



Public Comment From the Ethics Resource Center (ERC) Regarding the U.S. Sentencing Guidelines for Organizations

For the past several months, the Advisory Group on Organizational Guidelines to the United States Sentencing Commission has received public comments and has undertaken its own initial evaluation of both the terminology and application of Chapter Eight of U.S. Sentencing Guidelines for Organizations. As part of their work, the Advisory Group identified a series of concerns and created a list of key questions to focus and stimulate additional public comment.

As one of the oldest non-profit business ethics organizations in the United States, the Ethics Resource Center has earned international recognition for its expertise in implementing organizational ethics and compliance programs. The following constitutes the ERC's response to the Advisory Group's questions.

Questions

1. Should the Chapter Eight Guidelines' criteria for an "effective program to prevent and detect violations of law" at §8A1.2, comment 3(k)(1-7), be clarified or expanded to address the specific issues designated below? If so, how can this be done consistent with the limitations of the Commission's jurisdiction and statutory authority at 28 U.S.C. §994 *et. seq.*
 - a. Should §8A1.2, comment 3(k)(2), referring to the oversight of compliance programs by high-level personnel, specifically articulate the responsibilities of the CEO, the CFO, and/or other person(s) responsible for high-level oversight? Should §8A1.2, comment 3(k)(2), further define what is intended by "specific individual(s) within high-level personnel of the organization (*see also*, §8A1.2, comment 3(b)) and "overall responsibility to oversee compliance?"

ERC Response

The guidelines should, as a minimum, follow the responsibilities outlined in the Sarbanes-Oxley Act of 2002.¹

CFOs and other high level personnel should adhere to what is required of them under the FSGO and Sarbanes-Oxley. The current statement in Chapter Eight Guidelines requiring these persons to “...oversee compliance with such [compliance] standards (as the organization has established)” is too vague given the severity of the consequences of failure to meet the standard.

The Sarbanes-Oxley Act of 2002, on the other hand, specifically delineates the responsibilities of high-level personnel. Section 906 of Sarbanes-Oxley states what certification CEOs and CFOs must make and what punishments are possible on an individual basis if as (high-level personnel) they willfully violate the provision. The level of clarity achieved ties specific acts to potential punishments in very vivid fashion.

In essence, this legislation requires business executives to attest to the integrity of their organizations. Such an outcome is only possible if ethics and compliance programs receive oversight beginning at the top. While exceptional business models do develop reporting structures of this nature on their own, it should be expected that the vast majority of organizations will require encouragement through legislation and enforcement.

The requirement to oversee should be coupled with the responsibility to report the results of the oversight to the Audit Committee of the Board. This suggests that the designated person(s) need direct and unfettered access to that committee. There is a further implied notion that this person(s) should also have direct and unfettered access to the CEO and CFO. This would be a difficult reach today for many such designees (ethics officers) because their positions in the organizational hierarchy distance them from the CEO/CFO/Audit Committee by several levels of management.

- b. To what extent, if any, should Chapter Eight specifically mention the responsibility of Boards of Directors, committees of the Board or equivalent governance bodies of organizations in overseeing compliance programs and supervising senior management's compliance with such programs?

ERC Response

These provisions in Chapter Eight go a long way toward specifying the responsibilities of Boards, Audit committees and of senior management. Nevertheless, we advocate going a step further. The provisions should underscore the fiduciary responsibility of the board and audit committee. The provisions should comment on the inherent conflicts of interest of those charged

¹ President George W. Bush signed the Sarbanes-Oxley Act of 2002 into law on July 30, 2002.

with such oversight responsibilities and should focus on the need for audit committee members to be independent directors in all regards.

This is somewhat an articulation of §301 of the Sarbanes-Oxley Act that states that each member of the audit committee shall be a member of the board of directors of the issuer, and shall otherwise be independent. In the meaning of Sarbanes-Oxley, "independent" means not receiving, other than for service on the Board, any consulting, advisory, or other compensatory fee from the issuer, and not being a person affiliated with the issuer, and/or any subsidiary of the issuer.

- c. **Should modifications be made to §8A1.2, comment 3(b) (defining "high-level personnel" and §8A1.2, comment 3(c) (defining "substantial authority personnel")? Should modifications be made to §8C2.5, comments 2, 3 or 4, relating to offenses by "units" of organizations and "pervasiveness" of criminal activity?**

ERC Response

The current definition describing various personnel with responsibility for ethics oversight is adequately clear in terms of who they are. What is not as clear is the ease of access such personnel have to the CEO, CFO and Audit Committee of the Board (or Board as a whole, if there is no such committee). Access to the ultimate authorities and responsible parties must be clear and unfettered, especially in the case of "substantial authority" personnel and units of an organization other than those under the direct oversight of those personnel (this ties back to our answer to Question 1(a).)

- d. Should §8A1.2, comment 3(k)(3), which refers to the delegation of substantial discretionary authority to persons with a "propensity to engage in illegal activities," be clarified or modified?

ERC Response

Some modification/clarification is called for but the ERC review group is uncertain what the eventual language should address. In fact, review of this section raises even more questions that need to be answered. For example:

- How does one determine a "propensity to engage in illegal activities?" Does a prior criminal record indicate such a propensity? Does considering a criminal history unrelated to fiduciary misconduct or white collar crime constitute a form of discrimination that can be legally challenged? Are there observable organizational behaviors indicating a climate exists that *supports* individuals with a propensity to engage in illegal activities?
- Should the reference also require that the person deemed competent and to whom substantial discretionary authority is granted demonstrate necessary skill,

knowledge and judgment to be entrusted with that authority? In other words, is freedom from propensities to engage in illegal activities enough or should other demonstrated skills, knowledge and abilities be required?

- Consideration should be given to replacing the word “propensity” with a term or description that more clearly describes the concern. Does the issue one of conflict of interest coincide with the opportunity and means to act illegally? Should there be a corresponding requirement that calls for a greater amount of independent oversight of individuals?
- Does the inclusion of an ill-defined criterion in some way weaken the entire set of guidelines?

The whole question of determining propensities to engage in illegal activities has been frequently visited in popular culture, in addition to the business context. It is not wholly unrelated that in science fiction (most recently in the film *Minority Report*) questions of morality and legality have been raised, particularly with regard to actions that are reasonable to expect, given a propensity for certain types of behavior. Whereas in fiction the attempt to determine such propensity and predict future criminal activity on an individual basis always fails, in business and law, we cannot necessarily come to the same conclusion.

Recent research into the ethical climate of organizations indicates there are at least three readily identifiable indicators which may predict the presence of misconduct or of a climate that supports misconduct within an organization. This is discussed further in the ERC response to Question 1(g) on page 7 of this document.

- e. Should §8A1.2, comment 3(k)(4), regarding the internal communication of standards and procedures for compliance, be more specific with respect to training methodologies? Currently, §8A1.2, comment 3(k)(4) provides:

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

"The use of the "e.g." can be interpreted to mean that, "training programs" and "disseminating publications" are illustrative examples, rather than necessary components of "communicating effectively." The use of the word "or" can be interpreted to mean that "training programs" and "disseminating publications" are alternative means for satisfying the "communicating effectively" requirement.

Should the preceding language be clarified to make clear that both training and other methods of communications are necessary components of "an effective" program? If

so, should the term "disseminating publications" be replaced by more flexible language such as "other forms of communications"?

ERC Response

Specific methodologies are less important than required measurable outcomes. The goals for effective communication and training are to:

- Maintain a heightened awareness among all employees about the performance expectations of the organization regarding ethical business practices. This includes awareness of the means to clarify individual understanding or report misconduct.
- Develop and reinforce ethical business behaviors among individuals and groups.

Training-related social science goes against the notion that there is a "best" training methodology. For at least fifty years there has been an understanding that there are a variety of "learning styles" which then necessitate a variety of teaching styles.

For example, in 1984 David Kolb identified four types of learners in *Experiential Learning: Experience as the Source of Learning and Development*.² Kolb postulated that individual learners develop preferred learning styles based on the manner in which they perceive and process information:

- **Activists** – These individuals learn best through active experimentation and prefer to have material presented in small group activities, group discussions, reading assignments and through peer interaction.
- **Pragmatists** – Pragmatic learners absorb material best when it is presented in laboratory situations, through observation or in real life field events.
- **Reflectors** – The Reflective learner seldom takes anything at face value. Reflective learners tend to look at trainers or facilitators as "experts" and want them to serve as authorities that are providing guidance.
- **Theorists** – Theorists prefer to discover how concepts relate rather than being told what relationships exist. They like to think about what they are being asked to learn and find a high-level of group or instructor interaction to be of little benefit.

² Kolb, David A., *Experiential Learning: Experience as the source of learning and development*. New Jersey: Prentice Hall, (1984).

Other theories of learning exist including the VAK Learning Styles (Vision, Auditory and Kinesthetic)³, the Myers Briggs Type Indicators⁴ and Howard Gardner's Multiple Intelligences.⁵ Regardless of which model you select, the common thread is that people learn differently and, to be universal and successful, all training programs and/or disseminating publications need to consider the differences in ways people learn.

The guidelines would be better suited to define desired or required outcomes – e.g. awareness of a company code, familiarity with the code's content, familiarity with what constitutes a violation of the code, awareness of how to integrate the code into one's decision making processes, awareness of the resources provided by the organization for obtaining clarification of code provisions, means for reporting suspected violations of the code, etc., rather than specifying training modalities. However, some consideration should be given to acknowledge that training and communications need to be multi-dimensional to meet varying learner needs.

Regarding the use of training programs or disseminating publications – use of “or” would give the option, but “disseminating publications” is too limiting. We believe that both are needed, but that even together they remain insufficient.

- Publications can help to inform and maintain awareness.
- Effective training can change and reinforce behavior to be consistent with ethical business practices.
- However, organizational systems that select personnel for positions, measure and reward performance, and fund organizational activities further communicate and educate what the organization values and expects.

All of these forms of “communication” are necessary for a program to be deemed “effective.” Training, communications and organizational systems must be congruent and all are needed to ensure desired behavior is achieved.

Ultimately, must to be clear in this section is that the organization has an affirmative obligation to ensure that every employee understands what is required or expected and has obtained the knowledge, skills and abilities necessary to meet the desired performance expectations

It is not enough to require compliance... a support mechanism has to be in place to make compliance possible. Employees need to be made aware of the resources available to support ethical decision-making and know how to utilize those resources when they are faced with an ethical dilemma or decision.

³ The Visual Auditory Kinesthetic Learning Model is widely accepted although statistics concerning the percentages of individuals in each of the designated learning styles has not been scientifically validated.

⁴ Thorne, Alvin and Gough, Harrison, *An MBTI Research Compendium*, CAPT, Gainesville, Florida, (1999).

⁵ Gardner, Howard, *Frames of Mind: The Theory of Multiple Intelligences*, Basic Books, New York, (1993).

Any contradictory messages from leadership, training, formal and informal communications, systems or operational practices need to be identified and amended so that the message is consistent. Once this is accomplished, the communication about ethical expectations can be considered effective absent empirical evidence to the contrary.

- d. Should §8A1.2, comment 3(k)(5), concerning implementing and publicizing a reporting system that fosters reporting without fear of retribution, be made more specific to encourage.
 - i. Whistle blowing protections;
 - ii. A privilege or policy for good faith self-assessment and corrective action (e.g., 15 U.S.C. §1691 (c) (1); (1998);
 - iii. The creation of neutral or ombudsman office for confidential reporting or,
 - iv. Some other means of encouraging reporting without fear of retribution?

ERC Response

All four criteria mentioned deserve consideration. Effective programs need not have all four – but if they have fewer it is incumbent upon the organization to provide evidence that the system is safe and effective for whistleblowers to use and that employees see it that way as well.

To better identify potential ethics issues and to reduce the risks associated with them, organizations rely on employees to report the misconduct they observe and to raise their ethics concerns. However, for various reasons, employees are often unwilling to take such actions. Research on whistle blowing within the Federal Government suggests that the top two reasons employees fail to report misconduct are: (1) a belief that nothing will be done and (2) fear of retaliation.⁶

There are similar findings regarding employees in businesses and other organizations. Two in five employees do not report the misconduct they observe. Senior and middle managers are more likely to report misconduct than are lower level employees.⁷

The reporting issue has been extensively researched within the ERC Fellows program and the results of that research published in 1999.⁸ **Among other suggestions were protection of the identity of a reporting source from discovery, ability of an organization that has an in-house reporting system to assert protection on behalf of the reporting source, and discretionary exception to the rule for disclosures necessary to protect life or property.**

As for the four items cited in §8A1.2, comment 3(k)(5), a caveat should be included for multi-national organizations or those with foreign subsidiaries or partners.

Reporting systems in certain parts of the world are greatly divergent than ours. For example, former communist states are still very sensitive to the impact of the KGB. Reporting based on their past experience may have dire consequences and is often assiduously avoided. In parts of Europe and Africa the embedded culture sees reporting as a sign that the individual lacks a network of trusted colleagues and, therefore, the report itself may not be trusted or accepted as valid.

In other cultures, there are boundaries (e.g., it is acceptable to report to a family member or trusted elder but not an employer), which may make communication of a concern more roundabout than is common in U.S. culture. A recent experience with a focus group in mainland China indicated a total reluctance on the part of employees

⁶ U.S. Merit Systems Protection Board, “*Whistleblowing in the Federal Government: An Update*,” October 1993, p.13.

⁷ Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

⁸ See sample text from the *ERC Fellows Model Reporting Source Protection Act* that is attached to this document.

to criticize their "employer" or employer practices in any way. While participants were willing to talk about routine matters, requests for information that might be construed to be critical were met with stony silence.

All this suggests that reporting may be encouraged, but as we employ a multi-cultural workforce or operate outside the U.S., we are likely to encounter resistance to the process, and alternative processes should be considered. That consideration should include giving the company equivalent credit if their alternative can be shown to be reasonably effective in the context of their culture.

- b. Should greater emphasis and importance be given to auditing and monitoring reasonably designed to detect criminal conduct by an organization's employees and other agents, as specified in §8A1.2, comment 3(k)(5), including defining such auditing and monitoring to include periodic auditing of the organization's compliance program for effectiveness?

ERC Response

Yes, greater emphasis should be given to auditing and monitoring – especially those indicators of program outcomes and effectiveness, not just whether programs are in place.

Monitoring should be done, but it should be done independently from outside the organization – not by the organization itself – to ensure an impartial and thorough examination.

Further, effectiveness should not be defined solely in terms of known violations. Rather, there should be a climate assessment of conditions within the organization to predict the likelihood of future unethical and/or criminal activity.

In the 2000 National Business Ethics Survey (NBES)⁹, **the ERC collected reliable data on key ethics and compliance outcomes for use in benchmarking by interested organizations. The data help identify and better understand ethics issues that are important to employees within the United States.**

In organizations where employees see values applied frequently, there are fewer instances of misconduct at work. Employees feel less pressure to commit misconduct and are more satisfied with their organizations.

As a corollary, NBES 2000 provides statistical evidence that the opposite conditions serve as three predictors of unethical/criminal conduct: job dissatisfaction, awareness of unethical/illegal conduct by others, and pressure to perform illegal acts or violate organizational standards.

⁹Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

The effect of finding these predictors in an organization is cumulative:

- The presence of any one is a concern.
- The presence of any two is a warning.
- The presence of all three is cause for serious concern about an organization.

There are also valid baseline data regarding factors that influence employee conduct: trust in one's leadership, existence of double standards and the belief that one's immediate superiors are dishonest.

These types of behaviors should be monitored, measured and used in conjunction with criteria such as the perceived effectiveness and safety of using the organization's reporting systems.

Over time, comparison of a combination of those results will generate even stronger statistical evidence about the thresholds of program effectiveness, without necessarily having to experience actual criminal conduct.

- d. Should §8A1.2, comment 3(k)(6), be expanded to emphasize the positive as well as the enforcement aspects of consistent discipline, e.g., should there be credit given to the organizations that evaluate employees' performance on the fulfillment of compliance criteria? Should compliance with standards be an element of employee performance evaluations and/or reflected rewards and compensation?

ERC Response

Yes. We would encourage the reinforcement of the positives, not just punishment of the negatives. Experience with hundreds of organizations suggests that this is easier to conceptualize than to put into action. Very few organizations have effectively implemented employee evaluations that included anything more significant than a check box on ethics and compliance – check if there were no reportable violations.

A notable exception is Royal Dutch Shell. Shell has required each of its 168 Country Chairmen (CC) to submit an annual letter to his/her Managing Director answering a number of questions regarding the effectiveness of implementing Shell's General Business Principles (SGBP) in his or her particular country.

The annual letter includes several items such as: numbers of employees trained, joint ventures or partnership not entered into because the potential partner failed to meet SGBP standards, unique challenges, and plans to address the challenges. The letters

and subsequent one-on-one interviews with Country Chairmen are a significant portion of the CC's performance evaluations. The Country Chairmen promulgate the process throughout lower levels of management.

5. While the Chapter Eight Guidelines currently provide a three-level decrease in the culpability score of organizations that are found to have implemented an "effective program to prevent and detect violations of law" (at §8C2.5(f)), should this provision be amended to provide an increase for organizations that have made no efforts to implement such a program? If so, what is the appropriate magnitude for such an increase?

ERC Response

Yes, and more so. Culpability should increase for creating a program that had little likelihood of success or for which there were insufficient efforts made to determine the probability of, or ensure the actuality of, success.

Such an increase in culpability would discourage organizations from “going through the motions” and creating the appearance of having an effective program. A typical example of such “appearance” programs is found in the many organizations that require employees to sign a form attesting to having received, read and understood the code of conduct, when in fact no such thing happened. Employees are all too often coerced by their immediate supervisor to “just sign the paper.”

The same holds true for ethics training – there is anecdotal evidence in many organizations that pressure is exerted to sign a form attesting to attending a training session when in fact the employee did no such thing.

The absence of an effort to create an effective program, as well as deceptive efforts to create the appearance of an effective program, should be punished. Perhaps the deception is even more worthy of punishment than absence of a program.

If the program is ineffective, it should be treated as if the organization has no program and has not made a good faith effort to create one.

The magnitude of the punishment should be sufficient to encourage good faith efforts. Since a three-level decrease in the culpability score is specified in §8C2.5(f), it would seem appropriate to call for a three-level increase for deliberate attempts to circumvent the requirement for "effective program to prevent and detect violations of law."

6. How can the Chapter Eight Guidelines encourage auditing, monitoring and self-reporting to discover and report suspected misconduct and potential illegalities, keeping in mind that the risk of third-party litigation or use by government enforcement personnel realistically diminishes the likelihood of such auditing, monitoring and reporting?

ERC Response

It may be possible to encourage self-audits and monitoring but protect those findings from “random” subpoenas. Perhaps the solution would be to ensure that such data can only be “discovered” through an indictment and the presumption of probable cause.

If prosecutors are allowed to access these data on “fishing expeditions,” there would continue to be great reluctance to conduct and document such self-audit or monitoring efforts. For more information, the ERC Fellows report on “privilege” addresses this issue.¹⁰ **See Attachment A.**

7. Are different considerations or obstacles faced by small and medium-sized organizations in designing, implementing and enforcing effective programs to prevent and detect violations of law? If so, does §8A1.2, comment (k)(7)(I) adequately address them? If not, how can Chapter Eight better address any unique concerns and obstacles faced by small and medium-sized organizations? What size organization requires unique/special treatment (e.g., 50 employees, 200, 1000, 5000)?

ERC Response

Chapter Eight could offer small and medium-sized organizations the opportunity to benefit from the culpability decreases available to larger organizations by offering evidence of alternative means of meeting the current stated standards. If they can demonstrate effective efforts made to ensure an ethical and compliant work environment and business culture, the specific program elements might be less of an issue than the evidence of a good faith effort to create such a culture.

Evidence of such culture initiatives could include: formal and informal communications; strategies and programs; employee discipline records; evidence of ethics and compliance as topics of executive briefings, staff meetings and other employee gatherings; as well as evidence of how employee reports of questions and/or concerns were handled. Third party assessments of the culture, employee survey data on several standardized ethics and compliance questions, or other records of how ethics concerns were surfaced and addressed could be used as well.

- a. How frequently do small and medium-sized organizations implement "effective programs to prevent and detect violations of law" within the meaning of Chapter Eight of the Sentencing Guidelines? If the frequency is low, to what factors is this attributable, and how may Chapter Eight be modified to promote increased awareness and implementation of effective compliance programs among small and medium-sized organizations?

¹⁰ See sample text from the *ERC Fellows Model Reporting Source Protection Act* that is attached to this document

ERC Response

The ERC's 2000 National Business Ethics Survey¹¹ assessed the likelihood of written ethical standards based on organizational size. What size organization requires unique/special treatment (e.g., 50 employees, 200, 1000, 5000)?

We found:

Organization Size	Percentage
2 – 24	54%
25 – 99	76%
100 – 500	86%
500 – 1,999	89%
2,000 – 9,999	93%
10,000 or more	95%

As can be seen in this chart, the percentage of organizations with written standards begins to drop sharply among those with fewer than 100 employees. What may differ most dramatically between organizations with fewer than 100 employees and those with more than 100 employees is the amount of formalized communications about ethics programs. Communications may be less formal in smaller organizations and the presence of supporting infrastructure may not be necessary. Similar patterns have been found regarding organizations that provide ethics training and mechanisms for obtaining ethics advice.

- b. According to §8C2.5(f), if an individual within high-level personnel or with substantial authority "participated in, condoned, or was willfully ignorant" of the offense, there is a rebuttable presumption that the organization did not have an effective program to prevent and detect violations. Does the rebuttable presumption in §8C2.5(f), for practical purposes, exclude compliance programs in small and medium-sized organizations from receiving sentencing consideration? If so, is that result good policy and why?

ERC Response

The rebuttal presumption should not be a function of organization size. What may vary with size is the evidence required to demonstrate a good faith effort to create an effective program. As stated immediately above, the components of a program that are likely to prove effective may differ with organizational size. But program components, that are deemed reasonably likely to be effective afford small and

¹¹ Ethics Resource Center, *2000 National Business Ethics Survey*, Ethics Resource Center, Washington, DC, (2001).

medium-sized organizations the same protections and rebuttable presumptions as the components specified for larger organizations.

- c. In addition to the rebuttable presumption in §8C2.5(f), and §8C2.5(b), also provides an increase in the culpability score (from 1 to 5 points) where an individual within high-level personnel or with substantial authority participated in, condoned, was willfully ignorant or tolerant of the event. Is that good policy and why?

ERC Response

We agree with the stated policy. Leaders create organizational culture by their actions and by their inactions. When “an individual within high level personnel or with substantial authority participated in, condoned [or] was willfully ignorant or tolerant of” an offense, that person communicates to all employees who are aware of the action what the organization will condone, tolerate and/or expect. If that action (or inaction) is not punished, it is reasonable to expect that a recurrence of such behavior becomes more likely.

The nature of leadership is that leaders are, and should be, held to a higher standard, not an equal or lesser standard, since they are role models and shape the culture of organizations. The organization should be understood as increasingly culpable if it creates and sustains leaders who choose to participate in, condone [or] be willfully ignorant or tolerant of illegal or unethical behavior.

5. Should the rebuttable presumption in §8C2.5(f), continue to apply to large organizations and, if so why?

ERC Response

The rebuttable presumption is valuable regardless of organization size as indicated above. What may vary with size is how the necessary elements of an “effective program” are defined. Criminal or unethical conduct is sufficient grounds for presumption that the ethics program was not effective.

The burden of proof should reside with the organization to demonstrate that the program was effective, and that the criminal act in question could not reasonably have been prevented, despite the presence of an effective program. That presents a difficult challenge because one could be argued that an offense is proof positive of a program’s lack of effectiveness. We would argue that “effective” does not mean “perfect”. Every program has limits and a determined individual can often subvert or work around even the best-designed and best-intentioned program.

6. Should the provision for "cooperation" at §8C2.5, comment 12, and/or the policy statement relating to downward departure for substantial assistance at §8C4.1, clarify or state that the waiver of existing legal privileges is not required in order to qualify for a reduction either in

culpability score or as predicate to a substantial assistance motion by the government? Can additional incentives be provided by the Chapter Eight Guidelines in order to encourage greater self-reporting and cooperation?

ERC Response

The ERC does not have responses to the questions raised regarding paragraph §8C2.5, comment 12 and/or §8C4.1.

- a. Should Chapter Eight of the Sentencing Guidelines encourage organizations to foster ethical cultures to ensure compliance with the intent of regulatory schemes as opposed to technical compliance that can potentially circumvent the purpose of the law or regulation? If so, how would an organization's performance in this regard be measured or evaluated? How would that be incorporated into the structure of Chapter Eight?

ERC Response

We agree that the FSGO should expect organizations to make systemic and sustained efforts to form an organizational culture and climate that fosters ethical business practices and ethical employee behavior. The behaviors of individuals within organizations are strongly affected by the perceived and real expectations of peers and supervisors.

These expectations are formed over time and are based upon personal experience of behavior that is modeled, punished and/or rewarded. One's understanding of what is modeled, rewarded and punished forms his or her belief of what is truly valued by the organization. This belief system often leads the individual employee to act upon assumptions and without reflection. The ultimate goal of compliance efforts should be to instill belief systems that nurture performance expectations to act ethically.

Actions of the organization to manage the climate and culture should be observable, measurable and open to audit. There should be a demonstrated alignment of the organization's mission, goals, values, code of conduct, policies, compliance activities and performance management with integrity as a foundational element.

A thorough assessment of senior management's (including the Board of Directors) actions regarding exceptions to policy, preferential treatment of employees, selection/promotion practices and disciplinary employee actions should reveal consistency with legal requirements, stated organizational values and ethical business practice.

ERC Fellows Model Reporting Source Protection Act

Model 1: Reporting Source Protection Act

Overview:

The scope of Model 1 is the protection of the identity of a reporting source from discovery, both from within and outside the organization. This proposed privilege would shield the reporting source's identity from being discovered in any civil, administrative, legislative or criminal proceeding or hearing. This proposed privilege would also relieve the organization from the obligation of having to confirm in the course of such litigation that the reporting source utilized an in-house reporting system. This Model, however, does not protect from disclosure the substance of designated communications to an in-house reporting system.

Model 1 protects only the identity of a reporting source who did not participate in the wrongdoing and who uses an in-house reporting system in good faith. This protection is analogous to aspects of the Confidential Informant (CI) privilege long enjoyed by the government to aid law enforcement and recognized by the United States Supreme Court in *United States v. Roviato*, 353 U.S. 53 (1957). The CI who is not a wrongdoer but merely an observer of potential illegal activity may be reluctant to provide evidence that will be attributed to him or her, frequently because of a concern for personal safety. Under the CI privilege, the government uses the information from the CI to initiate its investigation and develops independent evidence to corroborate the CI's allegations. The government then prosecutes the case based on this independent evidence without needing to divulge the identity of the CI who provided the initial "lead." While this Model does not preclude an organization from taking disciplinary action against an employee based solely on the word of a single reporting source, prudent companies would probably not pursue such a course of action because it would unnecessarily expose them to liability and undercut the trust that is essential to encourage the flow of information for effective ethics and compliance programs.

A key aspect of this Model is that the organization would have standing to assert the privilege on behalf of the reporting source, and the reporting source would have the ability to waive the privilege. However, an organization's failure to adequately protect the privilege would not give rise to a new cause of action by the reporting source against the organization. This privilege is in addition to, and not in derogation of, any other privileges and protections that the parties may have available.

Draft Legislation:

§1. Purpose.

The adoption of voluntary ethics and compliance programs by organizations enhances compliance with laws and promotes the use of ethical business practices in the United States, to the benefit of all citizens. It is the policy of [this legislature] to encourage such programs and the steps necessary to make them effective. One such step is the operation of in-house reporting systems to encourage employees and other agents to report to an organization misconduct without fear of retribution.

Protecting the identity of a source who uses an in-house reporting system in good faith is an important way to protect him or her from retaliation and to encourage use of such reporting systems. This requires protecting the source's identity from discovery and use in any civil, administrative, legislative, or criminal proceeding or hearing. It does not give rise to a new cause of action by a reporting source against the organization in the event the organization does not adequately protect the identity of a source.

§2. Definitions.

¶a Source - A source is any person who is not a participant in the wrongdoing, including individuals and outside organizations (as defined in 18 U.S.C. §18), who in good faith uses an in-house reporting system to report wrongdoing, suspected wrongdoing, or any other information of concern to the source about unethical conduct.

¶b Good faith - A report is made in good faith if it is based on the belief in the accuracy of the information or concern being reported.

¶c In-house reporting system - An in-house reporting system is any system established by an organization to meet the standards of an effective program to prevent and detect violations of law, as defined in the United States Sentencing Commission Guidelines (hereinafter referred to as USSC Guidelines) §8A1.2. Application Note 3(k)(5), in order to provide employees and other agents with a means to report misconduct to the organization without fear of retribution.

¶d Organization - An organization is any entity defined in 18 U.S.C. §18, including but not limited to corporations, partnerships, associations, joint stock companies, unions, trusts, pension funds, unincorporated associations, governments and political subdivisions thereof, and non-profit organizations, that has made a bona fide effort to implement and maintain an effective program to prevent and detect violations of law, as defined in USSC Guidelines §8A1.2. Application Notes 3(k)(1)-(7).

§3. Protection of Sources.

¶a No person, organization or governmental entity shall have access through litigation, or in response to any legal process, to the reporting source's identity or any information likely to lead to the disclosure of his or her identity.

¶b The organization that maintains the in-house reporting system shall have standing to assert this protection on behalf of the source.

¶c The protection of the source's identity may be waived by the organization only with the consent of the source unless the organization believes that disclosure is necessary to prevent an imminent threat of serious physical harm.

¶d Except disclosures that are necessary to prevent an imminent threat of serious physical harm to any person, no organization may be compelled to disclose the identity of a source or to confirm that a source has used an in-house reporting system.

¶e The protections of this section shall apply to any civil, administrative, legislative, or criminal proceeding or hearing. These protections are to be construed broadly to give full effect to the Purpose of this Act.

¶f Waiver of the protections provided by this section may not be made a condition or inducement for any benefit or favorable treatment by any governmental office or agent. Assertion of these protections by an organization or individual is fully consistent with a cooperative approach to law enforcement.

§4. Other Protections and Privileges Preserved.

The protections provided in this Act are in addition to, and not in derogation of, any other privileges and protections that may be applicable.

§5. Effective Date.

This Act shall take effect upon its passage and shall apply to any civil, administrative, legislative, or criminal proceeding or hearing that is pending on, or instituted after, its effective date.

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