

**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**

EXECUTIVE SUMMARY

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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.

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