DEPARTMENT OF THE AIR FORCE
Arlington, Virginia 22203

Office of the Deputy General Counsel

GOVERNMENT TOOLS TO ENCOURAGE ETHICAL CONDUCT OF THEIR CONTRACTORS

Steven A. Shaw
Deputy General Counsel
US Department of the Air Force

Governments have obvious influence over the conduct of their corporate and individual citizens, exercised traditionally by criminal and civil prosecutions to incarcerate wrongdoers, and to impose monetary penalties. By those actions it is felt that those considering corruption will be deterred, and will behave responsibly. Those remedies are generally effective as to a limited number of persons, and only in those nations that have the resources and motivation to aggressively pursue wrongdoers.

This paper will discuss a number of economic incentives and disincentives that nations can offer to encourage citizens to behave honestly and ethically. The tools discussed in this paper are examples of those used by the US Government, in connection with its defense contractors. But there is no reason that these and similar tools cannot be used by all nation states to influence behavior in all industries.

Examples of some of the most effective features of ethics and compliance programs in the US defense industry will be discussed, and the paper will conclude with a call to action, to make values-based ethics a national priority within Government, to improve the ethical cultures of nations and their contractors.

I. Tools Governments Can Use to Discourage Corruption

The success of corruption in government contracting depends upon both the intent of contractors to make unlawful payments, and government officals' willingness to accept those payments. Actors on both sides of such transactions have committed unethical, if not unlawful acts, and need to be deterred, both internally within their organizations, and by external forces such as governments.

The tools discussed here address some external incentives that can be applied by governments to discourage wrongdoing by their contractors, and to encourage contractor organizations to

implement programs and processes to improve the cultures of their organizations so as to mitigate the risk of their employees acting improperly in the government contracting arena.[1]

A. Debarment of Contractors From Eligibility For Government Contracts

In one sense, the "hammer" of debarment can be viewed as a remedy similar to criminal and civil penalties intended to deter future misconduct. But in a broader sense, the fear of debarment by contractors – particularly those with significant revenues dependent upon government contracts – acts to encourage organizations to improve their ethical cultures in order to mitigate the risks that their employees will commit misconduct that would subject their companies to debarment.

In a nutshell,[2] debarment is the process by which the Government places the name of a company or individual on a public internet site which has the effect of prohibiting the award of any new contract to that person, effective throughout the US government. Every contracting officer in the federal government is required by law to check that internet site prior to awarding any contract. If the person's name is on that site, the contract may not be awarded.

Every US government agency and department has a "debarring official," who has the authority to enter a debarment (generally three years) against contractors, and to place their names in a searchable database. Such actions can be taken upon evidence of a broad range of misconduct establishing; (i) any criminal offense; (ii) any serious failure to perform, or history of failure to perform a government contract (whether intentional or negligent); or (iii) any other cause the debarring official determines to be so serious or compelling as to effect the responsibility of the contractor to be trusted with government contracts.

Prior to entering the final debarment, the official sends notice to the contractor advising it of the nature of the alleged misconduct, and provides an opportunity for the contractor to respond with information and argument, both in writing and in person. If the contractor raises a genuine dispute of material fact as to the information stated in the notice, the debarring official will then refer the matter to a judge who will determine the facts, based upon his review of testimony under oath, cross examination of witnesses, and other due process procedures. In the event a debarment is entered, the debarred contractor may contest the action in US federal courts, by alleging that the official abused his discretion, or otherwise acted contrary to law.

Following debarment, or in appropriate cases in lieu of debarment, the debarring official may terminate or defer the action, in consideration of the contractor's agreement to change its business processes, create or improve its ethics program and take other remedial actions to mitigate the risk that the misconduct will recur. Such is frequently reduced to writing in an "Administrative Agreement," requiring outside, independent oversight by a monitor or ombudsman who reports to the debarring official.

---

[1] Governments also need to act to improve the ethical cultures of their own departments and agencies. A "call to action" for governments to address those issues is set out below.

[2] A more detailed description of the US debarment process may be found in my paper, "Suspension and Debarment in a Nutshell."

Debarment and the threat of debarment create significant incentives to companies concerned with the potential misconduct of their employees to employ systems and programs improving the organizations' ethical cultures.

B. Debarment Regulations Encourage Compliance

The greatest impact of a debarment process is its ability to alter behavior of contractors, even where misconduct has not occurred and the contractor is not on the radar screen of the debarring official. In exercising discretion to debar or not to debar a contractor, the debarring official considers a number of "mitigating factors" set out in the US Federal Acquisition Regulation ("FAR"). Knowing that such factors will be considered in the future in the event the company gets into trouble, most sophisticated companies conform their behavior in advance so as to get "credit" for one or more of those factors.

The most significant factors in this context are:

- Whether the contractor had effective standards of conduct and internal control systems in place at the time of the misconduct, and prior to the time the government learned of the misconduct;
- Whether the contractor has instituted review and control procedures and ethics training programs;
- Whether appropriate disciplinary action has been taken;
- Whether the contractor has eliminated the circumstances within its organization that lead to misconduct; and
- Whether management recognizes the seriousness of this misconduct, and has implemented programs to prevent recurrence.

C. Government Policy on Charging Companies for Crimes Committed by Their Employees

An important feature of US federal law is that any organization may be charged and convicted of any criminal offense that was committed by any employee, so long as the criminal act benefited or was intended to benefit the company. This is a fearsome standard, as any organization, particularly large ones, will routinely have errant employees who cut corners.

The policy of the US Department of Justice ("DoJ") is not to charge the corporation every time one of its employees commits a criminal offense. In essence, DoJ in determining whether to charge a company with a crime will consider whether the company had an effective compliance and ethics program in place at the time the employee committed the federal crime and, most importantly, whether (i) the program was adequately designed for maximum effectiveness in preventing and detecting wrongdoing, and (ii) management is enforcing the program.

The Government does not take the company's word for the existence of such a program. DoJ demands evidence that (i) the company has provided sufficient staff, including audit and

program management resources, (ii) the employees are informed of the program and are convinced of management's commitment to it; and (iii) the program is sufficient to detect and disclose wrongdoing. If the Government determines that, among other things, the company has an effective program, it will charge only the employee, and will not criminally prosecute the company. This is a significant benefit to the company, in terms of its liability, resources and reputation.

D. US Law on Sentencing Organizations

Even where DoJ determines to charge and criminally prosecute a company for the criminal acts of its employee, the company, if convicted, may still benefit from having had an effective ethics program at the time of the commission of the crime.

Federal judges, in imposing criminal sentences upon organizations must choose a penalty within a monetary range set forth by US law in the "US Sentencing Guidelines." The range is computed mathematically, based upon a number of factors, such as the dollar loss suffered by the victim, the company's criminal history, and whether the company had an effective ethics program. Points are added to the calculation for crimes causing large dollar losses, and are subtracted from the calculation where it is found that the company had an effective ethics program.

Again, as with DoJ's decision whether to charge companies, US courts in this context also refuse to take a company's word for the effectiveness of its program. The following are a few of the factors judges consider in determining whether to lower a company's Guidelines score, so as to lower the range of the sentence that may be imposed:

- Board of Directors is responsible for the program;
- Ongoing compliance and ethics training;
- A process for employees to report violations;
- Management response upon learning of violations,
    - Discipline, disclosure to and cooperation with the Government
    - Evaluate sufficiency of ethics program and other processes;
- Monitoring the effectiveness of the program, by
    - Audits
    - Employee surveys, and
    - Risk management systems
- Management must actively promote an ethical culture, by
    - Having it be an element of performance ratings
    - Disciplining violators, and
    - Exhibiting ethical role modeling

Because of the large sentencing benefit that is given to organizations with effective ethics programs, companies are incentivized to insure the existence of such programs, even where there is no evidence that a criminal offense has been committed. By planning ahead in this way, companies will be prepared to make a strong case to the judge in the event of conviction at some future date.

E. Mandatory Clauses in Government Contracts

For several years the US Department of Defense has included clauses in large defense contracts encouraging contractors to have "effective" ethics programs. Although the Defense Federal Acquisition Regulation stated only that the contractor "*should"* have such a program, many companies chose to implement what their customers suggested.

The US Government as a whole decided in 2008 to go beyond what had been requested by the Department of Defense. The FAR now *requires* all US government agencies to include clauses in all large contracts, requiring contractors to have "effective" ethics programs. The description of the programs contractors are required to maintain is similar to that stated in the US Sentencing Guidelines; including requirements for training, procedures to detect and correct improper conduct, high-level management responsibility, commitment of sufficient resources, periodic reviews of the effectiveness of the program, a risk management process, and a reporting mechanism, such as an internal "hotline."

The FAR also now requires contractors to disclose certain misconduct, a requirement that essentially tests the effectiveness of many of the mandated features of an ethics program. Failure to make the required disclosure may subject the contractor to debarment. Many in industry view this as onerous, and unnecessary. The Government views this as required in order to further deter contractor misconduct, and to augment the Government's limited resources.

The importance to this discussion is that companies that don't have effective programs that will enable them to detect and report wrongdoing will be hard pressed to argue to the Government later that their failure to report their employees' violations to the Government was an innocent mistake. This is a strong incentive to insure that internal control systems and programs are in place and working, well in advance of the commission of any criminal violation.

II. An Overview of "Best Practices" of US Defense Contractors

Volumes have been written detailing the elements thought to be important to have in effective ethics programs, with little consensus, either between the Government and Industry, or within the Industry itself. The Government has attempted to list elements it considers important in a number of contexts, most notably in the US Sentencing Guidelines, DoJ charging policy and FAR clauses discussed above. It is useful in light of those detailed elements to consider three broad themes that incorporate many of those elements.

First, of greatest importance is the notion that no program can be effective unless it is designed to address the culture of the organization ("values"), rather than to merely train employees on the rules ("compliance"). Twenty years ago US companies that had programs of any kind, limited those programs to compliance. Attorneys trained employees to comply with US laws and regulations. Those programs have evolved over the years into "values-based ethics programs" that address culture through a holistic program that does more than train, and is not limited to rules. While it is important to encourage employees to obey laws and regulations, such an effort is only a sub-set of the need to encourage employees to "do the right thing," through values based training, and other important program features. The Government today gives little credit to companies having compliance-only

training programs. In fact, evidence of such programs is more frequently used by Government prosecutors and debarring officials against companies, as evidence of intentional wrongdoing and deliberate ignorance.

Second, the best companies exhibit a real commitment by Management to the program. Unless senior executives, including the Board of Directors, truly "get it," and sincerely communicate their commitment to employees, the program will fail, and the organization's culture will be one that will effectively encourage unethical behavior. Management commitment can be evidenced in a number of ways. Among other things, leaders lead by example. This includes the decisions they make, and the inclusion of notions of ethics in speeches, and in all they do throughout their daily activities.

Finally, another theme found in companies with effective ethics programs is whether the company has ethics officers empowered to further values within their organizations, and how those officers are used. Many US defense contractors today have designated ethics officers at every facility that can answer employee questions, provide advice on compliance and ethics, investigate complaints, and conduct training. The companies that are truly "best-in-class" do more.

The best companies' ethics officers don't do the training; they assist managers and supervisors at all levels to do the training themselves, so that employees will know that the person that matters to them – their immediate boss – truly wants them to behave ethically. Ethics officers are also used by the best companies to "sit at the business table" and to contribute their perspectives to all business decisions, not just those thought to relate to ethics. Lawyers have for years become imbedded into all business discussions, and have made valuable contributions even on issues not initially thought to require legal opinions. Companies that see the value to including ethics officers in business decisions receive similar benefits.

III. A Call to Action: Making Ethical Culture a National Priority

It is no secret that we face a crisis of trust. The people have lost confidence in public officials and those contractors who support the work of their government. No single incident generated this loss. Rather, it is the result of a series of ethical lapses. Each scandal over the last few decades has taken its toll and the government has responded by writing yet another law or regulation without identifying the underlying reason for the ethical failure. This simplistic approach and the accompanying proliferation of rules have not worked. Indeed, the scandals not only have continued, but are increasing in frequency. Individuals like Mel Paisley, Darleen Druyun, Jack Abramoff, Duke Cunningham, and Dusty Foggo all knew the rules. These individuals simply chose to ignore the rules, leading to a further erosion of confidence in government. The great tragedy is that too many people believe that a new law or regulation is the panacea.

While some rules governing conduct are necessary, governments unfortunately rely too heavily on rules to alter conduct rather than promoting a set of values that change behavior. As a result, governments and their suppliers have developed rules-centric environments rather than cultures based on values. This suggests that the problems we face today do not arise from a lack of rules. If we are to restore the confidence of the people in their governments, then our leaders must move away from this rule-reactive approach to one that instills a culture based on ethical values.

There are four fundamental values necessary to establish an effective ethical culture in any organization: integrity, trust, fairness, and respect. These fundamental values must become a way of life along with the complementary actions required to implement those values: responsibility, courage, and accountability. If governments and their contractors truly incorporate these values into everything they do and into every decision they make, they will create a culture that changes behavior and goes a long way to restoring the confidence and respect of the people.

Creating a more robust ethical culture is not easy. But our nations' leaders can create a new values-based ethical culture by taking ownership of this effort. Accordingly, I urge them to make the establishment of a new robust ethical culture a national priority. With this announcement must come long term dedication and commitment. This effort should not and must not become the obligation of one agency whose focus is on rules. National leaders must personally lead the effort to embed core ethical values in the daily life of every sector of their governments, and make the heads of their departments accountable to them for the success of the effort.

With such accountability, department heads must lead by example. A key element of this leadership includes ensuring that their managers and supervisors at all levels also lead by example and develop appropriate measures to incentivize their subordinates to act in an ethical manner. Furthermore, ethical behavior and efforts to promote organizational ethical culture must be factors in the performance appraisal of every government employee and the evaluation of contractors' performance. Finally, when the inevitable wrongdoing occurs, governments must first examine the culture for the underlying cause of the failure rather than presume a new law or regulation will solve the problem.

Over the last several decades, public confidence in government has continued to erode as each new scandal has resulted in a new round of rule-making. The solution is the creation and implementation of a values-based ethical culture. By making this a national priority heads of state will restore confidence in their governments and in their contractors.

Conference on Building Integrity
NATO 60th Anniversary
Monterey, California

27 February 2009