



SOCIETY OF CORPORATE
COMPLIANCE AND ETHICS

Third-Party Codes of Conduct: A Benchmarking Survey

by Rebecca Walker, Esq.

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Third-Party Codes of Conduct: A Benchmarking Survey

by *Rebecca Walker, Esq.*



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For many organizations, the existence of compliance and ethics programs—and the application of a company’s code of conduct and other policies to *employees* through those programs—has become the norm. Compliance programs seek to mitigate the risk of misconduct by, in part, defining a company’s standards and requirements via policies and other documents, and educating employees about those standards and requirements via training, communications, and other compliance “tools” that have been developed over the years. Of course, it is not only *employees* who create risks for organizations. Organizations are also subject to risks of misconduct by virtue of the actions of agents and other third parties who act on their behalf or partner with the organization in some way. One need look no further than recent prosecutions under the Foreign Corrupt Practices Act to understand the substantial risks that can be created by non-employees of an organization.

However, the extent to which organizations can and should extend their compliance and ethics programs (or various elements of them) to third parties continues to be the subject of some debate. It is also the subject of the first in a series of benchmarking columns that will appear in *Compliance and Ethics*.

By way of a side note, benchmarking is particularly important for compliance and ethics professionals because the standards in this field are, to a large extent, created in-house by compliance and ethics practitioners

themselves. In other words, government standards tend to reflect compliance and ethics initiatives developed by corporations and other organizations, so that the standards to which organizations are held are often a reflection of compliance and ethics practices within organizations. This is reflected in the Federal Sentencing Guidelines, which provide that, in determining what specific actions are necessary to meet the Guidelines’ requirements, the government will consider (among other things) applicable industry practice. The Guidelines further provide that an organization’s failure to incorporate and follow applicable industry practice will weigh against a finding of an effective compliance and ethics program. This makes knowledge about what others are doing particularly important, hence the importance of compliance and ethics benchmarking.

As mentioned above, this month’s benchmarking questions (on the extension of codes of conduct to third parties) is an important issue for many organizations. Companies continue to grow more dependent on relationships with third parties, from joint venture partners to agents to suppliers of goods and services to temporary employees to contractors. Third parties are necessary to do business for a variety of reasons, and they can also help reduce costs for organizations, as well as barriers to entry. However, while third-party relationships are essential to businesses, they also expose organizations to legal and reputational risk.

In recent years, the government has provided some incentives for organizations to extend compliance to third parties. For example, in the 2004 revisions to the U.S. Sentencing Guidelines for Organizations, commentary was added that provides that large organizations should encourage small organizations (especially those that have, or seek to have, a business relationship with the large organization) to implement effective compliance and ethics programs.¹ The Guidelines also discuss third-

party compliance in its definition of an effective compliance and ethics program. In the area of training and communication, the Guidelines provide that organizations shall periodically communicate their standards and procedures to employees, directors and *agents*,² as appropriate, by conducting effective training programs and otherwise disseminating information appropriate to their roles and responsibilities.³ Likewise, in the area of auditing and monitoring, the Guidelines provide that an organization must take reasonable steps to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees *and agents* may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.⁴ In addition, recent federal acquisition regulations create *requirements* for government contractors to, in turn, require certain compliance measures, such as codes of conduct, from certain types of third parties.⁵

Despite these government incentives and mandates and the risk mitigation that can occur through extension of compliance measures to third parties, companies should nonetheless be cautious in this endeavor. In particular, companies should be careful not to create compliance and ethics standards that are difficult to monitor or enforce and that could potentially create their own risks of "associative liability." Extending compliance and ethics obligations to third parties could lead to reputational harm when a company holds itself out as requiring others' compliance, when in fact the company's ability to ensure compliance by third parties may be limited, a problem which could be compounded if the third-party compliance requirements more closely link the company to the third party in the minds of the public (and press). There is also a risk that unsatisfied standards could be used against a company in the context of litigation or a government investigation.⁶

There are, of course, numerous ways in which to extend compliance and ethics requirements or expectations to third parties, including:

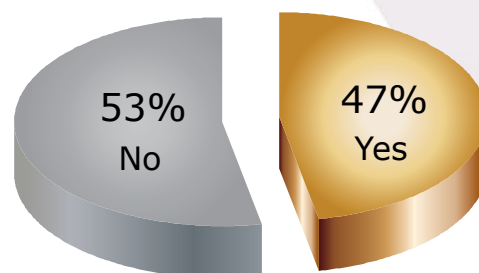
- Due diligence regarding potential business partners' compliance and ethics programs.

- Incorporating language into contracts with third parties requiring compliance with laws generally and with specific legal prohibitions, such as in the areas of bribery, environmental compliance, and child labor.
- Requiring third parties to report suspected misconduct and disseminating information to third parties regarding reporting procedures, such as the helpline.
- Communicating company policies to third parties, such as through letters to third parties regarding the company's gifts and entertainment policies.
- Training third parties on the ethics and compliance program or on particular company policies or procedures.
- Auditing third parties.
- Distributing the company's internal code of conduct or a third-party code to third parties.

The Survey

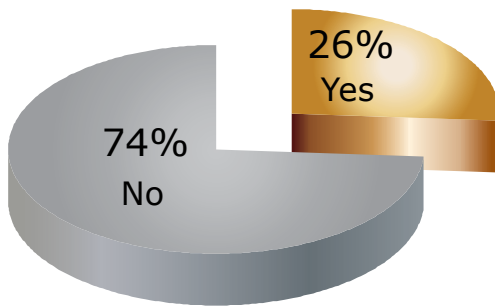
In January 2009, SCCE sent a random survey to compliance professionals. The benchmarking survey focused on codes of conduct. More than 400 people responded. The questions asked and responses received include:

1. Does your organization disseminate its internal, employee code of conduct to third parties?



47% of responding companies stated that their organization does disseminate its internal code of conduct to third parties, and 53% said that their organization does not.

2. Does your organization require third parties to certify to its internal, employee code of conduct?

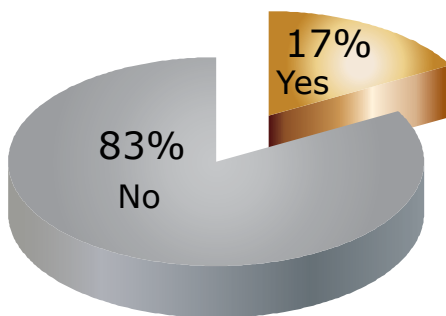


26% of responding organizations require third parties to certify to their codes, and 74% do not.

3. If yes, what dollar threshold of business between your company and a third party must be reached before the third party is required to certify to your organization's internal, employee code of conduct?

92% of respondents said they have no threshold.

4. Does your organization have a third party code of conduct that is applicable to third parties only (and not to employees)?



17% of respondents do; 83% do not.

The number of companies that disseminate their own code of conduct to third parties is fewer than half. In addition, only 17% have implemented a third-party code.

Conclusion

Regardless of where your organization is with respect to extending compliance and ethics standards to third parties, it seems likely that this is an area where organizations will continue to expand their efforts as government incentives and risk mitigation benefits become clearer. However, as noted above, companies are well advised to exercise caution in this area—extending standards and requirements to meet specific risks and in ways that can be monitored and enforced without creating additional risks of associative liability.

NOTES

1. United States Sentencing Guidelines Manual § 8B2.1(b), cmt. 2(C)(ii).
2. An “agent” is defined as “any individual, including a director, and officer, and employee, or an *independent contractor*, authorized to act on behalf of the organization.” U.S. Sentencing Guidelines Manual § 8A1.2, cmt. 3(d) (emphasis added).
3. U.S. Sentencing Guidelines Manual § 8B2.1(b)(4) (2005).
4. United States Sentencing Guidelines Manual § 8B2.1(b)(5) (2005) (emphasis added).
5. FAR 52.203-13, 72 Fed. Reg. 65,868 (Nov. 23, 2007).
6. For additional information, see Rebecca Walker, “Extending Compliance Requirements to Suppliers and Other Third Parties,” *ethikos*, at 1 (May/June 2006).

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