Employer Update

Drafting an Effective Code of Conduct

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In This Issue

From 2008 to 2013, the federal government collected nearly $17 billion in judgments from actions brought under the False Claims Act ("FCA"), collecting a staggering $3.8 billion this past year alone.[1] Most FCA actions are filed under the FCA's *qui tam* provision, which allows private citizens, referred to as "relators," to file lawsuits alleging fraud on behalf of the government. If the relator pursues the action alone and prevails, the relator receives up to 30% of the recovery. If the government intervenes and prevails in the action, the relator receives up to 25% of the recovery. *See* 31 U.S.C. § 3730(d). In December 2013, the U.S. Department of Justice ("DOJ") disclosed that $2.9 billion of the $3.8 billion recovered last year emanated from lawsuits filed under the *qui tam* provision of the FCA, with whistleblowers recovering $345 million.[2]

Imagine you are a manager at ABC Company and you learn from a fellow manager that your subordinate has voiced concerns to other employees that the company is promoting its new product for uses not approved by the federal regulatory authorities. In addition, your subordinate is concerned that the lavish dinners your company hosts for vendors of the product may be designed to induce those vendors to sell more of the product and to promote the unapproved use. Your subordinate is concerned that these actions may violate federal laws and is considering reporting the concern to an outside agency. What do you do?

You will likely find the answer to this question in ABC Company's code of conduct. A code of conduct is a company policy that, *inter alia*, provides guidelines for making ethical decisions, complying with relevant laws and regulations, and communicating concerns to management. A company's code of conduct should describe clearly the procedures for reporting complaints or concerns regarding ethical and legal violations and encourage employees to report their concerns to the company. A company's code of conduct is frequently a standalone document, separate from a traditional employee handbook, as the code generally applies not only to employees, but to officers, directors and sometimes contractors, vendors and consultants. Codes of conduct typically contain provisions outlining specific laws that are relevant to the company's industry, conflict of interest policies, and whistleblower and anti-retaliation provisions. Codes may also include sections on insider trading, anti-bribery, competition and fair dealing, and preserving confidentiality.

Given the recent increase in "whistleblower" actions, we reviewed a selection of codes of conduct from 20 public companies of different sizes and across various industries, to assess the varied approaches and strategic judgments made by companies in crafting their codes of conduct. In this article, we outline the important legal bases for adopting a code of conduct, analyze some of the differences we observed in these selected codes of conduct, and raise practical considerations for companies in evaluating and implementing their codes of conduct.

Legal Basis for Adopting a Code of Conduct

Under the Sarbanes-Oxley Act of 2002 ("SOX") and the New York Stock Exchange's ("NYSE") and the National Association of Securities Dealers Automated Quotations's ("NASDAQ") compliance standards, all public companies must have a code of conduct. Specifically, SOX requires public companies to institute procedures for the making and handling of complaints about accounting issues and to disclose whether the company had adopted a code of ethics for certain senior officers, and if not, why not. *See* 15 U.S.C. §§ 78j-1(m), 7264. The NYSE requires the adoption and disclosure of a code covering directors, officers, and employees, regarding the following topics: conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of listed company assets, compliance with laws, and encouraging the reporting of illegal or unethical behavior. *See* NYSE Listed Company Manual, § 303A.10. The NASDAQ contains similar requirements to the NYSE, and adds that each code must "contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for complaints, and a fair process by which to determine violations." NASDAQ Equity Rule 5610, IM-5610.

Beyond these legal obligations governing public companies, both public and private companies have many incentives for adopting codes of conduct. First, according to the DOJ's Principles of Federal Prosecution of Business Organizations, revised in 2008, the DOJ considers an effective compliance program as a factor in deciding whether to indict a company in the event of misconduct.[3] Second, the Federal Sentencing Guidelines provide that an effective compliance and ethics program is a significant factor in determining the sentence imposed on corporations convicted of criminal conduct.[4] Third, numerous statutes impose requirements with respect to compliance programs. For example, the Affordable Care Act requires that a broad range of providers, medical suppliers, and physicians adopt compliance and ethics programs. Fourth, an anti-harassment provision in a code of conduct may help to limit employer liability for supervisors' discriminatory actions.[5]

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In addition to legal requirements and other incentives, a code of conduct is a tool for companies to communicate their commitment to prohibiting retaliation against employees who voice complaints in good faith. Various federal and state statutes (including SOX and the FCA) contain anti-retaliation provisions that prohibit companies from taking adverse actions against employees who report violations of such statutes. Accordingly, a code of conduct is an effective way for companies to clearly express their commitment to prohibiting retaliation.

Comparing Code of Conduct Provisions

A code of conduct is not a "one size fits all" document. Rather, the contents of companies' codes will differ based on variations such as company culture, size, structure, and key areas of risk. Below we analyze some of the different approaches companies have taken and the judgments they have made in crafting their codes of conduct.

Reportable Conduct

Codes vary in terms of the scope of conduct that employees are required to report. For example, some codes broadly require employees to report any issues that *may lead to* a code violation or regulatory breach. Other codes instead more narrowly list a finite set of mandatory reporting events, such as actual or potential code violations, unethical behavior, or exposure to legal or reputational risks. A company may consider broadly defining reportable conduct to encourage employees to come forward with information. However, a company may instead consider describing reportable conduct in more defined terms, in light of factors such as company size and/or structures for receiving and evaluating reports.

Recipients of Reports

Some codes provide employees with multiple channels for reporting applicable conduct. For example, some codes instruct employees that they may report violations to any of the following: their manager, human resources department, legal department, internal audit department, finance department, or business conduct hotline. Alternatively, other codes provide employees with only one outlet for reporting – for example, an ethics compliance hotline. The multi-source approach may help encourage reporting, as it allows employees to report to the resource of their choice. However, this approach requires that all of the numerous potential report-recipients receive training on how to properly receive and direct reports. One potential advantage of the single-source approach is that all reports are centralized in one location, there is greater consistency in approach, and the company can track the content and volume of reports with comparative ease and certainty.

"Good Faith" Limitation

Protection against retaliation is an essential tenet advanced in codes of conduct. Most codes, however, limit protection against retaliation to those employees who report in "good faith." In other words, if an employee knowingly makes a false report, he or she may be subject to discipline consistent with the company's general anti-retaliation policy. As some codes correctly point out, reporting in "good faith" does not mean that the employee has to be right about the violation, but rather, that the employee must have been reporting information he or she believed to be true. A "good faith" limitation may discourage employees from reporting applicable conduct for fear that they may be accused of reporting in bad faith. However, in the absence of such a limitation, a code may fail to alert employees to the potential consequences for knowingly lodging a false report.

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Educating Employees

Some codes of conduct merely instruct employees to comply with the law, while other companies use their codes as a platform to inform and educate employees about the company's key legal obligations. For example, one multinational company uses its code of conduct to explain legal obligations with respect to privacy, business courtesies, competition and antitrust laws, social media, prohibitions against human trafficking, entertaining union officials, anti-bribery and anti-corruption requirements, trade embargos, anti-harassment, and corporate opportunities. Instead of merely instructing employees to comply with the law, this approach names key areas of legal compliance, explains what they require, and in some instances, provides examples of hypothetical violations. A benefit of this later approach is that employees are more informed of the company's particular legal obligations. However, some companies may prefer a simple instruction regarding compliance with law, in part to avoid omitting any particular legal obligation and to avoid overly complicating the code of conduct with legalese.

Confidentiality and/or Anonymity

In certain circumstances, a company may be legally required to share information internally or externally. For example, certain reports of misconduct regarding accounting, finance, or auditing must be shared with a company's audit committee (although, pursuant to SOX § 301(4), 15 U.S.C. § 78j-1, audit committees must establish procedures for confidential, anonymous submissions). Additionally, if a company needs to issue a legal hold notice or investigate facts alleged in a report, it may need to reveal some of the contents of the allegation. Accordingly, many codes of conduct offer confidentiality to reporting employees or an option to report anonymously through a company hotline, but only to the extent possible while ensuring that the company has the necessary latitude to meet its legal obligations. On the one hand, promises of confidentiality and anonymity may encourage reporting, but promises of complete confidentiality and anonymity may not be possible given applicable legal obligations.

Practical Considerations

Given the importance of a company's code of conduct, below are practical considerations for employers in crafting and implementing an effective code:

- Identify and periodically asses the company's key legal obligations. Consider using the code of conduct as an instructional tool for employees regarding their legal obligations through an honest evaluation of the company's key areas of risk.
- Consider the extent to which particular categories of employees (*e.g.* managers, human resources, compliance department) should receive specific training, including for receiving complaints.
- Consider the extent and frequency of any monitoring of company procedures for handling reports from employees, including with respect to documentation, evaluation, direction, and/or elevation of the report where appropriate.
- Consider a periodic assessment of the extent to which a particular region, division or manager is the subject of repeated reports, even if unsubstantiated. The frequency of such reports may suggest the need for additional training or further investigation as appropriate.
- Consider whether the company would benefit from direct involvement by senior managers in the design and execution of the code of conduct. "Buy-in" from the company's top levels may assist the company in effectively communicating the importance of the code to employees in all levels of the organization. Consider requiring employees to certify receipt, reading and compliance with the code on a periodic basis.

The specifics of these practical considerations will differ across companies, as variations such as company size, areas of legal risk, and structure will inform the content of any code of conduct and the appropriate reporting procedures. Given the sharp increase in "whistleblower" actions, companies would be wise to review their codes of conduct and applicable procedures to maximize their effect in promoting compliance with legal obligations.

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1. Department of Justice, Office of Public Affairs, *Justice Department Recovers $3.8 Billion from False Claims Act Cases in Fiscal Years 2013*, U.S. Dep't of Justice, Justice News (Dec. 20, 2013), http://www.justice.gov/opa/pr/2013/December/13-civ-1352.html.
2. *See supra*, at n.1.
3. http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf at 9-28.300.A.6.
4. http://www.ussc.gov/Guidelines/2010_guidelines/Manual_HTML/8b2_1.htm
5. Under *Faragher v. City of Boca Raton*, 524 U.S. 774 (1998), *Burlington Indus., Inc. v. Ellerth*, 524 U.S. 742 (1998), and their progeny, employers may avoid liability for discriminatory actions of supervisors that do not result in tangible adverse employment actions if the employer

has exercised reasonable care to prevent discriminatory behavior and has taken proper remedial action when inappropriate behavior has occurred. According to the Equal Employment Opportunity Commission's enforcement guidance on vicarious employer liability for unlawful harassment by supervisors, an employer's demonstration of reasonable care will generally require the existence, dissemination, and enforcement of an anti-harassment policy and complaint procedure, as well as other reasonable steps that may be required to prevent and correct harassment.

IRS Clarifies Applicability of *U.S. v. Windsor* to Qualified Retirement Plans

By Jeffrey Liberman and Zahava Blumenthal

On April 4, 2014, the Internal Revenue Service (IRS) issued Notice 2014-19 (the Notice), which provides guidance as to the current and retroactive application of the U.S. Supreme Court's decision in *U.S. v. Windsor*[1] (*Windsor*) to tax-qualified retirement plans (QRPs) under Section 401(a) of the Internal Revenue Code of 1986 (the Code). Notice 2014-19 also clarifies the IRS's earlier guidance in Revenue Ruling 2013-17.[2]

The *Windsor* decision did not address Section 2 of DOMA or provide practical guidance as to the treatment of same-sex spouses for federal purposes, which led to uncertainty in diverse aspects of federal law, including as to the treatment of married couples under QRPs.

By way of background, a refresher on the Defense of Marriage Act[3] (DOMA), and the *Windsor* decision overturning Section 3 of DOMA, is in order:

DOMA. The U.S. Congress enacted DOMA in 1996. Section 3 of DOMA effectively excluded all same-sex relationships from the definition of marriage for federal law purposes. Specifically, Section 3 of DOMA provided:

> In determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.

Therefore, under Section 3 of DOMA, a member of a same-sex couple had no spousal rights with respect to his or her partner's QRP, whether as a beneficiary, a survivor or otherwise. Section 2 of DOMA permitted U.S. states, territories and possessions and Native American tribes to not recognize same-sex marriages under the laws of any other state, territory or possession or territory of any Native American tribe.

Windsor. On June 26, 2013, the U.S. Supreme Court's opinion in *Windsor* struck down Section 3 of DOMA as unconstitutional. However, the *Windsor* decision did not address Section 2 of DOMA and did not provide practical guidance as to the treatment of same-sex spouses for federal purposes. This led to uncertainty in diverse aspects of federal law, including – among many other subjects – laws governing the treatment of married couples under QRPs. The decision potentially has implications for a number of tax-qualification issues, including, but not limited to, qualified joint & survivor annuities (QJSAs), beneficiary designations, qualified domestic relations orders (QDROs) and rollovers.

Revenue Ruling 2013-17. On August 29, 2013, the IRS issued Revenue Ruling 2013-17, which stated that the IRS:

(1) will interpret gendered terms such as "husband" and "wife" to include same-sex spouses who are lawfully married in any state, including a foreign jurisdiction ("state of celebration"), and will view the term "marriage" as including same-sex

marriages, and "spouse" as including same-sex spouses; and

(2) will only recognize a legal "marriage" (*i.e.*, where permitted under the laws of the state of celebration), and will not recognize domestic partnerships, civil unions or similar formal relationships as equivalent to marriage (regardless of the genders of the partners).

The requirement to recognize same-sex marriages under Revenue Ruling 2013-17 was effective as of September 16, 2013. However, the ruling did not address many potentially complex issues. The Notice did not provide guidance to plan administrators and participants as to how same-sex spouses should be treated for purposes of QRPs in respect of periods prior to September 16, 2013, and more generally whether and how to amend QRPs as a result of *Windsor* and Revenue Ruling 2013-17 in order to maintain their qualified status under Section 401(a) of the Code.

Notice 2014-19. By issuing the Notice, the IRS has further elucidated the impact of the *Windsor* decision on QRPs. The Notice requires that effective June 26, 2013 (the date of the *Windsor* ruling), any QRP tax rule that applies because a participant is "married" must be applied with respect to a participant married to a person of the same gender. However, because there was no guidance as to the state-of-celebration issue for periods prior to September 16, 2013, the Notice provides that a QRP will not be deemed out of compliance with the applicable tax rules because it applied the rules only as applied to same-sex spouse of a participant using the laws of the state where the couple resides ("state of domicile") rather than the state-of-celebration rule for periods before September 16, 2013.

A QRP does not automatically need to be amended in order to comply with *Windsor* and Revenue Ruling 2013-17. The Notice provides that a QRP whose terms are not inconsistent with *Windsor* and Revenue Ruling 2013-17 will not require amendment. For example, a QRP does not need to be amended if its terms do not distinguish between a same-sex spouse and a non-same-sex spouse. Nonetheless, a clarifying amendment may be useful for purposes of plan administration. Moreover, regardless of whether a QRP is or needs to be amended, it must be operated in compliance with *Windsor* and Revenue Ruling 2013-17.

Regardless of whether a QRP is amended, it must be operated in compliance with *Windsor* and Revenue Ruling 2013-17.

However, a QRP must be amended if its terms would otherwise be inconsistent with *Windsor* and/or Revenue Ruling 2013-17 (including if it defines a marital relationship by reference to Section 3 of DOMA). The deadline to adopt any mandatory amendment is the later of (1) December 31, 2014, and (2) the date determined pursuant to the plan amendment rules set forth in Section 5.05 of Revenue Procedure 2007-44.[4] Additionally, in the case of a governmental plan, an amendment may be adopted as late as the close of the first regular legislative session of the body that has the authority to amend the governmental plan ending after December 31, 2014.

Some practitioners raised concerns over the effect of Section 436(c) of the Code, which imposes limitations on amendments that would increase the liabilities of a single-employer defined-benefit pension plan where certain funding requirements are not met. Generally, this could restrict amendments to a plan to comply with *Windsor* if the plan liabilities would increase as a result. However, the Notice provides that for purposes of compliance with *Windsor* and Revenue Ruling 2013-17, these restrictions will not apply to amendments that are effective on or after June 26, 2013.

Windsor is not required to be applied before June 26, 2013. However, if a plan sponsor chooses to apply *Windsor* and Revenue Ruling 2013-17 for periods prior to June 26, 2013, an amendment to the plan that specifies the date as of which the rules are applicable is required. Such an amendment will not disqualify the QRP, provided that the amendment is otherwise compliant with applicable qualification requirements. The IRS notes, however, that such changes may trigger requirements that are difficult to implement retroactively (*e.g.*, what to do about distributions made to a non-spouse beneficiary of a participant who had a same-sex spouse) or that may create unintended consequences.

Notice 2014-19 provides useful guidance to QRP participants and administrators with respect to at least some of the aspects of plan administration and qualification. However, other questions remain unanswered. For example, same-sex spouses may need to bring suit in order to determine the scope of their rights with respect to their partners' QRPs prior to June 26, 2013. In addition, plan administrators may need to assess employees' same-sex relationships on a case-by-case basis in order to determine which employees are married for purposes of QRPs. Plan administrators may need additional guidance in order to ensure QRP compliance on an ongoing basis. The QRP compliance community (as well as same-sex advocates and other interested parties) will certainly continue the conversation that began with the *Windsor* ruling and has been adapting ever since. Whether any particular additional IRS guidance will be issued remains to be seen.[5]

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1. 570 U.S. ____, 133 S.Ct. 2675 (2013).
2. 2013-38 I.R.B. 201 (September 16, 2013).
3. 1 U.S.C. § 7 and 28 U.S.C. § 1738C.
4. Rev. Proc. 2007-44, 2007-18 I.R.B. 54 (in general, by the end of the plan year in which the amendment becomes effective, or the end of any application remedial amendment period).
5. We note that on May 15, 2014, the IRS issued Notice 2014-37, which deals specifically with midyear amendments to safe-harbor 401(k) plans to comply with the *Windsor* decision and concludes that such amendments will not be deemed to violate the usual restrictions on midyear amendments to such plans.

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