

# Questions—And Answers

## ***Creating and Implementing Codes of Ethical Conduct***

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In the wake of years of corporate malfeasance—from Enron to the 2008 financial crisis to the LIBOR (London Interbank Offered Rate) manipulation scandal—workplace codes of ethical conduct are more important than ever. The creation and implementation of codes of ethical conduct send a powerful message to employees and shareholders alike that unethical behavior will not be tolerated, and these codes are valuable even to companies free from allegations of wrongdoing. But without thoughtful drafting and application, as well as executive buy-in and support, codes of ethical conduct are worth no more than the paper they are printed on. The questions and answers below address why corporate codes of ethical conduct are important for all employers, when they are required, how they might be crafted, what they should consist of, and how they should be communicated to employees, including strategies to promote company-wide attention and compliance.

### **WHAT IS A CODE OF ETHICAL CONDUCT?**

Codes of ethical conduct are formal written documents articulating an employer's ethical standards and expectations, providing a set of rules and guidelines for employees to follow to conform with those expectations in the workplace. These codes set forth the employer's unique set of ethical norms and often reflect the workplace's culture. As such, each company's code of ethical conduct is unique. Codes of ethical conduct can not only help employers with legal compliance issues, but also create guidelines for smart decision making in the workplace.

## WHICH EMPLOYERS ARE REQUIRED TO IMPLEMENT A WORKPLACE CODE OF ETHICAL CONDUCT?

Companies that are covered by the Sarbanes-Oxley Act<sup>1</sup> and those whose stock is listed on the New York Stock Exchange (NYSE) or NASDAQ must have a code of ethical conduct. Under Sarbanes-Oxley, covered companies must publicly disclose (1) whether the company has adopted a written code of ethics that applies to the company's principal executive officer, principal financial officer, or controller, and persons performing similar functions; and (2) if the company has not adopted such a code, the reasons why it has not done so.<sup>2</sup> A company may either file a copy of the code as an exhibit to its annual report or post the text of the code on its website; if the code is classified as an undertaking in the employer's annual report, it must provide a copy to any person without charge upon request.<sup>3</sup> Additionally, every time the covered company amends its code of ethical conduct, it must disclose the change.<sup>4</sup>

The NYSE and NASDAQ have also promulgated their own rules mandating codes of ethical conduct for listed companies. NASDAQ Rule 5610 requires not only that listed companies comply with the Sarbanes-Oxley code of ethical conduct requirements, but also that the listed companies subject all directors, officers, and *employees* to the code.<sup>5</sup> Companies listed on the NYSE, like those listed on NASDAQ, must also promulgate a "code of business conduct and ethics" that applies to employees as well as company leadership.<sup>6</sup>

## DO CODES OF ETHICAL CONDUCT REALLY FOSTER ETHICAL BEHAVIOR?

Yes, if they are properly implemented. In a study performed by KPMG Forensic, 90 percent of surveyed employees who worked in a company with a code of ethical conduct reported that they felt "motivated to do the right thing," as opposed to 43 percent of employees who worked in companies without one.<sup>7</sup> Further, a 2009 Ethics Resource Center study determined that companies with strong codes of conduct experience less on-the-job retaliation, less misconduct, and a reduced rate of failure to report misbehavior.<sup>8</sup> Additional benefits of codes of ethical conduct include a reputation for honesty and transparency among shareholders, as well as fewer fines, penalties, and legal actions taken against the employer.<sup>9</sup> However, comprehensive commitment to making the policy work at all levels is a necessary part of the equation—after all, Enron also maintained a code of ethical conduct before it collapsed.<sup>10</sup>

## WHAT STEPS SHOULD AN EMPLOYER TAKE TO BEGIN DRAFTING A CODE OF ETHICAL CONDUCT?

Even if an employer is not required to maintain a code of ethical conduct by law or rule, these codes are excellent tools to establish straightforward expectations for honest employee conduct and to shape corporate culture. It is vital for employers to understand their current company culture before crafting a code of ethical conduct that will apply in any sector. Before you start drafting, consider the needs of your workforce. Take steps such as conducting a values survey among employees and managers or inviting employee participation in focus groups that make recommendations for code development. These surveys and focus groups can help employers create a relevant, realistic code from the outset because they provide a clearer view of employee values and expectations. Further, be sure to collaborate with company leadership during the drafting process and request input on the code from a high-level perspective. This strategy promotes executive "buy-in" on the code when it is complete.

## WHAT SHOULD BE INCLUDED IN A CODE OF ETHICAL CONDUCT?

Many parties, including regulatory bodies, the US legislature, and commentators have made recommendations regarding what should be included in an employer's code of ethical conduct. Ethical codes of conduct are not "one size fits all," and employers should carefully select which aspects are most appropriate for a given workforce. However, the elements below are basic and commonly recommended for inclusion:

- A definition of honest and ethical conduct and the employer's ethical values;
- A statement that the employer is committed to ethical conduct in the workplace and endorsements from company leadership;
- Guidelines on how to handle conflicts of interest in personal and professional relationships, including hypothetical examples of problems that might arise;
- Requirements for complete and accurate recordkeeping, retention, and disposal;
- Gift, meal, services, and entertainment policies;
- Prohibitions on employee sharing of intellectual property or confidential information;
- Prohibitions on the use of company property for personal use;

- ❑ A requirement for prompt internal reporting of actual or suspected code violations to person(s) named in the code, and adequate protections to keep such reports confidential (whistleblower protections); and
- ❑ An enforcement mechanism that ensures quick and consistent enforcement, objective standards for compliance, and fair process for identifying and handling violations.

## **HOW SHOULD A CODE OF ETHICAL CONDUCT BE COMMUNICATED TO EMPLOYEES?**

The best way to communicate the contents of a code of ethical conduct to employees is directly. For instance, an employer may choose to send a copy of the code to employees, provide a copy of the code to new employees, or visibly post the code on internal and external websites, preferably under the "About Us" section.<sup>11</sup> Remember to update employees each time the code is amended. Codes that include a clear table of contents,<sup>12</sup> are easy to understand, and are visually appealing are more likely to be read and used by employees.<sup>13</sup> Be aware of employees who may not speak English, and translate the code into key languages to ensure effective transmission of the message to everyone.<sup>14</sup>

The strongest codes of ethical conduct are comprehensive and written in clear, easily understandable language – not "legalese."<sup>15</sup> The language of effective codes should also be easily accessible to employees at every level and written plainly, clearly, and sensibly. With such clear language, strong codes address common company activities<sup>16</sup> and provide examples of appropriate conduct in predictable situations. Finally, employers should include clear descriptions of enforcement systems and protection for whistleblowers and back up the language of the document by consistently adhering to and enforcing that system.<sup>17</sup>

Employers should also do more than just give the code to employees. Companies creating a code for the first time should conduct company-wide training sessions to inform employees about the requirements of the code and answer any questions or concerns employees might have. If an employer already has a code of ethical conduct, it should enhance the code's message by conducting annual training sessions summarizing the code. Training sessions should cover the code's goals and how the code is administered, as well as a description of applicable reporting systems for known or suspected violations. Ideally, sessions in either setting should be conducted by management to express high-level commitment to ethical behavior in the workplace.<sup>18</sup> Both in-person and online training sessions are effective, and online courses reduce the need to travel to distant office locations. Additionally, remember that employees will not memorize the

code, so provide broad guidelines to help them evaluate situations that arise at work in everyday life. For instance, advise employees to ask questions of themselves before taking action, such as "Would I want this in the newspaper?" or "Will this action discredit me or the company if someone finds out about it?"

### **DO MULTINATIONAL EMPLOYERS NEED MORE THAN ONE CODE OF ETHICAL CONDUCT?**

No, but consider the best way to use a code of conduct drafted in the United States in other countries. International workplaces have different languages, cultural norms, and methods of effective communications. For instance, many countries have differing views about issues that could be included in a code of ethical conduct, such as bribery, alcohol, and language. Employers with a large international presence should consider implementing a broader or more universal code that can easily be tailored for use in other countries to avoid possible cultural differences that might result in employees disregarding or consistently violating the code over time.

### **HOW CAN EMPLOYERS ENSURE THAT EMPLOYEES PAY ATTENTION TO THE CODE?**

An employer can draft the strongest code of ethical conduct on the market, but employers must do more to make sure that it isn't just another piece of paper to employees. One of the best ways to accomplish this is executive buy-in. Without participation and compliance from executives, employees might perceive the code as toothless or as impediments to business goals.<sup>19</sup> Ensure that high-level management embraces and embodies the code to show employees that the code is important.<sup>20</sup> Additionally, include a preface to the code of ethical conduct that sets forth company leadership's commitment to ethical conduct, such as a letter from a high-level executive. It is only with this kind of top-down commitment that a code of ethical conduct will become a vital part of an employer's culture and an "organizational imperative."<sup>21</sup>

Finally, consider rewards for ethical behavior in the workplace or recognition for compliance with the code. For instance, an employer could send periodic company-wide e-mails praising particular employees for behavior consistent with the organization's ethical values. These reminders keep the code at the forefront of employees' minds and reiterate the employer's commitment to embracing the document's text as a way of life in the workplace.

## NOTES

1. Public companies, public company boards and management, and public accounting firms are covered by Sarbanes-Oxley. Some portions of the law also apply to privately held companies. US Securities and Exchange Commission, *The Sarbanes-Oxley Act of 2002 (2002)*, <https://www.sec.gov/about/laws/soa2002.pdf>
2. US Securities and Exchange Commission, *Disclosures Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002 (Jan. 24, 2003)*, <https://www.sec.gov/rules/final/33-8177.htm>
3. *Id.* If a company chooses the Internet-posting option, the company must also disclose its Internet address and intention to provide disclosure in this manner in its annual report on a Form 10-K, 10-KSB, 20-F or 40-F.
4. *Id.*
5. NASDAQ, *Corporate Governance Requirements (July 22, 2010)*, [http://nasdaq.cchwallstreet.com/nasdaq/main/nasdaq-equityrules/chp\\_1\\_1/chp\\_1\\_1\\_4/chp\\_1\\_1\\_4\\_3/chp\\_1\\_1\\_4\\_3\\_8/default.asp](http://nasdaq.cchwallstreet.com/nasdaq/main/nasdaq-equityrules/chp_1_1/chp_1_1_4/chp_1_1_4_3/chp_1_1_4_3_8/default.asp)
6. New York Stock Exchange Manual, *Corporate Responsibility*. Retrieved December 16, 2015, from [http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp\\_1\\_4/default.asp](http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_4/default.asp)
7. Magloff, L. What is the code of business conduct? *Houston Chronicle*. Retrieved December 16, 2015, from <http://smallbusiness.chron.com/code-business-conduct-2732.html>
8. *Id.*
9. AQ1 Schwartz, M. S., et al. (2014). *Creating a code of conduct: Providing guidance for an ethical workplace*. Aspatore Books & ExecBlueprints. [http://www.acolyst.com/wp-content/uploads/2014/09/ExecBlueprints-Creating\\_a\\_Code\\_of\\_Conduct\\_67773.pdf](http://www.acolyst.com/wp-content/uploads/2014/09/ExecBlueprints-Creating_a_Code_of_Conduct_67773.pdf)
10. McMillan, M. (2012, February 20). *Codes of ethics: If you adopt one, will they behave?* CFA Institute. <https://blogs.cfainstitute.org/investor/2012/02/20/codes-of-ethics-if-you-adopt-one-will-they-behave/>
11. Lunday, J. (2010, August 18). *What a code of conduct "says" about a company, corporate compliance insights*. Retrieved from <http://corporatecomplianceinsights.com/what-a-code-of-conduct-%E2%80%98says%E2%80%99-about-a-company/> (recommending this location because it shows "that the company sees the code as not simply a regulatory filing but rather a more strategic document that helps indicate the company's identity").
12. *Id.* ("Topic listing displays an awareness of ethics in all aspects of an organization's activities.").
13. *Id.*
14. See note 9.
15. See note 11.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*

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