

The Sentencing Guidelines: A 'still developing' picture

by Jeffrey M. Kaplan

How have the corporate sentencing guidelines—the seemingly obscure law that triggered a mini-revolution in the ethics/compliance sphere—been applied to corporations? While lacking the “clarity of an Ansel Adams or Dorothea Lange,” a picture is beginning to develop, Winthrop Swenson, Deputy General Counsel of the U.S. Sentencing Commission, told the Conference Board’s Seventh Annual Business Ethics Conference, held in New York City on May 2 and 3. That picture supports the prudence of those companies that have responded to the guidelines by implementing compliance programs. It also offers some pointers on compliance pitfalls that may be useful for designing and implementing programs.

First, what are the basic numbers? Swenson noted that the volume of guidelines sentencing is still small, owing to the Justice Department’s decision not to apply the law retroactively (that is, to cases involving offenses occurring before the law’s November 1991 effective date). Fiscal year 1994 saw only 86 corporate guidelines sentencing—fewer than the 300 to 400 that, according to past practice, the Sentencing Commission eventually expects to see, but a steady increase from the three prior years. The average fine in 1994 was approximately \$420,000, the average fraud fine about \$1,000,000 and the highest single fine \$15.5 million (involving an environmental fraud offense).

Four cases where the compliance program was considered

Swenson reported that there have apparently been just four prosecutions where a defendant’s compliance program was considered by the court. In only one of these did the company receive credit for having “an effective program to prevent and detect violations of law” (the guidelines’ phrase for a qualifying compliance program).

This case involved a small, thirty-employee firm, in the business of selling novelty products, which was convicted of illegal sales of drug paraphernalia. Before its offense, however, the company had made a videotape to train employees regarding sales of products

The new law is beginning to have a 'shadow effect,' impacting cases other than those brought directly under the guidelines.

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The average fine in 1994 was approximately \$420,000, the average fraud fine about \$1,000,000 and the highest single fine \$15.5 million.

that might be used illicitly. The court gave the defendant credit for having an effective compliance program. Although certainly not as elaborate as many compliance procedures, this videotape was deemed sufficient given the company's size and the nature of its business.

In the three other prosecutions credit was denied: one because a senior official was involved in the offense; a second because a senior official was aware of the offense; and the third because, although the defendant corporation did have a compliance program, the offense occurred at two newly acquired facilities that did not have such programs before their acquisition. The first two cases underscore the critical importance of a program involving top managers. The latter highlights the need to focus on compliance when acquiring new lines of business.

The reason that so few of the guidelines cases have involved compliance issues, Swenson said, is that the overwhelming majority of prosecutions to date have been of small, closely held corporations in which an owner was personally involved in the offense (a fact which, under the guidelines, precludes compliance-program credit). However, because larger cases often take longer to investigate, indict and bring to judgment, more prosecutions involving compliance issues may soon emerge.

Although compliance issues have yet to impact corporate fines to any significant degree, the same is not true of the other controversial aspect of the guidelines—probation. Fifty-eight percent of organizations sentenced in fiscal year 1994 were placed on probation, and a full fifth of these were ordered to implement compliance programs.

A 'shadow effect'

Even more significantly, the new law is beginning to have what Swenson termed a "shadow effect," that is, impacting cases other than those brought directly under the guidelines.

One such "shadow effect" prosecution involved *National Medical Enterprises* (now Tenet Healthcare Corporation), whose psychiatric hospitals division pleaded guilty to making unlawful kickbacks to gain referrals. Not only did

the company pay \$325 million in civil penalties plus \$33 million in criminal fines, it was also required to adopt a compliance program "unprecedented in the health care area." The settlement requires the company to open its books to government inspectors and to allow government interviews of its employees. It also requires independent review of both billing, and of the necessity of care in areas beyond those involved in the company's offense. The settlement also contains very detailed requirements on structuring compliance oversight, training and employee/contractor screening.

Other "shadow effect" criminal cases are the prosecutions of *Lucas Aerospace*—involving a conviction for falsifying testing data on missile launcher components, where highly detailed compliance requirements were imposed tracing the guidelines "seven-step" definition of an effective program; *C.R. Bard*, a fraud case regarding human heart catheters, the settlement of which also entails guidelines-type compliance requirements; and *Con Edison*, a prosecution for failing to report the release of asbestos, where the court appointed a monitor to oversee the company's compli-

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What's in a name? Plenty, when the subject is hotlines

One thing about an ethics hotline: "It should never be called a hotline." Why not? "The term conveys the impression that it could be a snitch line," says William Redgate. The best decision may be not to name it at all. "Better to call it an 800 number."

Redgate, Vice President for Business Practices at Dun & Bradstreet, imparted this advice at a meeting on hotlines at the Conference Board's Seventh Annual Business Ethics Conference, held May 2 and 3 in New York. Among other "dos and don'ts," according to Redgate:

- "If the purpose is to present the hotline as an alternate channel of communications, make that clear to all."
- "Don't over-emphasize statistics. You're not running a production shop."
- "Try to get problems resolved at the lowest level of management possible."

And if a hotline is too successful, warns Redgate, it may become independent, "which is inconsistent with values-based management." Hotlines, says Redgate, "are a necessary tool, but only one of the tools in an overall strategy." The real answer is for managers to be more accountable, from the top to the bottom.

Sears Roebuck's hotline

Redgate was one of four presenters at the hotline session. Another, Sears Roebuck & Company's Resolutions Manager Ed Schloesslin, observed that Sears' ethics hotline, established in 1993, is currently logging 15,000 calls a year from employees. Only a small number of callers are actually reporting instances of wrongdoing.

Most calls deal with human resources concerns. But that is fine with the retailer. Sears has sought to measure the success of its hotline by "how many people we help rather than how many we catch," says Schloesslin. The company sees it more as an "assist" line rather than a "snitch" line.

Interestingly, Sears has elected not to establish a 24-hour hotline that would allow employees to report problems at any time of day. Why not? The company didn't want to by-pass management, particularly store management. "Sears believes that a 24-hour hotline is how you get an 800-SNITCH-line," says Schloesslin.

When Sears trains its hotline operators, the company brings in people from the legal, human resources, audit, loss prevention, and operations departments as guest speakers. It is important for hotline operators to know how each of these department works.

Some Sears managers were initially skeptical about the hotline. They suspected that it would undermine their authority. But the first question that operators are trained to ask is: Have you gone to your immediate superior?

About 30-35 percent of the calls are "legitimate ethics issues," says Schloesslin, who

A senior United Technologies manager was convicted and sent to jail after embezzling \$400,000 from the company. He was caught as a result of a hotline call.

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adds that the breakdown of calls is 43 percent human resources-type concerns, 42 percent general guidance questions, 10 percent loss-prevention issues, and 5 percent substance abuse issues, code of conduct questions, and assorted other concerns.

Sears takes anonymous calls on its hotline. In such an instance, the caller will be issued a case number so that the case can be tracked. But the hotline operator will tell the caller that anonymity may limit the amount of action that can be taken.

'You can get a lot of trivia'

Many companies find that most hotline contacts are usually not of earth-shaking import. "You can get a lot of trivia on the hotline," says United Technologies Corporation's Corporate Ombudsman Tom Furtado, things like "Where can I get an annual report?"

But Furtado has gotten more serious calls as well, like the one about the manager who put an employee's desk in the middle of the work "shed" as punishment. The message was: "Don't mess with me." Another UTC senior manager was convicted and sent to jail after embezzling \$400,000 from the company. He was caught as a result of a hotline call. United Technologies has also headed off sexual harassment cases and age discrimination cases that might otherwise have been dealt with in court, notes Furtado. "They protect your reputation." Problems are dealt with internally.

UTC avoids the term "hotline" too. "Most employees call it an 800 number," says Furtado.

About 75 percent of hotline calls focus on what Furtado call "people" issues. These may or may not have an ethical dimension. About 15 percent of calls deal with policy issues, like UTC's smoking policy. Seven percent of contacts deal with what UTC calls business issues, and 3 percent touch on legal and compliance matters. The last figure is low because UTC has separate compliance hotlines.

The ombudsman hotline at Dun & Bradstreet, like others, relies on "privilege." The ombudsman promises employees confidentiality. Ombudsmen have gone to court

to protect that privilege, noted both Furtado and Redgate in their presentations. (Furtado is also president of the Ombudsman Association, Redgate is president of the Ethics Officers Association.)

While Redgate runs the corporate ombudsman hotline at D&B, the company also has hotlines in its operating units. People may favor the corporate line for the higher visibility they think it affords. And some questions, like benefits, are simply more properly dealt with at the corporate level. On a busy day Redgate may receive four or five calls. Other days he may get none at all. About 70 percent of calls are human resources issues, 30 percent business practices issues.

Are they trusted?

Hotlines, of course, have their critics. Even though the idea may be good, the problem with hotlines to date is that "employees don't trust them," says John R. Phillips, partner, Phillips & Cohen, Washington, D.C., who represents a number of corporate whistleblowers. "They feel that they will suffer professionally if they embark on a course of action that points out ethical problems in the company. They don't feel that they will be treated properly." And they doubt that the anonymity promised is for real, says Phillips. "With an 800 number, the company can tell where the call originated."

Other doubts arise in the minds of employees. "Will the person making the complaint be listened to carefully. And will something be done? People don't believe that either.

"If you complain internally, and go through the internal compliance program, companies are always trying to do damage control, which undermines the whole program."

The reality, continues Phillips, is if an executive discovers that some impropriety or mistake means that the company has to pay the government \$50 million for overcharging, say, that becomes an effective career-stopper. "It hurts your career advancement if you uncover something that requires a \$50 million payment to the government."

"I think there are problems with any hotline/guideline," says Michael Hoffman, Executive Director of the Center for Business Ethics at Bentley College. "People's anonymity may be violated. One terrible incident could happen if someone isn't careful. You only need only one case like that and you've blown the whole thing."

In response to these potential problems, some companies go to some lengths to ensure confidentiality. At United Technologies, for instance, the Chairman made it a rule: No one was to receive a telephone bill that contained phone

numbers of origin (that typically accompany an 800-line telephone bill). Thus, callers could not be identified.

24-hour access

UTC has 24-hour “access” to its corporate hotline. This is important because people call from places like Europe and Alaska. But security remains a preoccupation. Initially, the company used voice mail when employees called at odd hours. But that made Furtado uneasy. He’d had the experience of receiving other people’s voice mail by mistake.

“It presently rolls over to my home.” That is, phone calls bounce from company headquarters to Furtado’s house. Some callers receive an immediate response if they call in the evening or on weekends while Furtado happens to be working in his study. During one such night-time conversation a caller asked him: “Don’t you ever go home?” Others may have to wait until he gets to his answering machine.

“There are always going to be skeptics,” says Redgate, “but the quickest way to build trust is word of mouth.” If someone resolves a safety issue by calling the hotline, for instance, that person tends to talk about it afterward. That individual is proud of what he or she did and wants to take credit. “That builds trust.”

Nonetheless, “We should all strive to eliminate hotlines,” Redgate adds, although not for the reasons cited by critics. Redgate, who reports to the CEO of the \$5 billion company, observes that “everyone in the company is responsible for values, especially managers. The necessity for the hotline is the result of management’s not living up to its responsibilities.”

Still needed in 1995

Corporations probably still need hotlines in 1995, though. “None of us is naive enough to believe we’ve achieved perfection,” says Redgate. Hotlines, he says, “are a necessary tool, but only one of the tools in an overall strategy.” The real answer is for managers to be more accountable, from the top to the bottom.

Some companies put in hotlines for “insurance,” Redgate adds. If hotlines are used continuously, in high volume, it suggests to him that the ordinary human resources function is not working. (He says this as one who spent the best part of his career in human resources.)

Adds Furtado: “The thing that kills Human Resources is when someone goes down the hall to have a confidential discussion, and when he comes back is met at the door by his manager who says, ‘Let’s talk about what you just discussed in human resources.’”

The ombudsman hotline at Dun & Bradstreet, like others, relies on ‘privilege.’ The ombudsman promises employees confidentiality.

Human Resources departments have typically sought a “control” function versus a “facilitating” function, notes Furtado. “That’s what killed HR when I was there.”

Anonymous calls

All agree, however, that there are risks associated with hotlines. “You have to look out for the anonymous call,” says Furtado. If a company is undergoing downsizing, for instance, that often “leads to people fighting for their lives. They will use any tactic.”

Anonymous hotline calls tend to follow a certain pattern, however. “You can count on certain people calling the hotline when the moon is full,” says Furtado.

“When we get one anonymous report”—e.g., Joe is having an affair with Jane—“I don’t investigate,” he explains. Why not? An investigation might ruin a person’s reputation. And he would be suspicious if he were to receive several anonymous calls in a single day.

On the other hand, if Furtado were to receive six anonymous reports over a period of time, he probably would launch an investigation. And he would investigate a single, anonymous report if a person’s life were threatened.

But there remain impediments to hotlines that may run even deeper. “In our society there is something ingrained in us that says, ‘We ought not to snitch on people,’” says Hoffman. For example, “If Johnny cheats on an exam, you ought not to run up and tell the teacher.”

Hoffman attributes some of this to America’s individualistic tradition. “If you see yourself as having responsibility to the community, then you have to report violations of the community’s principles. But it’s a difficult process to turn the myth of the despicable tattle-taler into a moral hero.” The idea of the hotline is that one has a responsibility to see that the community remains, says Hoffman.

Hotlines “allow people to speak up about things that matter,” says Furtado. “When you have a manager who calls Italians in his department ‘wops,’ or one who puts an

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Sundstrand Corporation's Responsible Executive program

As noted in this issue's lead story, the federal Organizational Sentencing Guidelines have spurred a mini-industry in the corporate ethics and compliance area. Many companies are revisiting programs. Do they pass muster under the sentencing guidelines? If not, where can they improve?

One company that has taken an innovative approach in this area is the Sundstrand Corporation, a \$1.6 billion (sales) aerospace company based in Rockford, Illinois. It has developed a Responsible Executive program that attempts to create managerial accountability in all major risk areas. The program, which debuted in 1994, has since been copied by other defense contractors, including McDonnell Douglas and General Electric.

Sundstrand has had an ethics program since 1986. But with the sentencing guidelines, which took effect in 1991, "we felt we had to beef up the program," says Harlan W. Knuth, Director, Business Conduct and Ethics.

The company is perhaps more sensitive than most to such issues. It was touched by scandal in the 1980s, pleading guilty to defrauding the government in Navy and Air Force contracts. It was suspended as a contractor by the Department of Defense in 1988. The company's suspension was lifted in January 1989, at the same time it settled with the government for \$200 million. This was the largest military fraud settlement ever at the time. (See *ethikos*, November/December 1990.)

The Responsible Executive program takes its impetus from the sentencing guidelines' seven-part due diligence standards. The second item reads: "Specific individual(s) within high-level personnel of the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures."

Identifying risk areas

Sundstrand began by identifying eleven significant risk areas within the company. These were: 1) antitrust 2) copyright 3) employment 4) environment 5) FAA 6) government contracts 7) import/export 8) industrial security 9) political activities 10) securities 11) taxes.

Within each broad area, Sundstrand identified specific areas of risk. In the government contracts area, for instance, these included "standards of conduct," "product conformance" (i.e., quality), "pricing and estimating," "cost accounting standards and cost principles; labor charging," and "contract financing and payment."

The company then gathered the "controlling documents" that apply to each area. These can be company documents, such as corporate policies and procedure codes, as well as external documents, such as government statutes and rules.

Next, the company assigned a "responsible executive" for each area—usually a high level executive. Assisting the executive are several "functional experts." Overall, there are seven Responsible Executives. (Some handle more than one area.) There are usually three or four functional experts under each executive.

The program's first year was a 'learning experience' for the executives. It was in large part a data-gathering exercise.

The FCPA

One of the specific areas within the larger risk area of “securities,” for instance, is the Foreign Corrupt Practices Act. In this instance, the applicable internal document is Sundstrand’s corporate code, specifically the sections of the code that deal with “Business with Foreign Governments,” and “Corporate Policy 1-5-6, Foreign Corrupt Practices Act.” The “external” document is a federal statute, Public Law 95-213.

Sundstrand has assigned two responsible executives for the FCPA: its Vice President and General Counsel, and its Vice President and Controller. The functional expert is the company’s Assistant General Counsel, Litigation.

Another example: An area of risk within the “government contracts” area is Contract Financing and Payment. This area has two responsible executives, the Vice President of Contracts, Compliance and Management Services, and the Vice President of Finance. Functional experts include the Manager of Contract Compliance and Estimating, and the Manager of Contracts.

As for documents: the relevant sections in the company’s code of conduct address the need for “complete and accurate accounting books and records; pricing, negotiation and contract performance.” There is also a list of 14 potential criminal violations associated with this area of risk including “Criminal RICO—18 USC Sections 1961-1968” and “Anti-Kickback Act of 1986—41 USC Sections 51-58.”

Responsible Executives must complete a seven-question checklist for their areas of risk. The list follows the seven-part due diligence section in the guidelines. The first question asks: “Have compliance policies, procedures, and/or practices been developed and implemented for employees and other agents that are reasonably capable of reducing the prospect of noncompliant or criminal conduct?”

The responsible executive checks either “yes” or “no” and is then directed to “list and attach policies, procedures, and/or practices.”

The second question on the checklist: “Has a specific individual(s) in a high-level and substantial authority position been assigned to oversee compliance with the policies, procedures, and/or practices in Question 1 above?”

After checking off “yes” or “no,” the responsible executive is asked to “identify individual(s) by operating unit.”

The checklist ends: “Should an alleged or actual criminal violation occur in this area, I will immediately notify the Director of Business Conduct and Ethics.

“To the best of my knowledge and belief, the statements

‘We’ve had no problems getting the CEOs (past and present) to embrace the program.’

made herein are true and accurate.”

The executive then affixes his signature and the date.

Meeting with the committee

The Responsible Executive also appears before the company’s Corporate Business Conduct and Ethics Committee each year. He or she spends anywhere from five minutes to an hour with the committee, which is headed by the corporation’s vice president and general counsel. The committee is updated on the risks.

According to Knuth, the program’s first year, 1994, was a “learning experience” for both the Responsible Executives and the functional experts. It was in large part a data-gathering exercise, with the data being turned over to the law department. In future years, the company will not go through the major data-gathering process annually but will focus instead only on those areas that have changed.

What have they gained from the process? “Absolute heightened awareness,” says Knuth. They identified weaknesses in their compliance processes. The response from the executives themselves has been “absolutely positive,” says Knuth. The company went through rigorous reviews with the government in the late 1980s—so they had looked at their processes before—“but this reinforces what we know.”

Sundstrand’s government contracting scandal in the late 1980s took its toll. That explains to a large degree why the company takes compliance and ethics so seriously now. “We had a lot of growth,” says Knuth, referring to the general awareness about compliance and ethics. “A lot of employees wrapped around the program. We’ve had no problems getting the CEOs (past and present) to embrace the program,” which isn’t always the case at large corporations. “That has had a major impact. When the CEO embraces it, it isn’t difficult to drive the process.”

Knuth says the time commitment on the part of the Responsible Executives isn’t really burdensome, although the data-gathering process in 1994 did require a fair bit of time. In any event, “ethics and compliance is seen as another daily activity” at Sundstrand.

His advice to other companies contemplating such a program? “Go into it in a positive light; look at it as a means of continuous improvement.” ■

A report on the mandate: Ethics training in the futures industry

By John R. Wilcox

On April 26, 1993, the Commodities Exchange Act was amended to include mandatory ethics training for all registrants in futures markets. Some 60,000 registrants in the various exchanges (e.g., The Coffee, Sugar & Cocoa Exchange and the Cotton Exchange in New York, and the Chicago Board of Trade in Chicago) and firms dealing in futures contracts must now undergo at least four hours of initial training, with periodic training thereafter of at least one hour every three years.

The author has trained about 1,000 floor traders and floor brokers in courses offered in New York on a monthly basis, as well as about 800 “upstairs” persons registered for futures trading.

This is not the first time that a federal agency (the Commodity Futures Trading Commission, or CFTC, in this case) has mandated ethics training. The Office of Government Ethics requires and provides training for almost 5 million executive branch employees. But dating back to the late 1980s—when the futures industry was embroiled in several high profile scandals—the futures pits and companies dealing in future contracts have been under intense regulatory scrutiny. A review of the CFTC ethics training program may thus be of some interest.

‘Upstairs’ and ‘locals’

One of the best ways to understand how the mandate is being carried out is through a discussion of the two ethics programs. One is presented to “upstairs” participants in the markets, such as Account Executives, Associated Persons, Commodity Trading Advisers, and Futures Commission Merchants.

The second mandated CFTC course is presented to floor traders who trade for their own account and floor brokers who trade for customers and themselves.

Although the particular issues that “upstairs” registrants and floor brokers/floor traders discuss are somewhat different, the overall thrust of both programs is quite similar. Both are highly interactive. Although the CFTC allows for computer-based ethics training, the contract exchanges and the Futures Industry Institute give primacy to interactive presentations. Discussion of issues, especially through the case method, help sensitize the moral imagination and enhance the ability to delineate and prioritize problems and resolve ethical dilemmas.

The course is presented by an ethicist and a lawyer. Case studies emphasize the individual, client, colleague, market, and social impact of unethical behavior as well as the legal consequences in areas such as insider trading, trading ahead of a customer, churning, and deception of clients. About one-fourth of the program is devoted to legal issues and a

Will ethics training play an important role in reinforcing and enhancing a culture of moral responsibility in the futures industry?

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review of CFTC rules.

Spending so much time on the law may seem puzzling at first. A discussion of penalties that follow from breaking the law and CFTC regulations (e.g., fraud, prearranged sales) make all participants sit up and take notice. Whereas a “slap on the wrist” might have been administered in the past for a number of infractions, now the full weight of the law including mandated federal sentencing guideline penalties and even RICO enforcement may be invoked.

The law offers a point of contrast with ethics. Although it is much harder to persuade the audience of the intrinsic value of doing the right thing in the face of legal constraints, the argument is made throughout the program that ethics and the moral life are absolutely essential for the continuance and development of any culture or society. The law embodies the ethical minimum, but even the bright line of the law will not function unless much more than the ethical minimum enlivens the social group writing the law.

Reactions

Eyelids begin to droop if the ethicist and lawyer do too much talking. Those taking the ethics training, after all, usually come to the sessions after a strenuous day in the trading pits or a taxing morning at a trading desk. Case discussions invariably command trader and broker attention, although there is rarely unanimity of opinion in resolving a case. What creates the environment for reflection on the cases, however, is a brief discussion of the difference between egoism and ethics.

After discussing a scenario in which self-interest and fear are the dominant motives (e.g., a floor broker who decides not to trade ahead of a customer for fear of being caught) the audience is asked a seemingly rhetorical question: “What type of person do you want to be?” They are told that this is a difficult question to answer and one that often is not even asked. Yet it is one that goes to the core of meaning for every individual.

The question serves as a wake-up call for most attendees. The author has seen the reaction on countless faces: their eyes convey a moment of reflection and a non-verbal “I hear you.” It is at this point that many participants begin to understand the purpose of the ethics session.

Only when issues such as character and virtue are addressed—as opposed to self interest and the avoidance of wrongdoing—do the participants fully understand that the sessions are about personal responsibility and social conscience. A “hypothetical” that highlights excessive commissions or churning generates chuckles of recognition. Their

Eyelids begin to droop if the ethicist and lawyer do too much talking. Case discussions invariably command trader and broker attention.

understanding is evident further on when questions such as discretionary account documentation or adequate representation of risk are discussed. The conversation will most often return to the ethical framework of responsibility to self, customers, the financial industry, and society.

Case analysis tends to focus on the individual decision maker and often loses sight of the corporate culture that supports or denigrates right action. The small group discussion—a hypothetical that underscores the necessity of having adequate documentation, such as a corporate resolution for trading, or exchange leadership demonstrated by a responsive compliance officer, for instance—counters this concentration on individualistic ethics. The small groups are often the high point of the entire session. Teamwork and consensus making, diversity of opinion, and personal experience all feed into the development of a group score card. Each small group reports back to the overall group and there is time for interaction among all participants.

Often pleasantly surprised

The author and those with whom he has worked at the Commodities Exchange Center and the Futures Industry Institute are convinced that this part of the program has the most powerful effect on attendees. Brokers and traders leaving the session often express appreciation and pleasant surprise: “More interesting than I thought it would be” and “I learned something” are two common reactions. A round of applause often greets closure of the session.

The mandated ethics training program is still in its infancy. Assessment of its effectiveness will be a challenge for the CFTC. The litmus test is what happens at the office trading desk or in the contract market’s pit. The exchanges will need to develop effective assessment mechanisms to evaluate the outcomes of such a massive training effort. Some of the anecdotal evidence is encouraging, however. One exchange official indicated that more registrants were going to their exchange’s compliance departments about questionable activities on the trading floor.

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Chronikos

THE U.S. Commerce Department helped inspire a movement in total quality management with its Malcolm Baldrige awards several years back. Now it may be trying to do something similar in the ethics area.

In May, the Commerce Department announced that it would offer annual awards to U.S. companies that excelled at adhering to a voluntary code of ethical practices. The code, known as The Model Business Principles, was issued earlier in the year. It is aimed at U.S. corporations doing business overseas and encourages companies, among other things, to provide for a safe and healthy workplace, and avoid child- and forced labor, discrimination based on race, religion or sex, and bribery and environmental pollution.

The first awards will be made in early 1996. The government will begin searching for candidates in September 1995.

The Commerce Department issued a list of companies that it said has already supported the code "as a useful reference point for framing the codes of conduct of individual businesses." This list included the Boeing Company, Honeywell, General Electric, Westinghouse Electric, Eastman Kodak, and Rockwell International, among others.

In a generally upbeat story about the awards, *The New York Times* reported that "human rights activists welcomed the Administration's plans as 'a useful first step toward encouraging U.S.-based businesses to adopt voluntary codes of conduct governing their activities abroad.'"

However, *The Wall Street Journal* criticized the voluntary code as "a diluted set of business principles. . . with no mention of China"—which presumably was the original impetus for the code, given the human rights abuses in that nation—"that most U.S. companies overseas either already follow or that are already covered by U.S. or international law."

The *Journal* emphasized that the code "contains neither an enforcement mechanism nor any monitoring provision." It strongly implied that the issuance of the code represented a step back vis-a-vis the Administration's willingness to confront China on human rights abuses. As such, the Administration was a little sheepish about the whole business, the *Journal* suggested:

"It was released to a small group of reporters on Friday afternoon before the holiday weekend by three mid-level officials who insisted that their names not be used. The release took place at the Commerce Department, at a safe distance from the White House, and was printed on a plain piece of paper without any U.S. government identification."

Corporations may think that they have problems convincing employees that hotlines are confidential. But what about labor unions?

In February, the corruption-plagued Laborers' International Union of North America published a toll-free number in its magazine and promised callers that reports of wrongdoing "will be treated in confidence," the *Wall Street Journal* reported in a May 23, 1995 item. This was after the U.S. Justice Department gave the 500,000-member union 90 days to clean up its house.

One union member from San Francisco subsequently called the hotline. A union official promptly called back the whistleblower, asking about his complaint. Then a local union business manager announced the caller's complaint at a union meeting. "Now, wherever I go out on a job, I will have to look over my shoulder and hope no one arranges an 'accident' for me," the whistleblower wrote.

The union has pledged to do a better job of ensuring confidentiality in the future.

In addition to taking other compliance measures, companies should conduct "legal audits," says Federal Judge Stanley Sporkin. What is a legal audit? It begins with a review of laws and regulations relevant to one's business area, explained the judge at the Conference Board's Seventh Annual Business Ethics Conference on May 3, 1995. This review is used to audit, first, if the company is adequately organized to promote compliance with applicable laws and regulations; second, if all relevant standards have been communicated to one's workforce; and, finally, if those laws and regulations are being followed.

Many companies have traditionally resisted this common-sense exercise in "preventive law." In their book *The Legal Audit*, Louis Brown and Anne Kandel write, "There is an erroneous view that the recognition of incipient legal problems is obvious. Or, others say that the mark of a good executive is that he can instinctively recognize such problems. The brunt of such a position is that efforts to assist management in identifying incipient problems are not necessary."

Judge Sporkin's advocacy of periodic legal audits is but the latest reminder that when it comes to compliance and ethics, good intentions alone are not enough.

— Jeffrey M. Kaplan

An employee is sexually harassing a co-employee. The company investigates. But by that time the harassment has ended. Case closed?

Not according to the Ninth U.S. Circuit Court of Appeals in San Francisco. Even though the sexual harassment in the Oakland City Police Department had ended by the time of the investigation, the department should have punished the harasser. The reason: The organization has an obligation to deter future harassment.

“It is the existence of past harassment, every bit as much as the risk of future harassment, that the statute condemns,”

said the court. It referred the case to a lower court to determine an appropriate remedy for the harassment.

The Ethics Officer Association is holding its third annual conference in Toronto, Ontario on October 18-20, 1995. The title of the conference is “Meeting the Challenges of the Job—Workshops for Ethics Practitioners.” For more information contact W. Michael Hoffman, Executive Director, Ethics Officer Association, Center for Business Ethics, Bentley College, Waltham, MA 02154. Tel: (617) 891-3434. ■

Sentencing Guidelines . . . Continued from page 2

Recent cases demonstrate the extent to which the guidelines definition of an ‘effective’ compliance program is being used by governmental agencies other than the Sentencing Commission.

ance efforts for three years.

These cases underscore the lesson of the *National Medical Enterprises* prosecution: that voluntary compliance programs are generally seen as less burdensome than those dictated by the government in litigation, Swenson told *ethikos*. Additionally, *Lucas Aerospace* and *C.R. Bard* demonstrate the extent to which the guidelines definition of an “effective” compliance program is being used by governmental agencies other than the Sentencing Commission, providing further support for responding to the law.

In addition to these criminal prosecutions, Swenson said, guidelines-style compliance programs have been imposed in several civil cases, further evidence of the “shadow effect.”

One such highly publicized settlement concerned *Prudential Securities*’ massive fraud in connection with sales of limited partnerships. The company’s “deferred criminal prosecution” includes detailed compulsory compliance and

disclosure requirements. The company must (a) install an independent “ombudsman” to receive allegations of misconduct by any company employee and to file quarterly reports with the United States Attorney of any such allegations, (b) retain an independent law firm acceptable to the government to review company policies and procedures to determine the adequacy of its regulatory and compliance controls, and (c) fully cooperate in any criminal investigations, including voluntarily providing any requested records and unlimited access by government authorities to company facilities, documents and employees.

Another “shadow effect” civil case involved *Grumman Corporation*, whose executives were found to have given kickbacks. The *Grumman* settlement requires revisions of some company compliance policies and procedures, as well as continuing other compliance-related efforts, such as maintaining its “Business Ethics Committee,” abiding by the principles of the Defense Industry Initiative, and including consideration of an employee’s ethical behavior in making performance appraisals. Also, the company’s audit committee is required to consider on an ongoing basis whether further changes might be needed to meet the guidelines’ “seven steps.”

The sentencing guidelines picture indeed may not yet be fully developed. However, the outlines that can be discerned show that corporate compliance generally and the guidelines “seven-step” definition in particular are playing an increasingly significant role in government enforcement actions. Those companies that have yet to develop “an effective program to prevent and detect violations of law” should take a close look at Swenson’s timely legal snapshot. ■

Business ethics is 'catching fire' overseas

"The feeling has long been that this is a North American initiative," says Lori Tansey, speaking about business ethics. "That's changing." Business ethics is "catching fire overseas," particularly in Great Britain and Germany.

But taking an ethics program overseas still is not quite the same as developing one in the U.S., observes Tansey, President of the International Business Ethics Institute, based in Washington, D.C.

She has developed a list of "Top Ten Mistakes" that organizations make in taking ethics programs global. This was presented (in ascending order, like a skit by a well-known late-night TV host) at the Conference Board's recent business ethics conference. The 10 are:

10) *No consensus objectives for globalization.* Why is the company taking its program overseas? Because of the federal organizational sentencing guidelines? As a way to build bridges overseas? Companies must be clear in their own minds why they are taking an ethics program global.

9) *Not consulting with international personnel.* It seems obvious that one should inform the people in the company who are to be affected by the new program, "but sometimes we overlook it in the rush to get it done." It is important to talk with international personnel before rolling out a program "so it's not just seen as a North American initiative."

8) *Extensive use of the word "ethics."* The 'E' word is "not a particularly good word when taking a program overseas." For one thing, it's difficult to translate. The Japanese, notes Tansey, have no precise translation for ethics. And nuance is important. "Word choice can be extremely important." Even though ethics and morality are two terms that are close in meaning, and are often used interchangeably, "I'm not aware of any 'Corporate Morals Officers'" in the U.S.

The same problems with nuance can occur overseas. Thus, Daimler-Benz, the giant German company, prefers to talk about "managerial responsibility" rather than ethics.

7) *Translating the code without translating the Code.* Again, this may seem obvious, but it is important to eliminate American colloquialisms or terms peculiar to North American businesses. They may simply not have equivalent translations.

6) *Training materials only in English.* Companies may go to the expense of translating their codes of conduct into foreign languages, but many neglect to translate their ethics training materials. Tansey recommends translating these materials into the five or six most frequently used languages. If a company uses videotapes, it should add subtitles where possible. "It really sends the message that you are a trans-national company."

5) *No ethics offices in international locations.* It is important to have an ethics representative abroad. This doesn't have to be a stand-alone office. The ethics rep could even be part-time, but it is important to have "someone with a local phone number for questions and concerns."

The 'E' word is 'not a particularly good word when taking a program overseas.' For one thing, it's difficult to translate.

4) All ethics positions filled by Americans.

3) All rationales for the Company's code/policies are based on U.S. legal requirements. Many ethics programs are focused on U.S. policies and laws, such as the Foreign Corrupt Practices Act. This may not be necessary. A number of U.S. laws are reflected in the laws of other countries. One can make general pronouncements like "Many countries stipulate fair competition" without making reference to U.S. antitrust laws, for instance.

2) No "marketing" of the program based on practical business advantages.

1) Forgetting that there are more similarities to unite us than differences to separate us.

Overall, "We're seeing a formalization [of ethics] in all parts of the globe," says Tansey. She cites two studies that compare ethics programs in the United Kingdom (a 1992 study by Robertson & Schlegelmilch) and the U.S. (a 1988 study by the Ethics Resource Center). The corporations surveyed reported the following program elements:

Element	U.S.	United Kingdom
Code of Conduct	85%	50%
Ethics Committee	9%	10%
Ethics Ombuds/Officer	12%	30%
Ethics Training	28%	25%

Tansey acknowledges that there is a four-year gap between the studies, and a more recent ERC survey shows ethics officers and ethics training to be more widespread than is indicated above, but the main point is that "these are ideas that are already taking hold." She adds that The European Union is considering something along the lines of the federal Organizational Sentencing Guidelines, which encourage companies to set up "effective" compliance programs. Something of this sort is already being applied on an *ad hoc* basis in English courts.

Today, there is less ethics activity in Asia and Latin America than in Europe, but Tansey notes that 2,000 people

'90 percent of companies with foreign operations' are currently violating the FCPA—because they don't understand the law and the proper use of functionaries like agents.'

attended a recent conference in Hong Kong on developing a code of conduct. (See Graydon Wood's account of that conference in *ethikos*, January/February 1995.)

The Foreign Corrupt Practices Act

That said, navigating in international waters still has its perils. The Foreign Corrupt Practices Act, which makes it a felony for U.S. companies to bribe foreign officials, continues to present challenges for U.S. concerns. According to Tansey, "90 percent of companies with foreign operations" are currently violating the Foreign Corrupt Practices Act—mainly because they don't understand the law and the proper use of functionaries like agents. Companies are often not conducting proper accounting operations.

William Lytton, Vice President of Lockheed Martin (formerly Martin Marietta), another speaker, disagreed with this assessment—at least in reference to the aerospace industry. He acknowledges that the aerospace industry was scarred by scandal in the past—the Lockheed scandals in the 1970s, after all, are often cited as a main impetus for the passage of the FCPA. But that has made aerospace companies more careful than most, and those tendencies have been reinforced by the participation of aerospace companies in organizations like the Defense Industry Initiative.

Lockheed Martin simply sees compliance with the FCPA as a contractual obligation, explains Lytton. "We agree we aren't going to bribe," and when someone raises an eyebrow the company responds: "This is the way we are."

In general, "the larger the company, the stronger the [ethics] program, the less likely it is" to violate the FCPA, said Lytton. ■

CFTC mandate . . . Continued from page 9

Of course, it is very difficult to determine the causal relation between the ethics program and the knock on the compliance office door, but it is interesting to note that word-of-mouth reports indicate that participants do go back and argue points from a case days and weeks after a session.

Will ethics training play an important role in reinforcing and enhancing a culture of moral responsibility in the futures industry? The program alone cannot do that, but it may be a starting point for a long-term change in firms that do not yet see the value of rewarding good behavior and professional conduct. ■

When a people look to the law for all the answers

By Loren Singer

The Death of Common Sense: How Law is Suffocating America; by Philip K. Howard, Random House, 1994, 202 Pages.

Rarely does one read a book with such a slender spine that weighs so heavily on the mind. This one does for a number of reasons, some by virtue of the writer's abilities and special qualifications, another because so many Americans seem to share a belief that this country is on a downward slide into general incompetence, falling ever further from the very qualities that made it a great nation.

Thus Philip Howard, the son of a Presbyterian minister, who grew up in Eastern Kentucky, became a lawyer and is now a founding partner of a law firm in Manhattan has set forth his own assignment of causes that has brought about this contemporary national decline and how it might be countered. This is a prism and the image seen through it is subject to distortions. It depends on angle, opinion, and viewpoint. These, we see, vary widely just as they have throughout the American past.

Recently we have become aware that there are those who believe that the only solution is to withdraw to some enclave governed by a powerful authoritarian figure and opposed to the participation of any minority. There are others who would volunteer to take violent action against their own central government. Curiously, these are the attitudes that come to mind when Mr. Howard quietly and soberly builds his thesis, and makes his case against a government and the citizenry that gave it its vast powers.

Unfortunately Mr. Howard's catenary of unsound events is hardly unique. There are too many similar ones that we have run upon or afoul of ourselves, or that have been noted in one medium or another. Howard's have distinction; he tracks them from inception to, in many cases, ridiculous solutions. Having served in New York City's Industrial Development Agency, taught architecture and planning at Columbia, and worked with the Mayor's Institute on City Design, he has become all too familiar with bureaucracy and its shortcomings—its refusal to take responsibility for its own decisions, its complete indifference to the costs of the compliance it orders, or any attempt to weigh overall benefit against the impact on society. Unlike Justice, it has no blindfold; there's no need for one. Mr. Howard concludes that it is purblind on all of its levels from the most densely populated metropolis to the farthest reaches of suburbia, and on into the heartland. He supplies convincing proof.

The law of government

The book is organized in four sections. The first considers the law of government,

Portrait of a bureaucracy that refuses to take responsibility for its own decisions and is completely indifferent to the costs of the compliance it orders.

Loren Singer is the author of *The Parallax View* and other novels. His novel, *Making Good* (Henry Holt & Company) was a 1993 Washington Irving Book Selection. Mr. Singer is book review editor of *ethikos*.

that pervasive docket that controls “almost every activity of common interest.” It includes all of those codes and compilations of regulations that have been and continue to be applied in every corner of the land, the purported basepan upon which endless argument, litigation, and sometimes violent disagreement are based. Not many are distinguished by a high proportion of common sense:

Nuns serving Mother Teresa’s order planned to rebuild two fire-gutted buildings in upper Manhattan to provide temporary housing for 64 homeless men. The four floors included dining rooms and kitchen, a lounge, and small dormitory rooms on the upper floors. After eighteen months the city approved the plan, and the order began its rebuilding process. Then the nuns were informed that every multiple story building requires an elevator. Because of their beliefs the nuns would never use it; they were told that the law could not be waived. The additional cost—\$100,000—could be more wisely spent, the nuns decided, and withdrew their offer, noting in a letter that the episode “served to educate us about the law and its many complexities.”

Amoco complied with an EPA order to equip its smokestacks in its Yorktown, Virginia refinery with filters to remove benzene at a cost to the company of \$31 million. Some years later, “EPA found that its precisely drawn regulation almost entirely missed the pollution. The Amoco refinery was emitting significant amounts of benzene, but nowhere near the smokestacks. The pollution was at the loading docks.” In this context, the EPA rule was “almost perfect in its failure: It maximized the cost to Amoco while minimizing the benefit to the public.”

Environmental laws and rules are now seventeen volumes of fine print. The Federal Register’s daily report of new and proposed regulations increased from 15,000 pages in 1963 to 70,000 pages in 1992.

Government in the nursery school

A woman who has a small nursery school in Boston was ordered to keep a complete change of clothing on hand for each of 30 children in case of spilling or soiling. That presented a storage problem that the school thought could be met simply by keeping several sets of clothing on hand. Permission denied. Inspectors also ordered her to bolt a wooden toy refrigerator to a wall, and cited her for leaving dishwashing soap within the reach of children—it is used for blowing bubbles.

When Truman left the Oval Office he must have taken his desk motto, “The Buck Stops Here” with him to Independence. Mr. Howard notes that nowadays the buck never

When Truman left the Oval Office he must have taken his desk motto, ‘The Buck Stops Here,’ with him to Independence. Nowadays the buck never stops.

stops. He believes that if decisions are taken in these times, it is only by default. Rarely does any individual take responsibility for making them:

In 1992, weeks before the Chicago River poured millions of gallons of water through the masonry of an old tunnel, the city transportation commissioner with 30 years of “exemplary service” knew that there was a leak, ordered it shored up, and asked his engineers for cost estimates. A first guess was \$10,000. A reputable contractor was also queried; he quoted \$75,000. Given this great discrepancy, the commissioner called for competitive bids. Before that process had even begun, the tunnel collapsed and flooded the basements of downtown office buildings. The damages totaled well over \$1 billion. The commissioner had the authority to make the repair and was also entitled to an exception from the usual practices in the face of the emergency. Apparently, he did not want to take the responsibility.

There is an account of the constricted process of letting contracts. In New York City this may take “upwards of two years.” First, a detailed work plan is prepared that tries to foresee every eventuality before a full bidding document called a “Request for Proposals” appears. This package, “generally about two inches thick for a small project,” goes through a round of reviews by all interested agencies before a random drawing is made of all engineers who have registered for city work. After written submissions are made a committee reviews them and assigns a point system that rates them. Three more city approvals are still ahead—two from the mayor’s office and another from the comptroller. The method, according to one report, leaves the city “awash in a sea of paper and plagued by inordinate delays”—and rarely scandal free.

The city lets 9,000 contracts a year for \$6 billion. The Federal government adds \$200 billion. For all government entities the total is \$450 billion, about one tenth of the gross national product. “The waste is probably not possible to calculate precisely.”

The Federal Register's daily report of new and proposed regulations increased from 15,000 pages in 1963 to 70,000 pages in 1992.

A conflict over public toilets

Mr. Howard's next bear garden is "The Great Rights Rush" and opens the discussion on a basic level: There was a real need for some system of public toilets in New York City—most of those facilities had been closed down, some for years. Those in Grand Central and Penn Station were noisome; for decades they were wretchedly maintained. Thus a pilot program financed by a private foundation to test six coin-operated toilets to be imported from Paris met with wide approval. At inception.

These kiosks were self-cleaned and disinfected; they opened automatically after 15 minutes; they were five feet in diameter and would not block sidewalks, and best of all during the test mode, they would cost the city nothing—until the city made its commitment. Then a legal battle occurred. Since there was no accommodation for wheelchairs, rights supporters condemned the program as "discrimination in its purest form." When the city sought a legislative amendment to permit the test, a lobbyist for the disabled accused its lawyer of "conspiring to violate the law." Kiosks that could accommodate wheelchairs had been tried in London and Paris. They were larger, cycled for 30 minutes, and had certain other disadvantages—experience indicated that they were a venue for both prostitution and drug use. Nevertheless the lobby for the disabled demanded that model or nothing.

The resolution, if such it could be called, required two kiosks, one for the disabled, the other for the "temporarily abled," the general public. That did not satisfy the advocates

for the disabled—they chose to uphold yet another principle, "mainstreaming," the legal right of the disabled to do everything in the same way everyone else did, in this case the right to use the same toilet, not a specific model for them. The test results indicated some relief for the general public. Their kiosks averaged 3000 flushes a month, 50 percent more than the Paris average. The units reserved for the disabled were basically unused.

Outlandish as was the kiosk conflict, it is seen that there was a sizeable group involved. Mr. Howard has documented others that litigate special and wildly expensive solutions for situations that are unique, and sometimes horrifying: A federal appeals court ordered a school district to provide an educational program for a quadriplegic child who is also brain damaged and can do virtually nothing for himself.

One becomes aware in reading the book that there is a persistent undertone in our time that indicates not only distrust of government on all levels for its lack of responsiveness and repressiveness, but that it has a totalitarian aura about it. That begets glib, popular, and simplistic commitments by political and lay "leaders" to put matters right by one ukase or another—to destroy one supposed totalitarian system by installing another that will cut and prune or deracinate. What may appear afterward is a real concern, for whatever kind of society the U.S. has become, it could never be considered as one having criminal intent.

That, of course makes the solution more difficult. Mr. Howard has little to recommend save one basic change: "stop looking to law to provide the final answer. . . Life is too complex." So it seems, and the quotations that he has included in his work—from Aristotle, de Tocqueville, Holmes, Cardozo, Wilson and Roosevelt—impress upon one the pervasiveness of the problems of self-government through centuries. How burdensome it is to try to solve them—except when we consider the alternatives. ■

Hotlines . . . Continued from page 5

employee's desk in the middle of the shop floor as punishment, or a manager who calls the women in his department "toots" or "honey," we need an ombudsman.

"People talk about these as snitch lines," observes Furtado. "But if someone called up Oklahoma before [Timothy] McVeigh [allegedly] blew up that federal building,

would you call that person a 'snitch'?"

"I have little patience with those who refer to these as snitch lines when I think of McVeigh."

"Hotlines are a process for acting out an honor system," adds Hoffman. And if it doesn't take, then the only alternative is to have the police do that sort of thing.

— Andrew W. Singer

The United States Federal Sentencing Guidelines are rules that set out a uniform policy for sentencing individuals and organizations convicted of felonies and serious (Class A) misdemeanors in the United States federal courts system. The Guidelines do not apply to less serious misdemeanors or infractions. Although the Guidelines were initially styled as mandatory, the US Supreme Court's 2005 decision in *United States v. Booker* held that the Guidelines, as originally constituted, violated the Sixth Most significant in this regard was the sentencing Guidelines reduction of "drugs minus two" in 2014 that lowered the offense severity level for drug crimes and was subsequently applied retroactively.¹⁷ U.S. Sentencing Commission. (2017). 2014 Drug Guidelines Amendment Retroactivity Data Report 1. While these changes are praiseworthy, the revised prison terms are still quite harsh. For example, the shift in guidelines for "drugs minus two" circumstances lowered the average prison term from twelve years to ten years.³² U.S. Sentencing Commission. (2017). 2014 Drug Guidelines Amendment Retroactivity Data Report 1. How to use guidelines in a sentence. Example sentences with the word guidelines. The most voted sentence example for guidelines is If you abide by the guidelines... This record was compiled by CRD commissioned reviewers according to a set of guidelines developed in collaboration with a group of leading health economists. 0. It does discuss sentencing guidelines without talking about the significance of Barr overriding them. As laid out here, Barr provides three inconsistent explanations for why he intervened. In its story writing up its "exclusive" interview with Attorney General Bill Barr, ABC gets to the core of the issue: The Attorney General not only intervened to override the sentencing recommendation of career prosecutors, but he did so in defiance of the sentencing guidelines recommended by the Probation Office. Whether he believed sentencing guidelines were too harsh and should be amended downward, even while he maligns District Attorneys around the country for advocated lesser sentences. In short, in this "interview" ABC didn't ask Barr the first question that needs to be answered.