University of San Diego School of Law
5998 Alcala Park, San Diego, Ca. 92110

October 5, 2002

United States Sentencing Commission
One Columbus Circle, N.E., Suite 2-500
Washington, D.C. 20002-8002
Attention: Michael Courlander

Response to Request for Additional Public Comment
Regarding the U.S. Sentencing Guidelines for Organizations

Dear Advisory Group,

I am a law professor at the University of San Diego School of Law, a former lawyer at the law firm of Sullivan & Cromwell, and a graduate of the Harvard Law School. I am responding to your request for public comment regarding the U.S. Sentencing Guidelines for Organizations. I respond below to Questions No. 6 and No. 1(f)(iii).

No. 6.
(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 purposes of the law or regulation?

Yes, I believe that this is very important. Actually, modern ethics and ethical compliance systems within organizations that are adopted by good U.S companies are values-based rather than merely compliance or rule-based systems. Experts in this field support values-based systems. A recent survey found, for example, that ethical compliance programs that are values-driven, that is, are established to adopt a shared set of values to guide behavior lower observed unethical conduct.[1]

It is clear that those organizations that do not have ethical climates contribute to unethical/illegal decision making by their employees. That is, there is substantial evidence in the literature that individual factors are insufficient to explain unethical/illegal behavior. The social environment is a contributing factor that influences four aspects of ethical behavior: “moral awareness” which is interpreting a situation as raising an ethical issue, “moral decision making” which involves deciding which course of action is morally right, “moral intent” which is deciding that moral values should take priority over non-moral values, and “moral behavior” which constitutes executing and implementing the moral decision. At each step the corporation’s climate influences employees.

(B) If, so, how would an organization’s performance in this regard be measured or evaluated?

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[1]Chris Moon & Clive Bonny, “Attitudes and Approaches,” in Business Ethics 29-30 (2001)

Ethical climates are not difficult to assess. After all, the ethical climate is the employees' perceptions of the corporation's policies and practices as they relate to ethics and ethical behavior. There are a number of methods to ascertain ethical/unethical climate. Employee surveys are the most common. Questionnaires are available from nonprofit groups, such as The Ethics Center, academicians, and businesses who specialize in corporate cultures. These surveys address a number of issues. For example, they may ask whether employees have observed unethical behavior in the workplace (generally and specifically, such as theft, accounting irregularities), whether they perceive their leaders and peers to be ethical and to behave ethically, whether they believe that behaving ethically is consistent and in furtherance of the missions and goals of their organization, and whether unethical behavior is punished and ethical behavior rewarded. Although many organizations have a dominant climate, subgroups within the organization may have different ethical climates which suggests the advisability, in some organizations, of subunit questionnaires.

Other methods for ascertaining organizational climates consist of interviewing employees, conducting employee focus groups, and monitoring employee hotlines. Also, interviewing employees leaving the organization (exit interviews) is particularly helpful. These interviews may also be conducted by outside professionals to obtain unbiased feedback.

(C) How would that be incorporated into the structure of Chapter Eight?

Organizational ethics and ethics compliance is, in essence, part of an "effective program to prevent and detect violations of law." Under existing guidelines, however, there is no reference to obtaining employees' perceptions of the organization's policies and practices respecting ethics and ethical compliance.

Consider, for example, the following brief description that I gave at a recent USD alumni event concerning Enron's ethical culture:

> 1. The philosophy of the company was based on the neoclassical economic view that markets are superior and self-regulating. They tried to simulate a competitive market among employees within the firm. Consistent with this view they believed that rules constrained innovation, creativity and productivity rather than creating a foundation for them.
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> 2. Enron employees were placed in competition with one another with huge rewards for the winners and disgrace and possible firings for the losers. The objective was to book as much profit as possible and to get around the law and company rules to make money. An egregious example is an employee who used 30 million dollars worth of company hardware and enlisted the help of 380 Enron employees to develop a trading system that the CEO was on record as opposing. The employee was not reprimanded because the trading system made money. Employees were judged based on the outcome of their efforts with no attention given to whether ethical means had been used to achieve those outcomes. In addition, contrary to the market model this system became highly political with employees -- when facing precarious futures but the possibility of huge bonuses-- became fearful of criticizing superiors for fear of retaliation -- and there is substantial evidence of retaliation at Enron. As a result of this system, the managers who emerged to run Enron's new

businesses were not necessarily the most competent in those businesses, but they were the most competent in playing the game for power and recognition at Enron. Employees became adept at earnings management at Enron for internal reasons -- to maximize the chances for bonuses and to avoid disgrace and firing.

The ethical climate of Enron came from the top. The rhetoric from Kenneth Lay was that the company values were RICE, standing for Respect, Integrity, Communication and Excellence, but it is significant that on the day when internal Enron whistleblower, Sharon Watkins, met with Lay to discuss her allegations of accounting irregularities, Enron's law firm delivered a memo on the "consequences of firing someone who makes allegations of accounting irregularities." After Enron's problem had become public and just before it filed for bankruptcy, Lay knew what to do. He wrote to employees:

–"Enron's values will have more importance in employee evaluations;" and that

–"We are all responsible for how we treat our coworkers and customers."

It was too little -- too late.

I attach as Appendix A to this letter about some dimensions that I have found in my research to be relevant to establishing and maintaining an ethical corporate climate. These dimensions concern corporate values, business decision making, leadership, reward structure, guidance, and monitoring.

I will complete my article on this subject in the next couple of weeks and would be pleased to send it to you at that time for any help that it may provide.

No. 1(f) 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: ...(iii) The creation of a neutral or ombudsman office for confidential reporting.

I believe that this suggestion has great merit. I recommend that the ombudsman be appointed by the independent directors of the organization, meet standards of independence, serve for a fixed non-renewable term, and receive compensation that is determined by the independent directors and which is a fixed amount and not based on a percentage of the CEO's salary, corporate profits, or stock value of the organization.

Some time ago I wrote an article recommending boards to have a "board ombudsman" to keep the independent directors better informed and to provide, among other things, for "early identification of unlawful or unethical activity." This article is not directly on point because the recommendation was made in connection with the suggestion that corporations establish two boards, a "conflicts board," which would be composed solely of independent directors, to decide enumerated managerial conflicts of interest issues and a business review board, which would consist of independent and non-independent directors, to decide all other issues. However, the part of this article on ombudsmen may be useful if you substitute in your reading the term "independent directors" for "conflicts board." The article may be found in volume 54 of the Washington and Lee

Law Review, beginning at page 91, and is entitled "Proposals for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudsperson."

If I can be of any further assistance, please do not hesitate to contact me. My e-mail address is dallas@sandiego.edu and my telephone numbers where I can be reached during the day are 619-284-4278 and 619-260-4295.

Sincerely yours,

S/S Lynne L. Dallas

Lynne L. Dallas
Professor of Law

APPENDIX A TO LETTER FROM PROFESSOR DALLAS

Values.

Ethical behavior is highly valued in the organization and is as important, if not more important, in business decision making than profits.

The importance of ethical behavior is acknowledged by the leadership and in the organization's reward structure.

Ethical behavior consists of considering the consequences to all organizational stakeholders of business decisions.

The organization supports a values-based approach, not just a rule compliance-based approach, to ethical decision making.

Business Decision Making.

Ethical standards influence business decision making.

Ethical standards are taken into account in day-today decision making by all employees.

Business decisions are framed in ethical terms.

The consequences of business decisions to corporate stakeholders are considered by the employee decision maker.

Employees assume responsibility for the consequences of their decisions. Diffusion of responsibility is avoided.

The employee's role is to consider ethical standards and the consequences of his/her business decision on others.

Employees recognize that business decision should be based on ethical values and not just on compliance with rules.

Leadership

Leaders view their ethical responsibilities as important as any other responsibility that they have for the organization's operations.

Leaders model ethical practices.

Leaders are consistent in their words and actions with respect to encouraging and supporting ethical behavior and discouraging unethical behavior.

Reward structure.

Compliance with ethical standards are included in the assessment of employees for purposes of compensation and promotion.

Ethical behavior is rewarded.

Unethical behavior is not rewarded.

Outcome-based compensation systems that base compensation only on outcomes are rejected in favor of behavior-based compensation systems that also consider the ethical manner in which outcomes have been achieved.

Leaders are held responsible for the ethical/unethical behavior in the business units that they oversee..

There is no retaliation for good faith reporting of violations of ethical standards to appropriate persons within the organization.

Guidance

The organization has a code of ethics that provides guidance to employees in their decision making.

The organization's code of ethics contains guidance respecting common ethical dilemmas faced by employees.

The organization's code of ethics is distributed to all employees, including managers and lower-level employees.

Employees know whom to seek guidance from in the organization concerning ethically ambiguous situations and are encouraged to seek such guidance.

The organization provides employee training programs that provide opportunity for employee discussions and role playing and that are tailored to deal with business ethical dilemmas relevant to the employees involved.

The organization's training programs attempt to make employees self-aware of factors leading to unethical decision making.

Monitoring

A person with authority and high status in the organization has primary responsibility for gathering information, monitoring and reporting on ethics and ethical compliance within the organization and recommending changes in the corporation's policies and practices as they relate to ethics and ethical compliance. .

The board of directors or a board committee periodically reviews reports, discusses, and makes decisions concerning organizational personnel, policies and practices relating to ethics and ethical compliance within the organization.

The organization periodically makes a self-assessments of its ethics, ethical climate, and ethical compliance record. ..

The organization conducts employee surveys that apply to the organization as a whole, divisions, departments and other relevant sub-unit, and employees at various levels and job-classifications within the organization.

The organization interviews employees, particularly on their exiting the organization, and conducts employee focus groups, to assess ethics and ethical compliance within the organization.

The organization provides a method for employees to report violations of the code which method provide for their anonymity.

The organization's employees periodically acknowledge their understanding and compliance with the organization's code of ethics.

The organization's leaders periodically certify that:

> !. Ethical behavior is highly valued in the organization and is as important, if not more important, in business decision making than profits;.
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> 2. The organization's climate encourages and supports ethical decision making by employees;
>
> 3. Ethical decision making is rewarded, and unethical decision making is not rewarded, in the organization: and
>
> 4. A reasonably system is in place to review, monitor and modify if necessary the corporation's ethical climate.

The organization when deemed advisable seeks outside audits and advice on the organization's ethics and ethical compliance.

The reference to "employees" include the managers of the corporation. The reference to "organizations" include divisions, departments or other relevant sub-units of the organization.