-wide basis and for each business unit, thus allowing comparison of employee attitudes towards ethics among various divisions of the company. For our review, we have considered the company-wide survey results, as well as those for BCA, IDS, and IDS' two predecessor components, Aircraft & Missiles and Space & Communications. We have reviewed survey results from these business units for the years 1998 through 2003.

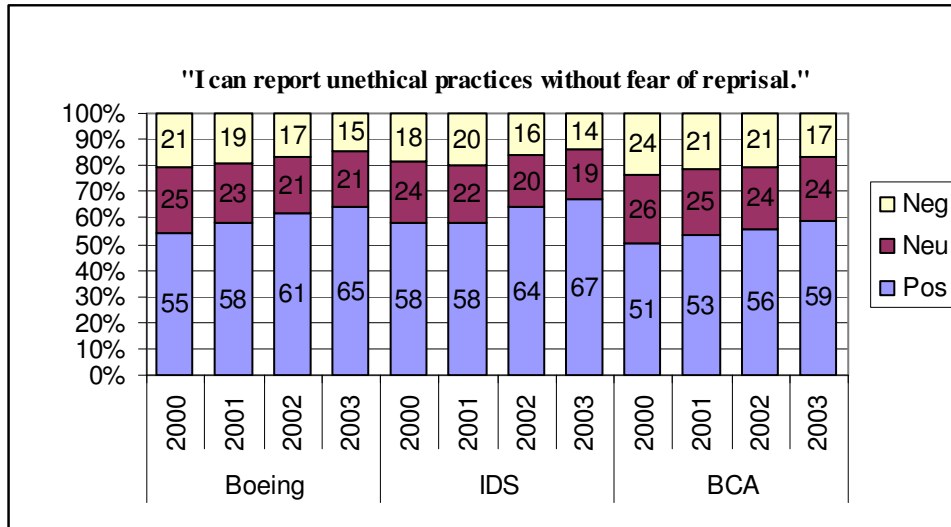
All employees at Boeing are encouraged to respond to a survey questionnaire, and the response rate has increased from 57% of all employees participating in the survey in 1999 to 69% of employees completing the survey in 2003. Two-thirds or more of the respondents completed the survey on Boeing's intranet web site.

The employee surveys ask respondents to indicate their agreement or disagreement with a number of statements concerning the company. Survey results are then graphed, indicating the percentage of positive reactions to the statements. The results on each statement are then compared with Boeing's historical results on that same item (as well as with industry averages where available).

Most of the surveys conducted at Boeing during the years reviewed contained a few statements relating to ethics matters. Three of the ethics statements appeared in each of the surveys that we reviewed. The reaction of employees – either positive, neutral, or negative – to the three statements is shown on the charts below.²⁰

²⁰ Although we reviewed survey data for 1998 and 1999, consolidated data for IDS was available only beginning in 2000. For ease of comparison, these charts consider only the years 2000 through 2003. The inclusion of 1998 and 1999 would not have significantly changed the appearance of any of the three charts.





As these charts indicate, the general trend of employee opinion on these ethics issues has been positive over the last four years. Also, the percentage of people within IDS who agree with the statements is uniformly higher during each year surveyed than either at BCA or in the company as a whole.

4. Other Proprietary Information Problems

Aside from certain well-publicized incidents (*e.g.*, EELV and EKV), the vast majority of employees we interviewed reported that they had no knowledge of any violations of procurement integrity rules or misuse of competitors' proprietary information. Without exception, every Boeing employee interviewed asserted that he or she was aware of the proper procedure for handling a competitor's document that might contain unauthorized proprietary information. In some of these cases, however, employees stated that they would take the document to their manager, which is not consistent with Boeing's newly revised policy of going immediately to the Law Department or Ethics, and which could lead to "information contamination" among a greater number of employees within a program area.

5. Ethics Component of Annual Personnel Reviews

Although compliance with Boeing's ethics policies is evaluated as part of each employee's annual performance review, some employees expressed frustration that this component almost never has any effect on the outcome of a review. Managers perceive pressure (often self-imposed) not to rate any employee as below average in ethics. There is also resistance against rating any employee above average, as that implies that other employees are not doing as well in terms of ethical conduct. The strong tendency, therefore, is to award all employees an average score for this component, effectively rendering it meaningless.

C. Boeing's Specific Policies on Procurement Integrity and Competitors' Proprietary Information

1. Relevant PROs

The Boeing POL and PRO documents are available for employee review in an on-line, searchable database.²¹ This system is supposed to provide easy access to this material and to ensure that the most recently updated version of each such rule or policy is always available. However, several interviewees cited the difficulty of using the database's search mechanism, which can make it difficult to find Boeing's stated policy on a given ethical question.

Our review of this search engine found that it provided an adequate search tool, but that the success of a particular search was likely to depend on the extent to which the party performing the search was already familiar with the terminology used within the policy document. The search engine looks only for exact matches to the

²¹ Six of Boeing's POL and PRO documents pertain to procurement integrity or related matters and are reproduced in the Appendix as indicated: POL-2 (Tab 6), PRO-3 (Tab 9), PRO-4 (Tab 10), PRO-5 (Tab 11), PRO-70 (Tab 1) and PRO-2227 (Tab 13).

keywords that are used in creating the search query and does not look at related concepts. This limitation may reduce the effectiveness of the policy document database and make these documents less accessible to rank and file employees not familiar with the terminology used in this area of the law.

POL-2 is the foundation document for Boeing's Ethics program. It requires each member of the Boeing community to take responsibility for understanding and implementing the company's ethics standards. POL-2 also requires that employees know and abide by all applicable laws and regulations. Furthermore, POL-2 mandates that employees not only follow the letter of Boeing's ethics standards and applicable laws, but also respect the spirit of those rules by avoiding the appearance of impropriety.

PRO-3 describes the offices, personnel, and procedures that comprise Boeing's Ethics program. PRO-3 also establishes the company's ethics education requirements and the guidelines for dealing with employee questions and concerns regarding Boeing's ethics policies.

PRO-4 outlines the company's policies on marketing practices, which are meant to ensure that no illegal or unethical practices are used to sell Boeing products and services. Specifically, PRO-4 prohibits employees from marketing to Boeing customers in any way that would create a conflict of interest or a legal violation. PRO-4 also forbids any attempts to influence customer behavior through the use of gifts, bribes, or other favors. Finally, PRO-4 requires that information on Boeing products and services be accurate and free from misleading or deceptive statements or omissions.

PRO-4 is currently undergoing revisions to address, among other things, the hiring of former employees of Boeing competitors and the resulting potential for

disclosure of competitors' proprietary information. Our understanding is that the new PRO-4 will require new employees at Boeing who worked for a Boeing competitor within the last two years to identify themselves to their managers and to abide by the confidentiality obligations owed to the competitor.

PRO-5 contains more specific guidelines on marketing to USG customers. PRO-5 describes the restrictions placed on USG employees who interact with commercial entities, including severe limitations on accepting business courtesies. PRO-5 also describes other restrictions on interacting with USG procurement employees during the various stages of a competitive procurement process. PRO-5 recognizes the sensitive nature of USG procurement processes and urges all employees to take particular care to avoid even the appearance of impropriety.

PRO-5 also is in the process of being revised to strengthen prohibitions on the use of competitors' proprietary information. As we understand it, the new PRO-5 will incorporate the more rigorous procurement integrity rules found in the new PRO-70, described below.

PRO-70 is the Boeing procedure document that specifically addresses procurement integrity issues. In the past, PRO-70 was narrowly focused on compliance with the PIA. In August 2003, PRO-70 was substantially amended to tighten procedures related to PIA compliance and to go beyond the PIA in covering material on the legal requirements governing third-party documents.²² However, PRO-70 still addresses these matters only within the context of a USG procurement. The use of such information in a

²² Both the current and immediately prior versions of PRO-70 are included in the Appendix at Tabs 1 and 12 respectively.

commercial setting has not yet been fully addressed in the Boeing policy and procedure documents. As of this writing, Boeing is in the process of developing standards to address the use of competitors' information in the commercial market.

Finally, PRO-2227 describes the company's policies relating to the marking and controlling of Boeing and third-party proprietary and competition-sensitive information. It lists various levels of restrictions placed on the dissemination of such information, both within the company and to outside sources. For the most part, this PRO's applicability to third-party information is limited to an admonition to follow the terms of the proprietary information agreement under which Boeing came to possess the information.

2. Firewalls/Proprietary Information Agreements

Boeing often participates in teaming arrangements with companies against which it competes in other procurement activities. For example, Boeing currently has teaming arrangements with Raytheon, Northrup Grumman, and Lockheed Martin, all of which are also key business competitors for defense contracts. In addition to these teaming arrangements, Boeing frequently receives sensitive proprietary information from its suppliers, many of whom also act as suppliers to Boeing's competitors. Because of these close teaming and supplier relationships, certain parts of the Boeing organization may become privy to information that could give an unfair advantage to other Boeing units if the information were to be freely shared across the enterprise.

In response to these issues and concerns, Boeing typically establishes internal "firewalls" to prevent employees with access to third-party proprietary information from releasing that information to the company at large. These firewalls are

generally established under proprietary information agreements or nondisclosure agreements, which are a standard tool within the defense industry for creating the rules under which proprietary information is shared. The scope and rigor of the firewalls will vary based on what protective mechanisms have been negotiated and what level of risk is presented.

One example of a major Boeing program with substantial firewalls is the FCS program. The FCS is a “system of systems” that links numerous combat systems and communication networks to each other and to soldiers in the field. The United States Army appointed Boeing and SAIC as the Lead Systems Integrator team on the project, responsible for overseeing the production of the individual components and their integration into the overall system.

Boeing employees will be involved in the evaluation and award of the FCS component subcontracts, including proposals from other Boeing organizations competing for the subcontracts. To ensure that there is no abuse of Boeing’s access to its competitor’s information, employees with access to competition-sensitive FCS information or procurement proposal information are required to sign a certificate acknowledging the program rules restricting access to such information. The certificate also acknowledges the employees’ understanding that, for a period of one year after their involvement with FCS, they are barred from working with any Boeing organization or any outside company on a project related to the FCS program if that organization or company is bidding on a proposal related to the program.

D. Recently Adopted Procedures Concerning Competitors' Information

As a result of the incidents involving competitors' proprietary information and the sanctions and legal liabilities that resulted from those incidents, Boeing's management has undertaken a systematic review of existing ethics and legal policies at the company, with special emphasis placed on enhancing procurement integrity and proprietary data policies and procedures. A number of steps have been taken in the past few months to enhance Boeing's policies and procedures in this area.

1. Revising Policy and Procedure Documents

Boeing is currently implementing or considering changes to a number of procedure documents relating to procurement integrity and the handling of competitors' proprietary information. PRO-4, for example, is being modified to require disclosure by new employees of a former employer-employee relationship with a Boeing competitor or a Boeing customer. In addition, PRO-5 is being revised to add new procedures that employees must use in response to the receipt of third-party proprietary information.

As mentioned above, PRO-70 has already been substantially revised to cover procurement integrity matters beyond the PIA, and to strengthen procedures for reporting possible violations and for documenting the proper receipt of competitors' information. Boeing also plans to expand the procurement integrity CRA as part of the 2004 CAP program to cover a broader range of procurement integrity and proprietary information issues.

In addition, Boeing is in the process of developing a new PRO that will address restrictions on the use of competitors' proprietary information in the commercial (non-USG) context. Although this issue is addressed in a few places in Boeing's ethics

training materials, it is not covered in detail by any PRO. The substance of this procedure document will presumably be guided by the provisions of the EEA and the UTSA.

2. Compliance Review Board

Boeing has recently established a new Compliance Review Board (“CRB”) within IDS, which will regularize involvement by senior IDS management in overseeing compliance policy, practices, and potential violations that may occur within IDS. The membership of the CRB consists of senior business executives and senior representatives of the Law Department, Ethics and other functional groups within IDS. The CRB is chaired by the President of IDS.

(a) Compliance Assessment Team

Under the CRB, IDS has established a Compliance Assessment Team (“CAST”), which will be responsible for monitoring compliance and reporting to the CRB on the state of compliance within IDS. The CAST will also be responsible for implementing Boeing’s compliance goals within IDS. The CAST will include members from the same business and functional areas as the CRB – including one functional representative from each Process Council within IDS – and will be chaired by the IDS Vice President for Ethics.

(b) Process Action Teams

The final element of the CRB structure are the Process Action Teams (“PATs”), which are multi-functional sub-groups to be established by the CAST. PATs will be responsible for improving and implementing processes relating to high risk compliance areas. They are intended to provide integration of best practices and

synergistic approaches, both horizontally and vertically, across business units. PATs will be able to draw upon resources from across IDS and the rest of Boeing.

3. Special Compliance Officer

Boeing is also considering the appointment of a Special Compliance Officer (“SCO”), whose responsibilities would include monitoring the implementation of the remedial measures undertaken by Boeing, as well as any requirements of a potential administrative agreement between Boeing and the Air Force. The SCO would also be expected to make regular reports to Boeing and the Air Force on these matters.

4. Overall Ethics Program Review

In addition to our review, and at the request of the Air Force, Boeing has engaged an outside consulting entity, the Ethical Leadership Group, to conduct a broad review of Boeing’s Ethics program.

5. Applying Lessons Learned by the Law Department from EELV

The Law Department has already integrated some of the lessons learned from the EELV investigation by revising its investigative procedures relating to procurement integrity issues. As described above, significant allegations of procurement integrity violations will now be taken directly to the Assistant General Counsel for Litigation (“AGC-L”), who will be responsible for assigning experienced Law Department litigators and/or retaining outside counsel to investigate and resolve the matter on an expedited basis.

The Law Department also conducted an “Ethics Standdown Day” on October 1, 2003 for its personnel, during which the details of the EELV incident and aftermath were reviewed, as well as the new procedures designed to ensure against a

repeat of those events. We understand that the Law Department also intends to commission an independent review of its investigative procedures.

6. IDS Ethics Recommitment Day

On July 30, 2003, all IDS employees were required to participate in the Recommitment Day activities, an all-hands “stand down” intended to reinforce the company’s commitment to ethical behavior. Several thousand non-IDS employees also participated.

Although planned and prepared in a very short time frame, Recommitment Day materials and activities were of high quality and effectively focused on perceived problem areas. Activities included video presentations that featured several members of Boeing’s senior management, as well as ethics instruction from Marianne M. Jennings, a professor of business ethics at Arizona State University. Following this presentation, employees participated in group exercises and discussion of ethics issues led by Ethics Advisors and selected managers. The video presentation dealt generally with the importance of ethical conduct to the company and ways to engender a more open, ethical atmosphere at Boeing.

The group exercises and discussions focused on procurement integrity and proprietary data issues. The handout material included a description of the relevant legal standards concerning the handling of third-party proprietary information.²³ Program attendees were also given a series of case studies on procurement integrity and

²³ Entitled “Competitive Information Guidelines,” a copy is included in the Appendix at Tab 13.

proprietary data issues and informed of the consequences of violations of the PIA and other relevant laws.

Based on our interviews with IDS employees at a variety of levels, from senior management to line personnel, Recommitment Day was well-received by all employees. Most of those interviewed mentioned feelings of sadness that the additional training had been necessary and a sense of outrage over the few details of the EELV incident that were discussed during the Recommitment Day sessions.

IDS is planning to repeat some of the elements of the Recommitment Day program on a regular basis, updated to focus on different issues as the ethics challenges that the company faces evolve. Although relatively few Boeing employees outside of IDS attended the Recommitment Day activities, the indirect feedback we received from that small sample was that a similar program would be well-received at other Boeing business units.

7. Certifications of Procurement Integrity

Another change to Boeing's ethics requirements that has been considered recently is to have Proposal Team managers certify to Boeing management that, to the best of their knowledge, no improper competitors' data were used in the preparation of the proposal and that the proposal was prepared in accordance with applicable laws, regulations, and Boeing policies. Within IDS, consideration has also been given to establishing broader certification requirements, to include members of Capture, Proposal and Blue Teams.

8. Cooling-Off Period

A number of the managers we interviewed stated that, although there was no formal Boeing policy on the subject, they would not place a former employee of a competitor in a program assignment closely related to the employee's program assignment at the competitor. These managers suggested that this would create an appearance of impropriety and would not be worth the risk to Boeing's reputation.

IDS is considering a more formal approach to these issues in which a "cooling-off" period would be established for new employees who previously have worked for competitors. As contemplated, this policy would limit the ability of a competitor's former employee to work at Boeing on a Capture, Proposal or Blue Team related to the same or similar project on which that employee worked at the competitor. The concept of a cooling-off period generated substantial interest and discussion among Boeing employees during the course of our interviews.

Several employees and managers expressed the view that a one-year cooling-off period would be sufficient to alleviate most competitive information concerns, as the type of proprietary information most often at issue – cost and pricing data – quickly becomes obsolete. Some managers suggested that such a policy would not be overly burdensome, because the PIA imposes similar restrictions on former government employees, and there is already an awareness among managers that they must be careful about placement of former government employees. In addition, it was noted that Boeing has systems in place to implement legal restrictions on the activities of non-U.S. citizen employees. These procedures and awareness, it was suggested, could be used to craft a cooling-off period for the former employees of competitors.

Other employees, by contrast, felt that a cooling-off proposal was both unworkable and unwise. Some expressed the belief that such a policy would waste the skills for which the employees had been hired, and would be seen as implying that, but for this restriction, new employees or their managers would act unethically. The fear also was expressed that a cooling-off period would discourage potentially valuable employees from joining the company.

In addition, some employees suggested that this cooling-off proposal would be difficult to implement, because Boeing's current hiring and the HR information systems do not collect and retain sufficient information to permit former employees of competitors to be identified and tracked. Finally, some employees expressed concerns about adopting restrictions that other defense contractors do not have, and which would thereby put Boeing at a competitive disadvantage.

9. New Employee Certifications

At the end of August 2003, Boeing adopted a new employee certification regarding competitors' proprietary information. Upon entering the company, all new employees must now sign a statement that they: (1) do not possess any third-party proprietary documents or proprietary information; (2) will not seek to use or disclose such information at Boeing; and (3) will report any concerns or knowledge regarding ethical or legal violations to Ethics or the Law Department. Although this new certification is intended to reduce the likelihood that another EELV-type incident will occur at Boeing, there appears to be some uncertainty as to what type of competitors' proprietary information should be covered. We found two versions of this new certificate within the company, one which refers to "improperly obtained" proprietary information

and another which refers simply to proprietary information. We understand that this discrepancy is under review.

V. FINDINGS

In conducting our investigation, we have tried to take into account the numerous changes to Boeing's Ethics and compliance programs that already have emerged as the result of the EELV incident and the company's internal effort to strengthen these areas. Although it is not yet possible to reach any definitive conclusions as to how effective these changes will be in practice, they appear to take the company's Ethics and compliance programs in a positive direction, and to address many issues of concern.

In our findings and recommendations, we have sought to look forward – *i.e.*, to identify and address any weaknesses that might remain despite the recent changes adopted (or currently under consideration) by Boeing. In looking forward, however, it is helpful to have an overview as to where Boeing's Ethics program stood at the outset of our review and before the Air Force suspensions.

In many respects, Boeing's Ethics and compliance programs in place prior to mid-2003 were excellent, both in general terms and in the specific area of procurement integrity and handling of third-party proprietary data. The company continues to have a robust and active Ethics program to which it devotes substantial resources. It has policies and procedures in place that emphasize the importance of maintaining the highest level of ethical conduct in all aspects of the company's operations. It has relevant training programs in both ethics generally and procurement integrity specifically. It would be both unfair and incorrect to conclude that the company treats ethics and compliance

matters lightly, or otherwise administers its ethics or compliance programs – including specifically those portions relating to procurement integrity – in a cavalier fashion.

That said, we believe that these programs have had some weaknesses. The weaknesses we have identified are as follows:

1. Engagement by the company’s senior management in the development and implementation of the ethics and compliance programs has been insufficient in terms of organization and regularity.
2. The Ethics program has had weaknesses in its internal profile, its structure, and its level of resources (including personnel resources).
3. The level of central command and control over internal investigations of alleged violations of law (including procurement integrity law) has been insufficient.
4. The company’s internal training, monitoring, and oversight in the area of procurement integrity and handling of third-party proprietary data has not been as strong as its written procedures, policies, and guidelines.
5. The company’s policies and programs directed at procurement integrity and handling of third-party proprietary data have placed insufficient emphasis on: (1) legal constraints other than the PIA; and (2) the issues raised by hiring and placement of persons who have worked for competitors.

As suggested, the company’s recent changes have in many respects already responded to these weaknesses. In our discussion below, we elaborate on these findings, and address the level of that responsiveness and the degree to which we believe certain weaknesses remain.

A. Overall Assessment of Ethics Program and “Culture”

Based on our extensive review of Boeing documentation and, at least as important, our numerous interviews with Boeing employees in a wide variety of positions and functions, we are left with the strong impression of a company that takes its Ethics program seriously. It commits substantial personnel and other resources to the program and is committed to making changes when something appears to go wrong. It

understands the consequences of a failure to act in an appropriate manner. It places great value on its business reputation with customers, suppliers, and the broader public.

This does not mean that Boeing has created an ideal ethics program, or that the company has found a foolproof means to counter personality flaws or business pressures that can lead employees to cut legal or ethical corners. It comes as no surprise that employees involved in major competitions, particularly on “focus” programs identified as “must-win” by senior management, feel considerable pressure to achieve a successful outcome for the company. There is also no doubt in our minds that the company is still working through some structural and industry-wide difficulties that have caused substantial internal challenges for company management, including the need to integrate a number of acquired companies with different business environments and practices, and the dramatic recession in certain industry sectors in which Boeing is a leading participant (such as commercial aircraft and satellites). Also, not surprisingly, there remain some variations in the degree to which the culture of “openness” has permeated the various business units and sites and in the degree to which employees are inclined to draw upon legal and ethics resources when confronted with a challenge.

Nonetheless, we found that employees, while acknowledging the business pressures, denied that they faced pressure from management to “win at all costs.” In fact, we encountered a number of employees who cited instances in which the company had walked away from business opportunities, either because something did not seem “right” about the competition or because something had happened that might create a perception of an unfair advantage for Boeing. Employees were also able to point to “firewalls” and other protections that Boeing had implemented to address procurement integrity and

competitors' proprietary information concerns. There was a strong view among employees that it is important to "play by the rules" and to maintain the company's reputation for high performance and ethical conduct.

In addition, although we encountered some employees who had specific concerns about individual former managers, employees seemed generally satisfied with the ethical behavior and standards of company management, and especially with the managers or executives to whom they reported. In fact, even the employees who asked to meet with or talk to us about ethics-related concerns typically did not express concerns about managers in their direct or indirect reporting lines.

We also found employee reaction to the EELV incident in particular to be uniform and strongly expressed. No one, regardless of business sector or function, expressed the view that such an incident could readily occur or would be tolerated in their business unit. Rather, the almost universal reaction to the EELV incident was anger and amazement at what employees understood to be the facts – amazement that such conduct could have occurred and not been immediately detected or revealed, and anger at the substantial impact on Boeing's business and reputation. In fact, numerous employees volunteered that they took great pride in being part of Boeing, and were uncomfortable having questions raised about the integrity of the company or its ways of doing business.

In addition, as suggested above, we found that the company has made a determined effort to identify the elements of its Ethics and compliance programs and related activities that could usefully be changed or improved in response to the EELV incident, and to implement a number of productive changes, both company-wide and within IDS. In fact, one of the challenges of our review has been attempting to assess an

evolving series of ethics and compliance measures and procedures. We cannot yet know how these changes will work in practice – and, in fact, some of the changes are still being finalized as this Report is being written. But our sense is that they represent a noteworthy commitment of time and money, and that, overall, they should be beneficial to the company’s procedures. Significantly, the company has sought not only to increase employee understanding of the “dos and don’ts” of handling proprietary competitor information, but has also sought to improve its reporting and investigative procedures for handling problems that do arise, as well as the level and nature of regular engagement by senior management on compliance issues and policies.

In recounting these impressions, we make no pretense of having fully or scientifically surveyed Boeing’s 165,000 employees. Rather, we sought, in the limited time available to us, to obtain a cross-section of employee views and reactions, with a particular (but not exclusive) focus on the USG-oriented business units within IDS. Our aim was to move beyond Boeing’s extensive ethics-related documentation, and to develop a sense of the company’s ethics “culture” and the “on-the-ground” reality perceived by employees. We paid particular attention to the ranking of ethical conduct among other core objectives of the company, as conveyed by senior management and implemented by middle management. Based on the selective interviewing we conducted, our sense is that Boeing employees generally take pride in the history and reputation of the company; understand that they are asked and expected to “do the right thing”; and perceive that, where they have concerns about potentially illegal or unethical conduct, they are asked and expected to take those concerns to their managers or to Law Department or Ethics personnel.

In sum, our overall sense of the company’s Ethics program and “culture” is positive. We have uncovered no reason to believe that incidents such as EELV and EKV were anything more than isolated events – albeit events with significant consequences and from which lessons can be learned. Those lessons have been studied by Boeing, and its responses have, in the main, been well-reasoned. However, there is still (and may always be) room for further improvement. Below we set forth more specific findings on elements of the company’s Ethics program and practices, including its policies and procedures with respect to handling competitors’ proprietary information, which form the basis of the recommendations set forth in the final section of this Report.

B. Extent and Nature of Engagement by Senior Management

Engagement by senior management involves two core areas: (1) direct involvement in overseeing broad policy and the functioning of the compliance and ethics systems; and (2) “flow down” of messages concerning the importance of ethical conduct and compliance with laws and policies. Most employees to whom we spoke reported that, except in response to “blowups” (like the EELV incident), they have rarely received messages from senior management concerning ethics matters – whether via e-mail, company publications, videos, or otherwise. Moreover, there was a common perception that the company’s fundamental ethics message has been heavily focused on compliance with laws and rules, with much less emphasis on core values and integrity. A number of employees contrasted Boeing’s rules-oriented approach with the McDonnell Douglas ethics message, which was perceived to have been more values-based, with constant emphasis on the “take the high road” message.

This is not meant to suggest that employees perceived they were adrift whenever they lacked specific rules to govern behavior, or that the company lacks an ethical compass. On the contrary, many employees expressed the view that “doing the right thing” is embedded within the Boeing way of doing business, and is emphasized on a daily basis within the workplace. What many did not perceive, however, was a strong and repeated message from senior management on these core values.

Our sense is that some of the recent changes at Boeing represent meaningful improvements in these areas. For example, the establishment of the IDS CRB appears to have benefits in terms of both oversight and “flow down” of the message. Although it is too early to tell how the CRB will function in practice, it systematizes engagement by senior IDS managers in compliance matters and sends a strong signal to employees of the importance of compliance and ethical conduct within IDS.

What is less clear, however, is precisely how the new CRB fits into the broader compliance structure of the company. Compliance matters raise company-wide risks and implicate company-wide policies and procedures. Admittedly, the company’s new procedure establishing the CRB speaks to both Law Department representation on the CRB and to the CRB reporting to the company’s Strategy Council “as appropriate.” Moreover, it may be the case in practice that the company’s General Counsel and VP-Ethics will, through designees, be substantively engaged in the workings of the CRB. But this is not entirely clear from the documentation we have reviewed. Nor is it entirely clear to what extent Boeing business units other than IDS will have structures in place similar to the CRB, whether called by a similar name or not.

Another positive mechanism that has been introduced within IDS is the highly successful Recommitment Day. In our discussions with employees, there was considerable anger expressed at the events which precipitated Recommitment Day, but employees almost universally praised the level and nature of management engagement, as well as the quality of the program itself. Many employees said that there would be value in repeating the exercise on a regular basis – and we understand that the company is pursuing such a project on an annual basis, at least within IDS.

Those employees who commented on the level and nature of senior management ethics messages in such places as the new hire orientation process and the manager-level training programs at the Boeing Leadership Center also suggested that those messages lacked sufficient emphasis and vitality to leave much of an impression. The company appears to be taking steps in both of these areas. For example, the new video on the importance of compliance and ethics matters by the company’s CEO, General Counsel, and VP-Ethics that is now being presented to new employees is a positive development. In addition, we understand that the company is in the process of expanding the ethics content of its training programs at the Leadership Center.

C. The Internal Structure of Ethics

Although Ethics Line personnel report directly to the Ethics Office at WHQ, this is not the case for the Ethics Advisors, who report directly to their business divisions, with a “dotted line” report to Ethics headquarters. Most Ethics Advisor expenses (including salaries) fall within the budgets of the business divisions rather than Ethics headquarters. In consultation with the Ethics Office, the business divisions decide how many Ethics Advisors they wish to have; where they wish to locate them; and which

Ethics Advisor positions will be only part-time. Responsibility for annual performance reviews for Ethics Advisors rests primarily with business division management, with input from the Ethics Office.

This structure is different from the one that applies to Law and Audit. In both of these cases, regardless of which business unit they may support, personnel are centralized for direct reporting, budget, and personnel review purposes, with only a “dotted line” report to their business units.

Whatever the historical reasons for this distinction, we found a marked difference in the level of satisfaction with this structure between business division management and the Ethics Advisors with whom we spoke. Some business unit managers thought that the present structure worked fine and that it was beneficial to keep the Ethics Advisors within their reporting chains; other managers were essentially neutral on the issue, believing that it made little or no difference whether Ethics Advisors were a “hard line” report to the Ethics Office or to the business divisions.

Ethics Advisors, by contrast, were almost unanimously of the view that being part of a centrally run ethics organization would be preferable, for both reporting and budget purposes. The vast majority of Ethics Advisors suggested that the present structure created a perception problem for them, of being too close to business division management, and this impression was to some degree confirmed by other personnel. A number of Ethics Advisors expressed the belief that this perception problem had a concrete effect, in that some employees went to the Ethics Line rather than to their Ethics Advisors because they sought someone with a greater degree of independence from their

business unit. Some Ethics Advisors also suggested that their perceived lack of independence affected their status in the eyes of employees and management.

Some Ethics personnel also suggested that the status and reporting lines at the top of Ethics affected their status with managers and employees. Although Boeing has recently made the head of the Ethics Office a Vice President level position, there were some views expressed that this should be a more senior position; that the Ethics Office should not be a subunit of the Law Department; and that the VP-Ethics should sit on senior management councils and should report directly to the company's CEO. There was also some sentiment expressed that, in terms of the perceived priority assigned to ethics and standards of business conduct, this structure compares unfavorably with some other defense and aerospace companies (including the structure at old McDonnell Douglas). Although this view deserves to be noted, we did not find it to be as broadly or as deeply held as the view that Ethics Advisors should not be "owned" by the business units.

D. The Level of Resources for Ethics

Boeing currently has 74 people engaged in the Ethics function: the VP-Ethics and 11 others at WHQ (including 6 Ethics Line operators), and 62 people assigned to the business divisions. Statistically, there is approximately one Ethics Advisor per 2,800 employees, although over half the Ethics Advisors are performing their Ethics duties on a part-time basis and have non-ethics functions within their business unit (such as HR, business planning, or audit responsibilities). In our interviews, we found full-time Ethics Advisors typically overseeing 4,000-5,000 employees, and sometimes as many as 15,000, distributed across multiple sites.

Although it is rare to find employees anywhere who do not believe that more resources could readily be used in their areas, our perception is that the Boeing employees involved in Ethics are stretched thin. This is true for Ethics Advisors as well as for Boeing attorneys who are involved in advisory and compliance matters related to procurement integrity and other ethics-related areas. Part of this resources issue is undoubtedly related to the increase in internal ethics-related inquiries that resulted from the EELV incident and Recommitment Day; but part of this appears to pose a broader structural question about the level of ethics and legal resources appropriate to a defense and aerospace company with 165,000 employees.

We are not aware of any perfect ratios or “one-size-fits-all” solutions in this area. In many ways, the caliber of the individuals selected to fill these types of positions is at least as important as the number of positions established. In this regard, we were generally impressed with the process of selection within Boeing, as the caliber of people we met in both Ethics and the Law Department was high. Assuming good people, the appropriate ratio presumably depends to a significant degree on the nature of the business and the manner in which it is organized. Given the level and nature of the risks involved, we believe that a higher ratio may be appropriate for the defense and aerospace industry than for many other industries. In addition, we believe that the Boeing matrix model – involving a decentralized, business-driven structure, with: (1) considerable power delegated to the business divisions; (2) complicated multiple reporting lines involving a dispersion of responsibilities; and (3) substantial dependence on committees and councils for decision-making – may demand a higher resource

commitment in these areas than it would in a company with more of a centralized, “stovepipe” structure.

In our interviews with Ethics personnel, we heard a strong consensus of views to the effect that the Ethics function would be improved with more resources and more stature for Ethics personnel. In our discussions with non-Ethics employees, we found some (including a number of managers) who could not tell us who their Ethics Advisor was, and a relatively small percentage who reported ever having met their Ethics Advisor. When we asked Ethics Advisors about this, they generally responded that, given the demands imposed by their caseloads, it was hard for them to engage in much proactive outreach, aside from occasional participation in ethics training discussion groups.

Part-time Ethics Advisors appear to face an even more daunting task, due to their non-ethics responsibilities. In our discussions with both full-time and part-time Ethics Advisors, we found little support for the concept of part-time Ethics Advisors. Rather, we found a strong belief that the status of Ethics Advisors, their level of professionalism, and their perceived level of independence from the business divisions would all be enhanced by moving away from a mixing of ethics and non-ethics functions.

The status issue was also raised in other ways in our conversations with Ethics personnel. Although many Ethics Advisors expressed the view that the company had taken a number of positive steps to enhance Ethics functions and activities, most nonetheless suggested that the company should do more to encourage Ethics as a career path in Boeing, and to increase the perceived status and professionalism of Ethics personnel situated within the business units. This issue was raised both in the context of

attracting the right people to fill Ethics positions, and in the context of ensuring the ability of Ethics personnel to operate effectively at management levels within business units and sites.

While this issue was raised by both full-time and part-time Ethics Advisors, part-timers also noted the additional challenge of trying to be the chief Ethics voice within a particular business unit while at the same time reporting to another manager for your other functional (*e.g.*, HR) responsibilities. In our view, the fact that Ethics Advisors have little time for outreach to other employees or to engage in ethics programs at the units to which they are assigned – a point confirmed by all employees – is particularly persuasive evidence of the need for more resources in this area.

E. Ethics-Related Training

Boeing had fairly extensive ethics training programs in place prior to recent events, and has subsequently worked to expand and improve those programs. All employees have ethics training soon after they are hired. In addition, all employees are required to take regular ethics refresher training, which used to be done on an annual basis, and has shifted this year to a cycle of three times per year. Ethics has an electronic tracking system that keeps a record of employee completion of each training module and permits tracking within each individual business unit. Managers are regularly provided with training completion data for employees they supervise, and employees receive e-mail notices if they slip behind. The vast majority of employees to whom we spoke (from line employees up to senior managers) had completed the first of the new training modules, and a substantial percentage had completed the second module as well. Almost every employee with whom we spoke was also aware of the Ethics Advisor and Ethics

Line resources available to him or her (although, as noted above, not necessarily the name of his or her Ethics Advisor), and of how to access those resources.

The Ethics Office recommends that the new three-times-per-year ethics training be conducted in discussion groups, but leaves the ultimate decision to the business unit managers. We found considerable variation in the actual practice among the various business segments. In some business segments, a substantial percentage of employees (including managers at all levels) appear to be conducting the training in discussion groups, often at the direction of their senior management; in other business segments, most employees appear to be taking the training on an individual basis, sitting at their computers. The Ethics tracking system records completion of training for all employees, but does not record whether the training was completed in a discussion group or as stand-alone computer training. Most employees to whom we spoke expressed the view that, while individualized training was necessary as a fallback to accommodate travel and other demands, the ethics modules provided more value when conducted in a discussion group.

Where the new ethics training was conducted in discussion groups, the most common structure appeared to be a first or second tier manager leading the session for employees in his or her group. Ethics Advisors participated as facilitators in some of these sessions, but generally for groups led by a senior or middle manager or when they were specifically asked to participate by a lower level manager.

Boeing's traditional ethics training was more case-oriented, more rules-driven, and more oriented toward selecting a "correct" answer than are the new modules. While most employees concurred in the decision to increase the regularity of training,

and many employees suggested that the new training generated interesting discussion group or “water cooler” conversations, the content of the new training drew sharply contrasting opinions. Overall, as noted above, the bulk of employees seemed to believe that the old case-oriented approach had greater practical application and was better at focusing employees’ attention on the hazards of unethical conduct; some of these employees favored discarding the new approach, while others favored mixing the two styles. We understand that the company is currently working toward creating ethics modules that will blend both approaches.

In addition to this “all hands” training, executives (*i.e.*, senior management) and middle and lower level managers have available to them a variety of training programs at Boeing’s Leadership Center, located near St. Louis, most of which have some ethics component. This content can take a variety of forms, including: (1) presentations by senior Ethics personnel; (2) appearances by outside ethics experts; (3) skits and role-playing; and (4) ethics issues incorporated within business problems and scenarios. We spoke with very few graduates of the training programs at the Leadership Center who could remember whether their training included an ethics component, or what that entailed. We understand that the company is presently examining each of these training programs (from those for new line managers up to those for the most senior executives), with a view to increasing the breadth and depth of the ethics-related content, including issues relating to procurement integrity and the handling of third-party documents.

Both Ethics Advisors and Ethics Line personnel also receive special training. Formal, ongoing in-house training of such personnel does not appear to be

extensive, although there is an annual Ethics “all hands” meeting within Boeing, and it appears that there are regular telephone and web conferences among Ethics personnel within business units. In addition, a number of Ethics Advisors and Ethics Line personnel noted that they are encouraged to attend industry conferences and training programs on ethics-related matters.

Boeing also has a series of training programs specifically focused on procurement integrity. All new employees who are or will be involved in USG procurements are required to take an initial program on procurement integrity shortly after joining the company, as well as a refresher course at least once every three years. Employees placed on Capture Teams and Proposal Teams also go through a briefing on procurement integrity. In addition, within both IDS and BCA, employees who are involved in preparing assessments of Boeing’s competitors receive training materials on the proper methods of information-gathering, including avoidance of proprietary competitor data. All of these materials and/or briefings are rules-focused, and they generally get favorable reviews from employees.

Finally, as noted above, the employee response to Recommitment Day was uniformly positive. While some employees viewed recorded management presentations as rather “dry,” there seemed to be a strong positive reaction to the seriousness with which senior management took the event; to the highly instructive nature of the situations described; to the content and tone of the presentation by the outside ethics professor; and to the discussion groups after the presentations. Employees did not suggest to us that, prior to Recommitment Day, IDS had been lacking in ethics generally or concern regarding procurement integrity specifically. Rather, they suggested

that Recommitment Day was a highly effective tool for crystallizing the importance of these issues, and generally supported having a Recommitment Day-type program on a periodic basis. We understand that, based on this type of employee feedback, IDS intends to have a similar program on a regular, ongoing basis.

F. Handling of Competitors' Proprietary Documents

Before its recent amendment, PRO-70 – the company procedure on procurement integrity matters – focused solely on the PIA, with no mention of related areas of law concerning the use of competitors' proprietary information (such as the EEA, UTSA, etc.). In addition, PRO-70 provided too many channels through which employees could report suspected violations, and did not emphasize the core principles of: (1) receiving and using only information reasonably believed to be authorized; (2) documenting proper receipt of information; and (3) asking questions whenever suspicions arise. To a large extent, PRO-70 codified the principles embodied in the PIA, but left much of the implementation of those principles to the discretion of individual employees.

Revised PRO-70 makes improvements in each of these areas. Among other things, it provides that any employee, who encounters what appears to be a competitor document containing proprietary information that is not clearly authorized for release to relevant Boeing employees, is to isolate the document and immediately notify either Legal or Ethics. Our testing of employee knowledge as to this procedure suggested that it is broadly understood, both as to the steps to follow and as to the rationale for such steps (including the need to avoid the potential for spreading the problem).

Not surprisingly (given the effects of the EELV incident and Recommitment Day), the sensitivity level and understanding appears to be especially high within IDS. In fact, it appears that, since Recommitment Day, employees within IDS have presented Ethics and Legal personnel with a whole series of inquiries and reports in this area, including everything from employees who have kept decades-old documents from companies that have ceased to exist, to employees who have documents from former employers stored in their homes, to employees who have competitor documents that they are fully authorized to have (*e.g.*, pursuant to a proprietary information agreement). Other business units within Boeing also report an increase in these types of inquiries and reports.

Although employees within both Ethics and Legal told us that the significant increase in these types of reports and inquiries has been burdensome, there seemed to be a general understanding that this is a natural result of the impact of the EELV incident and the increased commitment of company resources to “get the message out” in this area. There was also a sense that this “wave” phenomenon would settle over time, but still at a level of heightened consciousness.

An exhaustive review of these recent reports and inquiries was beyond the scope of our project; but we encountered no evidence suggesting that a substantial number of serious new “problem situations” involving competitors’ proprietary data had been uncovered. On the contrary, most of the reports and inquiries reportedly involve situations that are readily and quickly resolved, and any situations that do not fall into this category are being routed to Boeing litigators for investigation, often with assistance from outside counsel.

In a company of 165,000 employees, there are bound to be occasional situations in which employees come forward with, or are found to possess, competitor documentation that appears to be proprietary and may be unauthorized. Boeing appears to be: (1) taking such situations seriously; (2) acting quickly to isolate questionable documents and to launch investigations whenever doubts cannot be easily resolved; (3) returning other companies' proprietary documents to those companies where authorization cannot be confirmed; and (4) taking disciplinary action against employees who have violated proprietary data rules, up to and including termination of employment.

In fact, a number of Boeing employees expressed the view that the company is acting more aggressively in this area than are Boeing's competitors, in terms of internal rules and procedures, commitment of resources, and responses to "problem situations." This impression appears to be based in part on the proposition that, while Boeing frequently has turned over to its competitors documentation that might be proprietary and unauthorized (such as materials sent to Boeing in error, or proprietary materials mistakenly placed on a public website) in recent years there is little or no "reverse flow" of such document disclosures by Boeing's competitors. Given the regularity with which we heard the proposition advanced that Boeing is doing more than its competitors in this area, we wanted to take note of it in our Report. However, we lack sufficient information concerning the internal practices and procedures of other companies to test the validity of this proposition, and therefore express no view as to its accuracy.

During the course of our review, we spoke with numerous employees involved in business development, Capture Team, Proposal Team, Blue Team, and

program activities, operating within a variety of business areas. All denied that they seek proprietary information regarding Boeing's competitors from employees or former employees of those competitors or from other sources. A number of employees recounted instances in which customers or other sources attempted to hand them competitor documents with apparent proprietary markings, or such documents were discovered within larger bundles of documents provided by customers or others, and the documents were either rejected out of hand or turned over to the relevant competitor. Competitive analysis and Blue Team employees, both within and outside IDS, uniformly indicated that they seek information on Boeing's competitors only from public sources; are expected to document and justify the bases of their analysis; do not expect to encounter or use any competitor documents that appear to be proprietary; and know what to do with such a document if they encounter one (*i.e.*, route it to Ethics or the Law Department).

G. Hiring of Competitors' Employees

Boeing has recently introduced, or in some instances has under consideration, changes to address potential proprietary data concerns associated with hiring competitors' employees. The changes already adopted to date are being applied to all new employees, regardless of whether they have actually worked for a competitor of Boeing's. For example, all new hires are now required to certify that they are not bringing to Boeing any proprietary data from a former employer and will make use of no such data while employed at Boeing. In addition, all new hires are required to go through ethics training, which includes enhanced training in the area of procurement integrity and handling competitors' data.

Some changes under consideration are focused specifically on the placement of former employees of competitors. For example, the company is currently examining potential amendments to its employment application to require more specific information concerning the nature of an applicant's programmatic and functional responsibilities while employed at a Boeing competitor. In addition, consideration is being given to capturing this information in the company's electronic HR database, so that it can be accessed by managers and others responsible for assigning an employee to a particular project.

Within IDS, consideration is also being given to introducing some type of "cooling-off" period that would apply to employees who come to Boeing from a competitor, at least with respect to placement of such persons on IDS Capture, Proposal or Blue Teams. The concept has raised challenging issues, due to the significant movement of employees among competitors within some segments of IDS' business, and the related concern that introducing a fixed cooling-off period that is not part of a broader industry initiative could place those business segments at a significant competitive disadvantage.

In general, Boeing employees did not exhibit as much sensitivity with respect to this issue as they did with respect to handling competitors' documents. However, this may be the result of written policies and recent focus on the latter, as opposed to an inability or unwillingness to address the former.

For example, when presented with a fact pattern in which an employee of Company X working on a competitive procurement is hired by Boeing and is shortly thereafter placed on a Blue Team, Capture Team, or Proposal Team working on the same

competition, almost all employees with whom we spoke (including executives and other managers) acknowledged that this would be inappropriate and should not happen.

However, no one with whom we spoke, regardless of the business segment, was able to describe any established screening process for ensuring that it would not occur. This appears, therefore, to be one instance in which Boeing's ethics are "values driven" rather than "rules based."

H. The Compliance Assessment Process

Top-notch employee training programs combined with a state of the art ethics program will not prevent all problems. Employees will, from time to time, violate rules and policies, whether through deliberate action, errors of judgment, or failure to identify risks or issues. As a consequence, effective internal monitoring is important for compliance programs, as are effective internal investigative procedures. In the area of procurement integrity and handling competitors' proprietary data, it is not clear to us that the company's commitment of resources in these areas has, until recently, either matched the level of risk or been comparable to the resources committed to other high risk areas.

As part of Boeing's internal compliance monitoring, the company identifies high-risk compliance areas on an annual basis. It then conducts a self-assessment of these identified risk areas within each business unit, with the results compiled on both a business division and company-wide basis. These materials are then used to identify target areas for the company's annual internal audit, and the results of this internal audit, including recommendations for remedial measures or other changes, are presented to senior management for action.

Procurement integrity has been one of the risk areas identified in the annual CAP for several years. Prior to the EELV incident, however, it was not identified as one of the highest risk areas, and the recommendations arising from the annual CAP audit have not tended to focus on procurement integrity. Moreover, the company's focus on procurement integrity as a CAP risk area has, to date, been narrowly limited to compliance with the PIA.

We understand that, procurement integrity and use of competitor proprietary information will be a focus of particular attention in this year's CAP audit. In addition, we understand that the company is currently revising its questionnaire for next year's CAP self-assessment, in order to obtain a greater depth and breadth of responses related to procurement integrity from the business units, and in order to expand the scope of the inquiry beyond compliance with the PIA (and beyond USG procurement activities).

Our review of CAP documentation and discussions with Boeing employees indicate that the CAP process is perceived as, and seems to operate in practice as, a useful element of the company's internal checks and balances. The fact that the EELV problems were not identified by means of the CAP process does not mean that the process is inherently flawed. The CAP process is aimed at detecting problem trends and flaws in procedures or processes. Other elements of the company's internal controls are better aimed at identifying and addressing in a timely fashion specific incidents that may expose the company or its employees to liability.

With regard to prior CAPs, we found considerable variation in the quality and utility of the self-assessments among the business units, with some responses taking

on a rote element that undercut their usefulness to auditors and managers. Although the CAP questionnaire itself is carefully structured, the process of deciding who has the task of filling out the self-assessment appears to be rather random, with individual business divisions deciding how they wish to delegate the task. Moreover, the process of assembling the business division self-assessments does not appear to involve a centralized critique of the adequacy of the responses. This problem shows itself in two respects: (1) some elements of the business unit responses look like mechanical answers and a “box checking” exercise; and (2) not all of the business unit responses appear to be consistent with the statements of company-wide procedure and practice.

I. Procedures for Internal Investigations

In interviewing a range of individuals who had some familiarity with the EELV incident, we found a broad recognition that the investigation of that incident, while leading to swift disciplinary action against employees central to the incident, did not quickly and effectively identify the full scope of the problem or result in adequate remedial measures to address it. Since identifying these deficiencies, the company has wrestled with how best to improve internal investigatory procedures without misdirecting resources to minor problems or building excess rigidity into the process.

The core principle that has been adopted is that, when allegations of potential wrongdoing are raised that involve procurement integrity or misuse of another company’s proprietary data, and when those allegations cannot be quickly resolved in a satisfactory fashion, the matter must be referred to the Law Department at WHQ for consideration and direction by the AGC-L, the company’s chief litigator, using Law Department and other company resources, as well as outside counsel, as appropriate.

Under newly adopted internal investigatory procedures, key decisions regarding: (1) the staffing and scope of an investigation; (2) the acceptability of investigation results; (3) the nature of remedial measures; (4) the briefing of company management; and (5) disclosures to the customer or a competitor will all be overseen by the Law Department at WHQ, in consultation with the chief attorney for the relevant business unit (for example, on issues such as whether a pending USG procurement might be affected).

This does not mean that every inquiry or allegation involving procurement integrity or possible misuse of another company's proprietary data will lead to a WHQ-led internal investigation. Ethics and Law Department personnel assigned to the business units have, to varying degrees, been inundated with these types of inquiries and allegations since the EELV incident and Recommitment Day, most of which reportedly involve minor matters. When it can be readily established that there is no real problem – for example, because a document does not contain proprietary information, or it is 50 years old, or its possession is authorized under a proprietary information agreement – the matter need not be referred to WHQ for investigation.

Under the new procedures, investigations involving procurement integrity or possible misuse of another company's proprietary data are to be completed promptly – normally within 60 days, and with an even higher priority assigned where there may be an impact on a pending procurement. In addition, quarterly reports concerning the status and outcome of these investigations will be presented to the company's General Counsel and its VP-Ethics, as well as to IDS' newly created CRB.

We firmly believe that investigations of the sorts of issues covered by this new procedure must be managed by senior Law Department personnel outside of the

affected business unit who are in a position to expeditiously commit major resources to the task. The new internal investigatory procedures have just been adopted, and consequently there has been no opportunity to examine their effectiveness in practice. On paper, they appear to be helpful in moving the company in the direction of centralized management and oversight of these types of investigations.

The new procedures also raise certain questions that may merit consideration going forward: (1) Should these procedures be extended to investigations involving other compliance areas? (2) What is the counterpart to the IDS CRB for investigations that involve activities outside IDS? and (3) Should all parts of the company that are involved in internal investigations (notably, Law, Security, and Audit) be centrally managed? In the latter regard, we note that Audit, like the Law Department, is centrally managed across the company, and directed from WHQ. By contrast, Security is part of SSG and there are portions of Security that (like Ethics) report to individual business divisions within the company rather than to a centralized command.

J. Integrated Defense Systems Compared to Other Business Divisions

We committed particular attention to IDS in the course of our review, in light of recent events, the importance of IDS to Boeing's overall business, and the focus of much of IDS' business on USG procurements. At the same time, we sought to get some sense of other portions of Boeing's business operations. This naturally included company-wide operations such as WHQ and SSG. But we also interviewed a number of employees in non-IDS business segments, including BCA, Phantom Works, and ATM.

Perhaps not surprisingly (given the EELV incident and Recommitment Day), we found the sensitivity level with respect to procurement integrity and the

handling of other companies' proprietary data to be particularly high within IDS. We also found that IDS had gone further than other business divisions in thinking about, and to some extent devising, ethics and compliance tools and mechanisms for reducing and addressing risks in this area.

In noting this, we do not mean to ignore the very real differences in competitive environment, customer focus, and legal constraints between IDS and certain other business divisions – notably BCA, which is focused largely on a commercial market with one large competitor. But we did not find wholly convincing the suggestions of some BCA employees that the lessons learned and improvements devised within IDS, while useful in the government-focused world, were not particularly relevant to the commercial world. Rather, our sense is that some of the mechanisms devised or considered within IDS, such as establishment of a CRB and related compliance team, as well as screening mechanisms for the placement of new employees hired from competitors, are worth considering for broader application within Boeing.

VI. RECOMMENDATIONS

A. Introduction

As discussed earlier in our Report, we believe that Boeing has gone to great lengths to establish, maintain, and continually improve upon, an Ethics program that is impressive in both its scope and detail. Similarly, as discussed above, we do not believe that the recent instances of improper possession of competitors' competition-sensitive documents reflect either a fundamental flaw in the Boeing "corporate culture," or a systemic lack of diligence or concern regarding such matters. Rather, we believe that these incidents are what they appear to be: a series of unfortunate events, each of

which was independent of the others, involving widely-differing facts. It is also noteworthy that Boeing “inherited” two of the three most widely-reported incidents from other companies, and confronted these problems at a time when the company was undertaking a sweeping transformation of its core businesses and corporate organization.

Nonetheless, despite our confidence in the overall rigor of Boeing’s Ethics program, there were areas in which Boeing’s (and its heritage companies’) prior procedures were, with hindsight, inadequate. We believe that remedial steps can be taken (and Boeing already has taken many) that may significantly reduce the likelihood of similar episodes in the future. However, it must be emphasized that no thicket of regulations, no matter how dense, can guarantee that, in a universe of 165,000 employees, compliance will be perfect. Similarly, no matter how loudly, or sincerely, or often management reminds employees of the importance of ethics, values and compliance with the spirit and the letter of the law, violations (intentional or inadvertent) are bound to occur.

We believe that Boeing is fully committed to doing the utmost to minimize the likelihood of future violations, and to having in place reporting and investigative mechanisms to ensure the complete, accurate and expeditious resolution of any incidents that do occur. We also believe that, had the following recommendations (along with several already adopted by Boeing) previously been in place at Boeing (and, of equal importance, at McDonnell Douglas, Rockwell and Hughes), some or all of the past incidents might not have occurred, or would have been handled differently by Boeing employees and management once they had come to light.

Our recommendations fall into four general categories: (1) those of a structural nature, with a particular focus on the organization and status of the Ethics organization; (2) those that would modify certain aspects of Boeing's hiring and training procedures; (3) those of a procedural nature, that would directly affect, *e.g.*, the staffing and other procedures employed in response to certain USG procurements, and the manner in which Boeing responds to procurement integrity problems once discovered; and (4) those that focus on periodic assessments of the effectiveness of the overall Ethics program. Our recommendations are in some instances quite specific, in other cases more thematic. It is not our purpose or intent to recommend a dramatic transformation in the manner in which Boeing handles its day-to-day business, or to force Boeing to adopt particular procedures. Rather, our intention is to identify certain areas in which Boeing could, and perhaps should, augment its existing Ethics programs and procedures and to suggest means for doing so.

Finally, we believe that many (and perhaps all) of the recommendations should be considered by Boeing for company-wide application. Our focus has been, for obvious and stated reasons, primarily on IDS. However, we believe that, at a minimum, these recommendations are equally applicable to any USG procurement activity, not just those pursued by IDS. Moreover, because issues involving competitors' data can implicate the EEA and various state trade secret and unfair competition laws – and other legal, ethical and regulatory matters could arise at any of the other business units – we believe that many of these recommendations could have relevance throughout the Boeing organization.

B. Structural Recommendations

It should be noted at the outset that, although the following recommendations focus primarily on the role and placement of the Ethics organization within the corporate structure, they also address the few concerns that did come to light during our review regarding the company's "ethics" culture. We have sought to formulate recommendations that, on the whole, will emphasize the importance the company places on ethics issues, and enhance the awareness of those matters throughout the company.

Recommendation 1

Management, at the most senior corporate and business unit levels, should place additional emphasis on the importance of ethics and compliance and should do so in a manner that conveys this message to employees at all levels.

We cannot stress enough how important it is for senior executives to incorporate into their everyday planning and communications the unambiguous message that ethics, integrity and compliance are at the core of Boeing's corporate culture. This cannot be an annual or quarterly exercise; the message must resonate daily throughout the company.

This is not to say that, special, high-profile reminders have no value. We believe that the recently introduced video for new employees featuring the Chairman and CEO, the General Counsel, and the VP-Ethics provides an excellent foundation upon which to build. The Recommitment Day sponsored at IDS was another important indication to everyone within that business unit of the importance the company places on ethics, compliance and integrity in all matters. We encourage similar efforts.

Recommendation 2

All Ethics personnel and activities should be consolidated into a single functional department within the WHQ operation. Ethics Advisors assigned to the company's various business units should report directly up through the Ethics Office, with "dotted line" reporting/support responsibility within the Boeing "matrix" to management of the relevant business unit. The head of the Ethics Office should have periodic access to the CEO. Overall, we believe that the visibility of the Ethics Office within the company should be elevated. We leave it to the company to determine how that is best accomplished.

Our concern here rests at least in part on the importance of ensuring that the Ethics program be, and be perceived as, independent. Currently, most of the company employees who are involved in Ethics functions have a "hard line" report to the business unit with which they are associated. This has raised concerns that Ethics Advisors are not independent of the entities whose ethics they are intended to address as part of their duties. Both Ethics Advisors and other employees have told us that Ethics personnel are perceived as being too closely tied to the business units, and it appears as well that many employees refer issues to the company's Ethics Line (which is a corporate function), rather than to the Ethics Advisors associated with their own site or business unit, because of perceived concerns about an Ethics Advisor's independence.

Shifting the Ethics reporting lines to the Law Department model will serve two additional purposes. Historically, there have been few mechanisms within Boeing for bringing problems to the attention of corporate management, so that the problems can be addressed quickly and with appropriate resources. The EELV incident is a classic case in which a matter became more of a problem than it might otherwise have been because it was mishandled at the outset, and not given appropriate attention in a timely fashion. Our expectation is that making the Ethics Office a functional unit that

incorporates all of the Ethics personnel and resources will ensure a clear channel of communication to WHQ.

We also believe that this change will serve to highlight the importance of the Ethics Office. According to a number of our interviewees, the message conveyed under the current structure is that Ethics is an adjunct to the business units. It is considered something of a management backwater, and is not seen as an independent career path within the company. The message should be that Ethics is an important company function that transcends the individual business units.

Ethics Advisors should have “dotted line” reporting responsibility to their assigned business units, and they should maintain at least the same access to business unit officials as currently is the case (we would expect that our recommendations regarding an increase in the number and stature of Ethics Advisors would, in fact, enhance that level of access). We think that the budget for Ethics should be centralized as well, so that issues regarding personnel and resources are made at the corporate level. While we understand and generally concur with the concept that the business units must “own” all aspects of their enterprise, we believe that the Ethics Office should have a similar organizational structure as the Law Department if it is to be most effective in carrying out its mandate.

We are not recommending that the Ethics Office be separated from the Law Department, or that VP-Ethics report directly to the CEO. We are aware that other companies in the defense industry have their ethics departments as a direct report to the CEO, and that such a change in corporate structure has been recommended to Boeing by others. There are reasonable arguments for and against such a structure, and

reconsideration of the relationship between Ethics and the Law Department at Boeing might be appropriate at some future date.

We are concerned that, in a company so large and diverse as Boeing, adding Ethics as another “direct report” to the CEO might reduce, rather than enhance the program’s effectiveness and visibility. In our view, the question is not the reporting structure *per se*, but whether senior Ethics personnel have access to the CEO when important issues need to be addressed. We believe that the VP-Ethics should continue to have direct access to the CEO on a periodic basis and as necessary to address matters of company-wide concern.

Recommendation 3

Boeing should: (1) increase the number of Ethics Advisors assigned to the various business units; (2) over time, strive to replace part-time Ethics positions with full-time positions; and (3) undertake to ensure that Ethics is seen as a long-term career opportunity within the company.

Notwithstanding our overall conclusion that Boeing devotes substantial resources to ethics and compliance matters generally, Ethics Advisors are typically stretched thin. Their core responsibilities leave Ethics Advisors with little time to be proactive, focus on training, or otherwise “spread the word.” Even after Recommitment Day, a number of employees could not name the Ethics Advisor assigned to their site (although they knew how to obtain that information).

An additional problem in this regard is that Ethics Advisors are often part-timers, with other substantial duties (such as internal audit or HR responsibilities). Not only does this situation send a less-than-optimal message about the role of an Ethics

Advisor, but the combination of the Ethics role with some other functions can at least appear to detract from the Ethics Advisor's ability to act independently and impartially.

A closely related concern stems from comments to the effect that the stature generally accorded Ethics professionals was materially lower than those who otherwise would be their peers within a business unit, and that being an Ethics Advisor does not represent a long-term career path within Boeing. Increasing the number, profile and visibility of Ethics Advisors would enhance the perceived status, significance and desirability of such positions. Having more Ethics Advisors "in the field" would also result in increased communication regarding matters of concern, and perhaps enhance the Ethics Advisors' ability to identify potential problems before they reach a critical stage.

Finally, as we recommend below, we believe that training (initial and refresher) on procurement integrity matters should become a much more group-oriented, discussion-based process. The availability of more full-time Ethics Advisors may be essential to carrying out those recommendations.

C. Hiring and Training Recommendations

These recommendations are directed to the point that there have been few opportunities, other than basic training and refresher courses, to remind employees of their ethical obligations relating to procurement integrity, particularly with respect to the possession and use of third-party documents. Whether these specific recommendations (or others currently being considered by Boeing) are implemented, the company should take advantage of opportunities during the hiring and training (including refresher) processes to remind employees of their obligations in this area.

Recommendation 4

All new employees should, as soon after the date of hire as possible, receive specific, in-person counselling (in an individual or group setting) concerning Boeing's Ethics program from an appropriate Ethics Advisor or other similarly qualified individual. Included in this counselling should be information specifically focused on the laws and company policies governing the unauthorized possession and/or use of competition-sensitive/proprietary documents or trade secrets of other companies.

In addition, as a condition of hire, each new employee should be required to sign a certification that he or she: (1) does not possess any proprietary documents (either hard copy or electronic); (2) will not attempt to obtain any such materials or information except in accordance with relevant law and established Boeing procedures; and (3) will not obtain or reveal any other companies' proprietary information while a Boeing employee.

It is our understanding that Boeing has or is in the process of adopting new procedures along at least some of the lines described above. We emphasize that, in our view, it is critical that the subject discussion with new employees take place as close to the onset of their employment as possible, and that the discussion be more than a rote exchange. As discussed elsewhere in this Report, we believe that in-person discussion of these issues (whether in an individual or a group setting) frequently is much more effective for imparting the seriousness of the subject matter than other means of communication, such as directing the employee to an on-line training module.

With regard to the certification, we believe that it is preferable that the employee provide an unqualified certification that no third-party competition sensitive/proprietary materials are being brought to Boeing, rather than leave it to the employee to decide whether some materials in his possession were "properly" or "improperly" obtained or possessed. If the employee's judgment regarding that distinction subsequently proves incorrect, Boeing may be exposed unnecessarily to allegations of wrongdoing. By requiring an unqualified certification, it is more likely that

any questions regarding documents or materials the employee may have in his or her possession will be brought to Ethics personnel or the Law Department for resolution.

Recommendation 5

The Boeing Leadership Center should prepare modules for all levels of managers and executives that provide an overview of the Boeing Ethics program and raise ethics issues for discussion.

Currently, the Boeing Transition to Management program, an e-based training program for new managers, includes a module on ethics. The ethics training for other managers at the Leadership Center is not as evident. There are some discussions and simulations covering theoretical ethics issues available for senior managers, but less for first-line and middle managers. As discussed above, to the extent that there is ethics training in the courses for these managers (and certainly there is some), it was not notable or memorable.

We understand that management training at the Leadership Center cannot focus on all legal and ethical issues a manager might face. Nonetheless, Leadership Center training would appear to be an excellent opportunity to encourage managers to: (1) consider the various types of ethical and compliance problems they will face (including, among others, matters relating to treatment of a competitor's proprietary information and other procurement integrity and intellectual property matters); (2) focus managers on the resources available within Boeing to address these matters; and perhaps most importantly (3) emphasize the need for openness and full disclosure once a situation or potential situation arises.

Moreover, now that virtually all current managers have received training at the Leadership Center, we understand that more time is available for specialized

training in particular areas. To the extent that available resources and procedures permit, therefore, consideration should be given to instructing the Boeing Business Development and Ethics Councils to identify jointly areas of particular risk (including procurement integrity concerns) and use the resources now available to develop specialized training modules in these areas, just as the Business Development Council has done for export control and related matters.

Recommendation 6

Training materials – whether in the context of the Leadership Center or those available to all employees – that are addressed to ethics and compliance matters should include “real world” examples.

We do not mean to disparage the efforts made to address ethical problems in an interesting and philosophical fashion. The feedback we have received from employees, however, and our own observation of the recently-released training modules, suggests that the training would have more of an impact if it were geared to sensitizing employees to practical situations that raise ethical or other compliance problems. In the area of procurement integrity and economic espionage, there are very clearly delineated prohibitions contained in statutes, regulations and company policies and procedures. These precise standards of conduct can be emphasized in a clear and unambiguous way, without sacrificing the quality of the material. While philosophical underpinnings may be relevant and it is certainly important for employees to understand that good ethics and sound business practices go hand-in-hand, ensuring each employee’s fundamental understanding of the relevant laws and Boeing procedures is critical to the success of such training programs. We understand that new ethics programs under development by Boeing are moving in that direction.

Recommendation 7

Boeing's ethics and procurement integrity training – including initial briefings for new employees, discussions at the time of forming a new proposal or similar team, and refresher courses – should emphasize group discussion rather than individual on-line training.

We do not mean to suggest here that there is no place for on-line training, or that procurement integrity issues should have priority over other equally important matters. However, we repeatedly were told that training on procurement integrity issues was most effectively presented in-person, often in a group format, with give-and-take discussions; reliance on the on-line system did not encourage the sort of in-depth consideration that is warranted by these issues.

We were told that some managers insist that the annual refresher course be taken in a group setting (and led by the manager), for precisely this reason. Essentially all the employees with whom we spoke who participated in these group discussions agreed as to the effectiveness of this approach. Indeed, one of the lessons of Recommitment Day appears to be that discussion of “real-world” issues and examples in a group setting is most effective, not only in imparting information, but in ensuring that management at all levels is seen to view these issues with the utmost seriousness.

Thus, we believe that, to the extent practicable, all initial and refresher training regarding procurement integrity matters should rely primarily on group discussions led by the relevant business unit manager, with assistance from the appropriate Ethics Advisor.

Recommendation 8

An “all hands” event such as Ethics Recommitment Day should be repeated, adjusting the precise content, duration and frequency as deemed appropriate.

The many Boeing employees we interviewed were essentially unanimous in their praise for Recommitment Day. Some told us that they approached Recommitment Day with a measure of skepticism and frustration at having to “waste four hours” reviewing that which they already “knew.” All came away inspired and impressed; they were most enthusiastic about the group discussions and “real-world” examples that effectively placed these issues in a more relevant context.

We appreciate the extraordinary expense – in terms of monetary expenditure, lost productivity, etc. – of this undertaking, and do not lightly suggest that it be repeated regularly. However, one comment that we heard with some frequency was that, except for a few e-mail messages and the like, it did not appear to many employees that Boeing’s senior executives were overly concerned with these issues, until, of course, the EELV matter achieved critical proportion.

Given the breadth and depth of Boeing’s existing Ethics program, it is difficult to conclude that senior management historically has not been concerned with these issues. Nonetheless, we understand the basis for the employees’ impressions and, as we note in Recommendation 1, more visible and regular expressions of that concern by senior management would be useful. Further, periodic “all hands” activities – particularly once the company is out of the shadow of the EELV debarment – would send an unambiguous message to even the most cynical employee that these issues are of the

utmost concern to Boeing at every level of the company. In our view, the expenditure of the resources necessary to send this message would be justified.

Moreover, to the extent that the Boeing “culture” is still evolving, the regular presentation of Recommitment Day-type programs will have a salutary effect. Even after Recommitment Day, some employees expressed concerns to the effect that Boeing’s goal of an “open culture” has not yet been fully realized, citing to hearsay stories of past retaliation for raising ethics issues. We emphasize that the few stories we heard regarding alleged instances of retaliation were not based on first-hand knowledge and/or did not appear to be of recent vintage. Nonetheless, a highly visible and well-developed program such as Recommitment Day can do much to combat these concerns.

Finally, although we do not include a specific recommendation that Recommitment Day-type programs be instituted company-wide, serious consideration should be given to providing the program to all business units.

D. Staffing and Procedural Recommendations

The following recommendations focus on the process of preparing Boeing’s response to procurement proposals, including staffing, management oversight, and procedures for responding to possible third-party document violations. The goal of these recommendations is, first, to prevent employees from being placed in situations in which, to an outside observer, there is an appearance of impropriety, or which could impose unnecessary pressures on an employee. Second, in the event that a situation involving a potential violation of rules regarding competition-sensitive information may

arise nonetheless, procedures must be in place to resolve the matter in a thorough and timely fashion.

Recommendation 9

Each new Boeing employee who worked for a competitor within the past three years should be “tracked” for a specified period of time after that employment, to ensure that the employee and Boeing are not placed in a potentially compromising position. A “flag” should be attached to the employee’s personnel file that is accessible to his business unit management, the Ethics organization, the Law Department and HR, so that changes in the employee’s assignments can be assessed to ensure that the assignment is appropriate given the employment history.

In a separate recommendation presented below, we discuss a possible cooling-off periods for employees previously employed by competitors, to prevent them from working on or supporting Boeing teams involved in competitive procurements in which their prior employer is also a participant. The point of the instant recommendation is that detailed information regarding that prior employment should be obtained immediately upon the employee’s hiring, and must be entered into an appropriate data base that is readily accessible to management of the relevant business unit(s), HR, the Law Department and Ethics.

Although we understand that this requirement might require some changes to Boeing’s existing HR and related systems, we believe that this proposal could be implemented to operate in a fashion similar to the present system that “flags” former government employees and foreign nationals so that their participation in certain programs can be monitored and assessed to ensure compliance with applicable laws and regulations. Moreover, the implementation of this system would provide a clear demonstration that Boeing places concerns about improper receipt of proprietary

information from competitors on a par with those other statutorily mandated restrictions on job assignments.

In the context of Boeing's matrix management system, it might not be clear which manager should be responsible for making the determination regarding the proper assignment of a competitor's former employee. We leave that issue to be determined as the circumstances warrant – provided, of course, that the lines of authority and responsibility are clear, and assistance from the Law, Ethics and HR organizations is readily available.

Recommendation 10

Boeing should establish substantive policies that prevent employees recently employed by competitors from being placed in positions that could create an appearance of impropriety.

We are reluctant to try to fashion hard and fast rules in this area, given the difficulty of assessing each situation, and given that there are similar proposals already under consideration by Boeing. However, we believe that Boeing should adopt policies that prevent the ex-employee of a competitor from being placed in a position that creates the appearance of impropriety, such as being assigned to Capture, Proposal, Blue or similar Teams involving a matter on which the employee had worked for that competitor.

Illustrative examples of such potentially troubling assignments include:

- Assignment to a Capture or Proposal Team if the employee worked on that same procurement, or an earlier phase of the procurement, for a competitor (such an assignment could be particularly problematic in a “must win” procurement).
- Assignment to a Blue Team or any other competitor-assessment activity for some period of time from the date of that employee's most recent employment with a competitor.

In addition, Boeing must be sensitive to other sorts of contact (*e.g.*, briefings) that such an employee might have with the relevant Teams. The information regarding prior employment activities contained in the “flag” on the employee’s file should enable the relevant business unit managers, Ethics Advisors, HR and Law Department representatives to enforce such restrictions.

With regard to the duration of any such cooling-off periods, it is difficult for us to identify how long an employee’s knowledge of his ex-employer’s strategies, technology choices, etc. retain currency. Obviously, these issues must to some extent be examined on a case-by-case basis. In some instances, for example, a one-year bar may be unnecessarily long; in others, not long enough.²⁴ The regulations that restrict former U.S. Government employees from working on certain matters can provide a measure of guidance, and could form a basis for establishing a program that achieves the necessary objectives, without unduly constraining either the company’s ability to compete effectively or an employee’s ability to pursue a productive career.

We are aware that at least some variations on the cooling-off concept are being considered by IDS. Additionally, we understand that such policies might extend, in appropriate circumstances, to the former employees of suppliers, consultants and contractors who have worked for or with a competitor. Finally, we believe that Boeing

²⁴ In some cases, Boeing might reasonably conclude that no “cooling-off period” is necessary. Certain categories of employees – such as those involved in production activities or routine administrative tasks – might be excluded from the program if it were determined that their access to a competitor’s sensitive technical, financial or commercial information was minimal, and would be of little utility in their employment at Boeing.

should give consideration to adopting the instant recommendation for all business units engaged in government procurements.

Recommendation 11

Before an employee can begin work on a Capture, Proposal or Blue Team, that employee should be required to certify that she/he has completed procurement integrity training, including training regarding the handling of competitor’s confidential information, within the past 90 days and that she/he will comply with all applicable laws and Boeing policies and procedures.

We understand that employees are required to take refresher courses at the establishment of a Capture, Proposal or Blue Team, but it is not clear that these refresher courses are taken by employees added to a team at a later date. The certification would address this issue; it would also emphasize the importance of the training to team members and provide documentation that Boeing could use to confirm that its teams have been made aware of their legal and ethical obligations.

We also make this recommendation because of some confusion we encountered among employees as to who would be responsible for ensuring that employees complete the required training. In the matrix structure, that responsibility could fall on either the program manager responsible for the procurement, or the functional manager to whom the employee reports directly. We believe that in most cases the responsibility should fall on the program manager, who is the “CEO” for the procurement and responsible for ensuring that the procurement is handled properly. By requiring a certification, and assigning specific responsibility for ensuring that the certifications are received, the company can eliminate this ambiguity and remind the program manager of the importance of this issue as well.

Recommendation 12

Boeing should establish procedures (such as a certification process or structured legal review) to confirm compliance with legal and ethics rules following completion, and prior to submission, of a proposal to the federal government in a competitive procurement.

This recommendation invites Boeing to consider different possibilities for creating, at the end of the procurement process (but prior to the submission of a proposal to the government) a counterpoint to the employee training/certification process that we recommend be implemented at the start of a procurement. Strictly by way of example, one alternative that we understand is currently being considered at Boeing would require that the procurement program manager provide a certification, for internal use only, to the effect that, to the best of the manager's knowledge: (1) the proposal does not contain, and is not based on, information that was obtained improperly; and (2) that there have been no unreported material deviations from applicable laws or Boeing policies in preparing the proposal.

While a personal certification regime might prove useful in some circumstances, an alternative approach that might be more suited to a broader range of procurements would require Law Department and/or Ethics personnel to debrief the program manager prior to submission of the proposal, and/or to address compliance issues during the management meetings that are held at the end of the proposal preparation process. Another benefit of this approach is that it would necessarily involve Law or Ethics personnel in the review process, and not rely exclusively on a single program manager to make critical legal judgments independently.

The point of any process should be to ensure that the procurement program manager understands that the materials Boeing submits to the government, and

the means by which those materials were acquired, will be subject to scrutiny before the material is delivered. We encourage Boeing to address this recommendation by adopting practices and procedures suited to the variety of procurement activities in which it participates.

Recommendation 13

The recently announced IDS CRB should establish a mechanism to ensure prompt reporting of CRB activities to WHQ. It is essential that, however the CRB is composed, there be a mechanism for immediate reporting to the General Counsel and VP-Ethics on matters of concern.

We fully concur with IDS' decision to create the CRB to provide ongoing, high-level review by senior IDS management of any matters of concern in this area.

However, history has shown that such matters can have a direct and significant adverse impact not only on IDS, but on the company as a whole. We believe that it is critical, therefore, that in addition to any periodic reports that the CRB may make to the Boeing Strategy Council (or other WHQ entity), it must expeditiously report to the General Counsel or VP-Ethics regarding any serious matters that come to its attention. It bears repeating that we do not take issue with the general proposition that each business unit must "own" its own problems. Nonetheless, Boeing's recent experience shows that problems within IDS may quickly transcend IDS and have a direct and significant impact on Boeing as a whole. We deem it prudent in such circumstances to ensure that WHQ is informed in a timely manner of issues of concern.

Finally, although we have not recommended specifically that the company institute CRBs for the other business units, we do recommend that the matter be given consideration. Other business units have told us that, because they are more commercial

in orientation, or for other reasons, the same issues that arose in the EELV and EKV incidents would not arise in those units. This position could be a sign that these units are not paying sufficient attention to other legal and ethical matters that do apply to their businesses (such as the EEA, UTSA or other regulatory compliance issues). Although we have no reason to believe that this is the case, the application of lessons learned at IDS to other business units would reduce the likelihood of problems of similar magnitude arising in other parts of the company.

Recommendation 14

Responsibility for ensuring the thorough, accurate and expeditious investigation and resolution of all incidents involving the unauthorized possession or use of third-party or USG competition sensitive/proprietary information should rest with senior levels of the Boeing General Counsel's Office.

We have reviewed the Law Department's new procedure entitled "Investigation Procedure: Potential Procurement Integrity & Third Party Proprietary Data" dated September 26, 2003 ("New Procedure"). We believe that the Law Department has established an appropriate template for handling these matters. We agree with the central point of the New Procedure: that both ultimate responsibility for ensuring the thorough, accurate and expeditious resolution of these matters, as well as day-to-day oversight responsibility, must be vested at the highest levels of the Law Department, regardless of the general company policy that each business unit "own" its problems. As we have noted, certain matters transcend the interests of any one business unit, and the potential adverse consequences for the company as a whole of a failure to properly respond to such issues can be enormous.

As the New Procedure recognizes, not all cases involving the appearance of a third-party document need to be addressed by the General Counsel's Office. Our many interviews with Boeing attorneys revealed that, through no fault of Boeing's, third-party documents are – with troubling regularity – mistakenly faxed or e-mailed to Boeing, or improperly posted on a web site by, *e.g.*, the USG or third parties. The Boeing system for dealing with such incidents – which relies on the attorneys assigned to the relevant business unit – seems to work swiftly, appropriately, and to the satisfaction of all concerned. The focus of our recommendations is on those rare incidents that cannot fairly be characterized as inadvertent or mistaken, or otherwise easily resolved by reference to, *e.g.*, a nondisclosure or proprietary information agreement.

Under the New Procedure, the General Counsel will delegate to the AGC-L responsibility for the actual staffing and oversight of the investigation. It is critical that decisions regarding staffing, allocation of internal and/or external resources and the like be made, at the outset of the investigation, at the highest levels of the Law Department. The decision as to whether the actual investigation is conducted by in-house Boeing attorneys and security personnel, or by an outside law firm retained for that purpose, or some combination thereof, should be within the AGC-L's discretion.

Moreover, once the initial decision has been made to refer a matter to the General Counsel's Office, attorneys assigned to the subject business unit should not be responsible for the investigation (or any major facets thereof) or have any veto (express or implied) over the direction of the investigation or the conclusions/recommendations set out in any final report. Either the General Counsel or the AGC-L should have responsibility for briefing corporate management and the subject business unit

management on both the progress of an investigation and with respect to final conclusions and recommendations.

The development of the written investigation plans and related documents contemplated by the New Procedure should be completed with the utmost dispatch, and it must be made clear that the attorney designated as the “Investigation Lead” must begin all necessary aspects of the investigation immediately upon his appointment, without waiting for preparation/approval of the “Investigation Plan.” That is, there should be no undue delay in the initiation of, *e.g.*, document and data preservation, witness interviews, etc., and that the investigation should proceed as expeditiously as possible consistent with a thorough collection and evaluation of the relevant facts.

Finally, the New Procedure should be applicable to all divisions and business units. Third-party document matters are covered by, *e.g.*, the EEA and various state unfair competition laws, regardless of whether the case involves a USG procurement.

E. Assessment and Evaluation Recommendations

Our final two recommendations focus on the need to assess the effectiveness of the various new policies and procedures being adopted by Boeing, either those of its own devise or ones based on our recommendations. We deem it essential that periodic review of these matters be conducted in a systematic manner.

Recommendation 15

At appropriate intervals, Boeing’s Audit group should conduct an assessment of the effectiveness of the various new policies and procedures adopted to address procurement integrity issues in general and issues relating to possession and use of third-party documents in particular. Such an inquiry should include an examination of, *inter alia*: (1) general compliance with laws and policies governing third-party documents; (2) compliance with relevant training and certification

policies; (3) compliance with “cooling-off” periods for former employees of competitors; and (4) the effectiveness of new company procedures for addressing potential third-party document violations.

We have recommended, and Boeing has independently developed, a host of new policies and procedures intended to minimize the possibility of any new EELV-type events. Ultimately, the passage of time will measure their effectiveness. We think it important, however, that Boeing’s Audit group monitor and assess the implementation of these various procedures to maximize the likelihood of their success. This could be accomplished through modification of the annual CAP program, in which issues regarding third-party documents (within the broad scope of procurement integrity issues) historically do not appear to have received sufficient attention. Alternatively, a separate assessment of these new procedures by the company’s Audit team might provide a more finely focused mechanism for measuring the effectiveness of these new policies and procedures. We leave it to Boeing to develop an appropriate auditing tool.

Recommendation 16

The Ethics program, including its interaction with the business units and with other organizations within Boeing, should be subject to ongoing scrutiny, examination and, possibly, further reorganization.

Our recommendations have focused generally on areas in which there might be a perceived or apparent conflict, or in which we believe that compliance and enforcement mechanisms relating to Boeing’s legal and ethical obligations can be strengthened further. In the course of our work, however, we have had the opportunity to examine Boeing’s management and organizational structures, and in particular the structure of its Ethics operation.

In our view, the Ethics program at Boeing is complete and impressive in its scope and detail. The organization, however, is complex and bureaucratic. Some of the initiatives the company has undertaken recently – such as the three-tiered structure of the IDS CRB – would appear to add to the complexity and the bureaucracy, perhaps unnecessarily.

We recommend that, after the latest round of recommendations has been implemented and sufficient time has passed to gain operational experience, the company undertake a final review, using either company resources or an outside consultant, to examine the Ethics organization in particular, with an eye to making it more workable, more understandable, and more efficient.

* * *

We would like to conclude our Report by expressing our appreciation to the many Boeing employees who devoted significant amounts of time and expertise to our effort. We respect the pride that these employees take in the quality and integrity of the products and services they generate on behalf of Boeing.

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

November 3, 2003

LIST OF ACRONYMS AND ABBREVIATIONS USED IN THIS REPORT

AGC	Assistant General Counsel
AGC-L	Assistant General Counsel for Litigation
ATM	Air Traffic Management
BCA	Boeing Commercial Airplanes
BEAT	Boeing Ethics Advisors Training
BSS	Boeing Satellite Systems
C&P	Contracts and Pricing
CAP	Compliance Assessment Process
CAST	Compliance Assessment Team
CMOP	Compliance Management Oversight Process
CRA	Compliance Risk Area
CRB	Compliance Review Board
CSA	Controls Self-Assessment
EBC Committee	Ethics and Business Conduct Committee
EEA	Economic Espionage Act
EELV	Evolved Expendable Launch Vehicle
EKV	Exoatmospheric Kill Vehicle
EPC	Ethics Process Council
FCS	Future Combat Systems
FSG	Federal Sentencing Guidelines
GBAP	Global Business Acquisition Program
IDS	Integrated Defense Systems
PAT	Process Action Team
PIA	Procurement Integrity Act
POL	Policy Document
PRO	Procedure Document
SCO	Special Compliance Officer
SSG	Shared Services Group
USG	United States Government
UTSA	Uniform Trade Secrets Act
WHQ	World Headquarters