

**THE FRAMEWORK FOR CORPORATE SELF-GOVERNANCE:
AN EFFECTIVE ETHICS AND COMPLIANCE PROGRAM**

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June 5, 2002

I. Introduction

Over the past decade, American corporations have become increasingly willing to accept responsibility for monitoring their own activities. This trend, in part, has been induced by the promotion and encouragement of corporate self-governance by government law enforcement authorities and regulators as well as by corporations' realization that their economic self-interest is served by preventing and detecting employee misconduct.¹

Corporate self-governance is designed to ensure that a corporation aspires to and insists on uncompromising ethical behavior in its activities. Self-governance at its core involves the development of a "corporate ethic" or "corporate culture" of ethical conduct. A vigorous and effective ethics and compliance program provides two critical components of corporate self-governance: it causes a corporation to conduct its business in strict accordance with all applicable laws, rules, and regulations and it persuades corporate employees at all levels that operating within the bounds of the law is in the corporation's interest and, more importantly, in the interest of all of the corporation's employees.

This paper will discuss corporate ethics and compliance programs in three respects. First, it will identify the benefits and potential problems associated with developing and implementing a corporate ethics and compliance program. Second, it will outline the minimum elements necessary for an effective ethics and compliance program. Third, it will discuss the

¹ See e.g., Pendergast & Gold, "Surviving Self-Governance: Common Interests Approach to Protecting Privileges under the DoD Voluntary Disclosure Program," 22 *Public Contract Law Journal* 195-97 (1993); Perry, Dakin & Gharakhanian, "State Attorneys General Encourage Voluntary Corporate Compliance Programs," *Corporate Conduct Quarterly*, Vol. 2, No. 4 (Spring 1993) at 49 - 54; Obermaier, "A Practical Partnership," *The National Law Journal*, November 11, 1991 at 1.

experience that Lockheed Martin Corporation has had with the development and implementation of its self-governance program.

II. Benefits And Potential Problems Associated With An Ethics and Compliance Program

A. Benefits of an Ethics and Compliance Program

The development and implementation of an effective ethics and compliance program offers a corporation a number of advantages.² As a fundamental matter, the true value of an ethics and compliance program lies in its ability to detect and prevent criminal and other improper activity by corporate employees. In other words, an effective ethics and compliance program will foster and encourage ethical conduct by employees in all aspects of the corporation's business. Constant reminders (and examples) to employees that it is the corporation's policy to abide by the law and to punish violators discourage and deter criminal behavior and other unethical conduct, discourage employee tolerance of improper activity, and encourage employees to report misconduct to management. The early detection of misconduct maximizes a corporation's ability proactively to respond to and address the causes of wrongdoing and to minimize its consequences.³

The financial savings resulting from the prevention or early detection of criminal and other improper conduct are substantial. A corporation can avoid criminal, civil, and

² See generally, "Seven Steps May Help Corporations Avoid Criminal Liability," *BNA Corporate Counsel Weekly*, Oct. 21, 1998, at 7-8; Webb & Molo, "Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Organizational Sentencing Guidelines," 71 *Washington University Law Quarterly* 375 (1993); Sandler & Klubes, "The Organizational Sentencing Guidelines: Increased Criminal Penalties for Corporations and the Implications for Corporate Self-Governance," *The Lawyers Brief* (Feb. 29, 1992).

³See "Programs for Employees Keep Companies on Track Ethically," *BNA Corporate Counsel Weekly*, Dec. 9, 1998 at 5 (reporting view that business professionals behave unethically due to pressure to achieve management

administrative fines, penalties, offsets, civil judgments in *qui tam* and shareholder lawsuits, and the significant legal fees associated with litigation with either the government or private parties. Moreover, an effective ethics and compliance program may prevent the loss of business which will result from suspension or debarment from government contracting, denial of export licenses, the loss of customer confidence, or a damaged reputation. In addition, prevention or early detection of misconduct will avoid the employee morale and productivity disruptions that often accompany an investigation of, or legal action involving, allegations of corporate impropriety.

One of the more significant advantages of a corporate ethics and compliance program is avoiding altogether prosecution for the criminal acts of corporate employees. This point was underscored by a former senior prosecutor from the United States Department of Justice in remarks made September 8, 1995, to a United States Sentencing Commission symposium on corporate compliance and ethical behavior. Then Deputy Assistant Attorney General Robert S. Litt of the department's criminal division pledged that strong compliance efforts will receive serious consideration by federal prosecutors deciding whether to charge corporations.⁴ Mr. Litt acknowledged that prosecutors realize that no compliance program is going to prevent all criminal activity by rogue employees. What is important, Mr. Litt pointed out, is that a corporation be able to demonstrate that the measures that it has taken are "effective" even though a crime occurred. Mr. Litt noted that prosecutors have long taken into account the existence of a compliance program in deciding whether to bring charges against a corporation.

objectives, with top pressures including: (1) meeting overly aggressive financial priorities; (2) meeting schedule priorities; (3) helping the organization to survive; and (4) rationalizing other peoples' often unethical behavior).

⁴ 57 Crim.L.Rptr. 1580 (September 20, 1995).

"A good corporate citizen, one that is devoted to an effective compliance program, is much less likely to be prosecuted itself for the acts of its wayward employees," Mr. Litt stated.⁵

In another forum, Department of Justice Fraud Section Deputy Chief Barbara A. Corprew emphasized the benefits that may attach to a corporation committed to self-governance:

If a company is a corporate good citizen, we may not prosecute . . . the Justice Department looks for programs that establish a culture of integrity throughout the organizations. Companies should be aware that, during an enforcement action, the Department will examine whether the program is a facade or indeed a genuine ethics program . . . the Justice Department has been observing a change in attitude in the corporate community. More companies are taking responsibility for compliance efforts, more in-house training programs are available and more problems are being reported through company hotlines . . . the public is best served when companies seek out and solve their own problems . . .⁶

Two prominent cases highlight the comments of Mr. Litt and Ms. Corprew concerning the Department of Justice's willingness to factor a corporation's ethics and compliance efforts into the exercise of prosecutorial discretion. In May 1992, the United States Attorney's Office for the Southern District of New York elected not to prosecute Salomon Brothers in connection with a managing director's misconduct in auctions of United States Treasury securities largely due to Salomon's disclosure of the misconduct, its cooperation with law enforcement authorities, and its agreement to institute remedial measures designed to prevent reoccurrence

⁵ *Id.*

⁶ *Federal Ethics Report*, Vol. 3, Issue 7 (July 1996) at 4. More recently, at the 13th annual Defense Industry Initiative on Business Ethics and Conduct Forum in June 1999, Philip Urofsky, a trial attorney for the U.S. Department of Justice Fraud Section, discussed how the department decides to prosecute a company when one or more of its employees has violated the Foreign Corrupt Practices Act ("FCPA"). Mr. Urofsky stated that prosecutors from different divisions of the department give different weight to the existence of a compliance program when deciding whether to prosecute. For FCPA violations, the Fraud Section weighs the existence of a compliance program in deciding to prosecute. If a company has a good compliance program and the violations are committed by a rogue employee, the company may avoid prosecution. Mr. Urofsky added, however, that the

of the violations. On the other hand, in May 1999, the same office prosecuted Bankers Trust Company for a scheme in which senior officers and employees illegally diverted \$19.1 million in unclaimed checks and other credits owed to customers into the bank's own books to enhance its financial performance. The United States Attorney credited Bankers Trust officials with first uncovering the scheme and reporting it to the government, but accused the bank of initially minimizing the extent of the culpability of its officers and employees and noted that the scheme originated after senior management placed severe pressure on managers to generate revenues to meet financial targets.⁷

An effective ethics and compliance program, however, does not mean that a corporation will never be prosecuted. In a recent policy paper issued by the Department of Justice on June 16, 1999, entitled "Federal Prosecution of Corporations,"⁸ the Department outlines the factors federal prosecutors should consider in deciding whether to pursue criminal charges against corporations. The guidance recognizes that the existence of a corporate compliance program may play a significant role in a prosecutor's charging decision.⁹ "The

further up the chain of command the violation goes, the more likely a corporate prosecution becomes. *Federal Ethics Report*, Vol. 6, Issue 7 (July 1999) at 5.

⁷ See Benjamin Weiser, "Bankers Trust Says It Illegally Diverted Unclaimed Money," *The New York Times*, Mar. 12, 1999, at A1; Obermaier, "Do the Right Thing -- But if a Company Doesn't, It Can Limit the Damage," *Barron's*, Dec. 14, 1992, at 18 (comparing the Salomon Brothers case and a securities fraud case in which the United States Attorney for the Southern District of New York prosecuted the Cooper Companies after the company resisted any acknowledgement of wrongdoing). In September 1996, the United States Attorney's Office for the Central District of California elected not to prosecute Coopers & Lybrand in connection with its dealings with then-indicted (later convicted and then granted a new trial on appeal) former Arizona Governor J. Fyfe Symington. The United States Attorney's Office's decision, in part, was based on Coopers' agreement to cooperate with the government, its recognition of the impropriety of its employees' conduct, and its agreement to establish a company-wide ethics program for all employees. See "Coopers Settles in Symington Dealings," *The Wall Street Journal*, September 23, 1996, at B12.

⁸ "Federal Prosecution of Corporations," U.S. Department of Justice (June 16, 1999), *reprinted in*, 66 *Crim.L.Rptr.* 189 (Dec. 8, 1999).

⁹ *Id.* at 190.

Department of Justice encourages such self-policing," the guidance states, but "the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal conduct . . ." ¹⁰

Even if an effective ethics and compliance program does not prevent prosecution, it can minimize the severity of a corporation's sentence upon conviction. The Organizational Sentencing Guidelines reduce a corporation's "culpability score" by three points if an offense occurred "despite an effective program to prevent and detect violations of the law." ¹¹ This reduction can result in substantial mitigation of the sentencing fine range and the corporation's sentencing exposure (in some instances up to eighty percent). ¹² In addition, an effective ethics and compliance program may prevent imposition of a burdensome and intrusive sentence to a term of organizational probation. ¹³

Aside from having a role in avoiding or mitigating criminal prosecution, an effective ethics and compliance program will reduce the potential for suspension or debarment from

¹⁰ *Id.* at 192. According to the Department of Justice guidance, "the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. *Id.* In evaluating whether a company's program is well designed and whether it works, the guidance explains, a prosecutor should look at its comprehensiveness, the extent and pervasiveness of the wrongdoing, how many employees were involved and how high up in the company they were, the seriousness, duration, and frequency of the lawbreaking, and remedial measures -- restitution, discipline, program revisions -- undertaken by the corporation, and the promptness of any voluntary disclosure and the extent of any cooperation. *Id.*

¹¹ U.S.S.G. § 8C2.5(f). The three-point reduction is lost if a "high level individual" or an "individual responsible for administration or enforcement" of the compliance program participated in, condoned, or was willfully ignorant of the offense." *Id.*

¹² *See* U.S.S.G. §§ 8C2.6 and 8C2.7.

¹³ *See* U.S.S.G. § 8D1.1(a)(3). In 1996, 96 companies were placed on probation, nearly twice as many as in 1993. "Corporate Monitors Form a New Industry," *The Wall Street Journal* (December 1, 1997) at B12. In some instances, companies have found particularly onerous and disruptive, the conduct of outside monitors appointed by the sentencing court as a condition of probation in order to provide the court with continuing authority over the day to day operations of the corporation.

government contracting, a serious administrative action that poses a substantial threat to the economic viability of a corporation. The Federal Acquisition Regulations ("FAR") provide, and experience shows, that suspension and debarment authorities will favorably consider an ethics and compliance program in assessing the present responsibility of a corporation.¹⁴

Finally, the creation and implementation of an effective ethics and compliance program may shield company directors from personal liability arising from the wrongdoing of employees. The Delaware Court of Chancery in *In re Caremark International Inc. Derivative Litigation*, in the context of approving a settlement of a derivative action, held that Caremark's directors did not breach their duties to shareholders because they took steps to ensure that the corporation had a compliance system (an "information and reporting system") to assure the board that appropriate information would come to its attention in a timely manner as a matter of ordinary operations.¹⁵ Some of these steps including naming the chief financial officer as the corporate compliance officer, creation of an internal audit plan monitored by a board committee designed to assure compliance with business and ethics policies, and the compilation of an employee ethics handbook concerning compliance policies (including the requirement for all employees to report illegal conduct to a toll-free confidential ethics hotline). The court made two interesting observations. First, it noted that any corporate self-governance effort must take into account the requirements of the organizational sentencing guidelines.¹⁶ Second, it pointed out that no rationally designed information and reporting system will remove the

¹⁴ See FAR subparts 9.406-1(a)(1) and 9.407-1(b)(2); 48 C.F.R. §§ 9.406-1(a)(1) and 9.407-1(b)(2).

¹⁵ *In Re Caremark International, Inc. Derivative Litigation*, 698 A.2d 959 (Del.Ch. 1996). The derivative action before the court arose from a 1994 federal indictment of Caremark, which led in 1995 to Caremark pleading guilty to a single felony charge and its payment of \$250 million in criminal fines, civil penalties, and civil damages.

¹⁶ *Caremark* at 970.

possibility that the corporation will violate laws or regulations, or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law.¹⁷

B. Potential Problems Associated with an Ethics and Compliance Program

Although outweighed by the benefits, there are potential problems associated with the implementation of an ethics and compliance program.¹⁸ Once a corporation establishes compliance standards, it must devote the necessary resources to ensure that the standards are met or risk having the compliance program deemed "non-effective" due to lack of enforcement. In some instances, a corporate ethics and compliance program may be used as a sword against the corporation. For example, a prosecutor or plaintiff's counsel may try to use a corporation's ethics and compliance program as the standard by which employee conduct should be judged in a civil or criminal trial, arguing that any failure to meet the program's requirements is indicative of fraudulent intent, a knowing act, or negligence.¹⁹

An ethics and compliance program may generate through reporting procedures and an internal investigation damaging evidence that, if obtained by government investigators or private litigants, will assist in the development of a criminal or civil case against the corporation and could ultimately lead to the corporation's prosecution. Reporting procedures or an internal investigation may also alert corporate employees to suspected wrongdoing and

¹⁷ *Id.*

¹⁸ Webb & Molo, "Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Organizational Sentencing Guidelines," 71 *Washington University Law Quarterly* 379 (1993).

¹⁹ *Id.*, citing Pitt & Groskaufmanis, "Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct," 78 *Geo.L.J.* 1559, 1605-14 (1990).

these employees may take advantage of such information and file lawsuits against the corporation under the *qui tam* provisions of the Civil False Claims Act. In that regard, taking disciplinary action against employees may not only cause them to become *qui tam* relators, but can serve as a "roadmap" for government investigators by providing insight into the corporation's assessment of relative culpability among sanctioned employees through a comparison of the varying severity of discipline imposed.

Although the results of an internal investigation are normally protected by the attorney-client privilege, prosecutors and private litigants in some instances nonetheless may obtain access to the information. A corporation may elect to disclose to the government portions of an internal investigation's findings in an effort to avoid indictment, mitigate sentencing exposure or avoid suspension or debarment. Such disclosure, however limited, creates a substantial risk that the corporation will waive the attorney-client or work product privileges, not only with respect to the internal investigation's findings, but to all information related to the same subject matter.²⁰

III. Elements Of An Effective Ethics and Compliance Program

Aside from the substantial volume of literature addressing ethics and compliance programs generated by the private bar and commentators,²¹ corporations can look to three sources from which to derive the essential elements of an effective ethics and compliance

²⁰ See e.g., *United States v. Massachusetts Institute of Technology*, 129 F.3d 681 (1st Cir. 1997); *In re Steinhardt Partners*, 9 F.3d 230 (2d Cir. 1993); *Westinghouse Electric Corporation v. Republic of Philippines*, 951 F.2d 1414, 1428-29 (3d Cir. 1991); *In re Martin Marietta Corporation*, 856 F.2d 619 (4th Cir. 1988), *cert. denied*, 490 U.S. 1011 (1989); *United States ex rel. Mayman v. Martin Marietta Corporation*, 886 F. Supp. 1243 (D.Md. 1995); *In re Leslie Fay Companies, Inc. Securities Litigation*, 152 F.R.D. 42 (S.D.N.Y. 1993).

program. The primary source is, of course, the Organizational Sentencing Guidelines at Chapter 8 of the United States Sentencing Guidelines. Two other sources exist, however, particularly for corporations doing business with the Department of Defense ("DoD"). The Defense Federal Acquisition Regulations Supplement ("DFARS") establishes for DoD contractors the general requirement for ethical conduct, defines broad program elements, and provides examples of what a system of management controls should include.²² The Defense Industry Initiative on Business Ethics and Conduct ("DII") principles provide another source for ethics and compliance program elements.

A. Organizational Sentencing Guidelines

The Organizational Sentencing Guidelines specify the type of corporate compliance effort that is required for mitigation of a corporation's sentence upon conviction.²³ As a practical matter, however, the real benefit to corporations of instituting an effective ethics and compliance program will not be at sentencing, but will be in its role in preventing crime in the first place.

The Guidelines provide that an "effective program to prevent and detect violations of law" means a program that has been reasonably designed, implemented, and enforced so that it generally will be effective in preventing and detecting criminal conduct.²⁴ The hallmark of an effective program to prevent and detect violations of law, according to the Guidelines, is that

²¹ *E.g.*, James A. Dobkin, "Fundamental Principles for Organizational Compliance Programs: A Practitioner's Perspective," *Federal Contracts Report*, Vol. 68, October 13, 1997, at 416; Rakoff, Blumkin & Sauber, *Corporate Sentencing Guidelines: Compliance and Mitigation*, Law Journal Seminars-Press (1993).

²² DFARS Subpart 203.70, 48 C.F.R. § 203.70.

²³ U.S.S.G. § 8A1.2. (n.3(k)).

²⁴ *Id.*

the organization exercised **due diligence** in seeking to prevent and detect criminal conduct by its employees and other agents.²⁵

The Guidelines articulate the minimum steps that the organization must take to establish that it exercised due diligence:²⁶

- (1) The organization must establish compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.
- (2) High-level individuals within the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.
- (3) The organization must use due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities.
- (4) The organization must take steps to communicate effectively its standards and procedures to all employees and other agents, *e.g.*, by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.
- (5) The organization must have taken reasonable steps to achieve compliance with its standards, *e.g.*, by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution.
- (6) The standards must be consistently enforced through appropriate disciplinary measures, including, as appropriate, discipline of individuals responsible for failure to detect an offense. Adequate discipline of individuals responsible for an offense is a necessary component of enforcement; however the form of discipline that will be appropriate will be case specific.

²⁵ *Id.*

²⁶ U.S.S.G. § 8A1.2. (n.3(k)(1)-(7)).

- (7) After an offense has been detected, the organization must take all reasonable steps to respond appropriately to the offense and to prevent further similar offenses -- including any necessary modifications to its program to prevent and detect violations of law.

The Guidelines explain that the precise actions necessary for an effective program to prevent and detect violations of law will depend upon a number of factors:²⁷

- (1) Size of the organization -- The formality of a compliance program will vary with the size of the organization. Larger organizations must have more formal programs with established written policies defining the standards and procedures to be followed by its employees and other agents.
- (2) Likelihood that certain offenses may occur because of the nature of its business -- If the nature of an organization's business engenders a substantial risk that certain types of offenses may occur, the program must focus on those offenses.
- (3) Prior history of the organization -- An organization's prior history may indicate types of offenses that it should take actions to prevent.
- (4) An organization must incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation.

The Guidelines reward self-reporting and cooperation by sentence mitigation.²⁸ The Guidelines urge an organization to take responsibility for its actions as soon as it detects an offense. The organization must disclose wrongdoing to government authorities and its cooperation must be both timely and thorough. The Guidelines require that the organization must begin cooperating at the time it receives notice of an investigation and the organization

²⁷ U.S.S.G. § 8A1.2. (n.3(k)).

²⁸ U.S.S.G. § 8C2.5(g).

must disclose all pertinent information sufficient for law enforcement officials to identify the nature and extent of the offenses and the responsible individuals.

B. DFARS Subpart 203.70

DFARS Subpart 203.70 articulates policy and procedures applicable to government contractor ethics programs that are directly relevant to establishing and implementing a compliance program and, in general terms, complement the compliance requirements established by the Organizational Sentencing Guidelines. The DFARS policy statement is straightforward: government contractors must conduct themselves with the highest degree of integrity and honesty.²⁹ To meet this goal, the DFARS requires that contractors have standards and internal control systems that:

- (1) Are suitable to the size of the company and the extent of their involvement in government contracting.
- (2) Promote such standards.
- (3) Facilitate the timely discovery and disclosure of improper conduct in connection with government contracts.
- (4) Ensure corrective measures are promptly instituted and carried out.³⁰

The DFARS identifies elements that a contractor's system of management controls should provide for:

- (1) A written code of business ethics and conduct and an ethics training program for all employees.

²⁹ DFARS Subpart 203.7000; 48 C.F.R. § 203.7000.

³⁰ *Id.*

- (2) Periodic reviews of company business practices, procedures, policies, and internal controls for compliance with standards of conduct and the special requirements of government contracting.
- (3) A mechanism, such as a hotline, by which employees may report suspected instances of improper conduct, and instructions that encourage employees to make such reports.
- (4) Internal and/or external audits as appropriate.
- (5) Disciplinary action for improper conduct.
- (6) Timely reporting to appropriate government officials of any suspected or possible violation of law in connection with government contracts or any other irregularities in connection with such contracts.
- (7) Full cooperation with any government agencies responsible for either investigation or corrective actions.³¹

C. DII Principles

In 1986, representatives of eighteen defense contractors drafted six key principles of business ethics and conduct. The principles, which became known as the DII principles, pledge the signatory companies to implement policies, procedures, and programs in six areas.

- (1) Company codes of ethics.
- (2) Ethics training for employees.
- (3) Internal reporting of alleged misconduct.
- (4) Self-governance through the implementation of systems to monitor compliance with federal procurement laws and the adoption of procedures for voluntary disclosure of violations to the appropriate authorities.
- (5) Responsibility to the industry through attendance at Best Practices Forums.
- (6) Accountability to the public.

³¹ DFARS Subpart 203.7001; 48 C.F.R. § 203.7001.

The DII principles generally reflect the policies and procedures of corporate self-governance and effective ethics and compliance programs articulated by the Organizational Sentencing Guidelines and the DFARS.

IV. Lockheed Martin's Self-Governance Program

Lockheed Martin Corporation was formed on March 15, 1995, through the merger of Lockheed Corporation and Martin Marietta Corporation. While each company brought with it a commitment to ethical conduct and compliance programs, the merger afforded Lockheed Martin Corporation a unique opportunity to emphasize core ethical principles central to the new corporation and a self-governance program designed to ensure that those core ethical principles became an integral part of doing business throughout the corporation.

Fundamental to Lockheed Martin's self-governance program is the establishment and promulgation of a strong corporate culture of ethical conduct. In a videotape shown to all new employees, the President and Chief Operating Officer of Lockheed Martin makes it clear that the Corporation is committed to the highest standards of ethical conduct in every aspect of its dealings with all its constituencies: employees, customers, communities, suppliers, and shareholders. The videotape highlights the Corporation's guiding ethical principles:

- (1) Honesty: to be truthful in all our endeavors; to be honest and forthright with one another and our constituencies.
- (2) Integrity: to say what we mean, to deliver what we promise, and to stand for what is right.
- (3) Respect: to treat one another with dignity and fairness, appreciating the diversity of our workforce and the uniqueness of each employee.
- (4) Trust: to build confidence through teamwork and open, candid communication.

- (5) Responsibility: to speak up -- without fear of retribution - and report concerns in the workplace, including violations of laws, regulations and company policies, and seek clarification and guidance whenever there is doubt.
- (6) Citizenship: to obey all the laws of the United States and the foreign countries in which Lockheed Martin does business and to do our part to make the communities in which we live a better place to be.

A key element of Lockheed Martin's ethics and compliance program is high-level program management. To develop and implement its self-governance program, the Corporation established the Office of Ethics and Business Conduct and the position of Vice President of Ethics and Business Conduct. The Vice President of Ethics and Business Conduct reports directly to the Office of the Chairman and to the Audit and Ethics Committee of the Board of Directors. The Vice President of Ethics and Business Conduct annually attends two meetings of and has unrestricted access to the Audit and Ethics Committee of the Board of Directors and reports on matters of ethics, compliance, and business conduct.

The Corporation has also created the Corporate Ethics and Business Conduct Steering Committee. The Committee is chaired by the Corporation's President and Chief Operating Officer, and is further comprised of senior corporate officers including the Vice President of Ethics and Business Conduct, the Vice President and Chief Financial Officer, Senior Vice President and General Counsel, Vice President of Human Resources, Vice President of Internal Audit, Vice President of Business Development and, on a rotating basis, one Business Area Executive Vice President and four Business Unit Presidents representing the other business areas of the Corporation. The Committee meets quarterly to provide guidance, counsel, and strategic direction on the Corporation's ethics and business conduct programs to

include monitoring compliance with applicable laws, regulations, and business practices policies, oversight of corporate-wide ethics education and awareness programs, reviewing ethics and compliance program performance of business units (including foreign locations), and reviewing ethics helpline statistics, trends, and survey data.

Each business unit within Lockheed Martin has established a steering committee with similar responsibility for management and oversight of its ethics and business conduct program. A business unit committee is chaired by the business unit president and includes, at a minimum, the senior human resources, legal, internal audit, and finance executives, and the business unit ethics officer.

The Corporation has developed and distributed to each of its more than 128,000 employees a code of conduct designed to ensure that every employee understands and adheres to the Corporation's principles of integrity and ethical behavior as well as its policies and procedures. Lockheed Martin's Code of Ethics and Business Conduct, entitled "Setting the Standard," updated in 1999 to reflect Lockheed Martin's global business environment, provides a common source of reference for general ethical guidance for all employees at every level of the corporation. The code initially was distributed to each employee individually by his or her immediate supervisor during annual live ethics training and is provided to all new employees. All employees must acknowledge receipt of the code in writing or via electronic acknowledgment. The code, published in English and 13 other languages, is a pocket-sized, spiral-bound booklet, which articulates the Corporation's core ethics principles of honesty, integrity, respect, trust, citizenship, and responsibility, as well as general standards of conduct and principles to guide employees in their daily activity. The code is also available for viewing by all employees, suppliers, or any other interested party at the Ethics Home Page at

the Corporation's website: www.lockheedmartin.com/about/ethics.html. Those general standards of conduct include:

- (1) Treat in an ethical manner all those to whom Lockheed Martin has an obligation.
- (2) Obey the law - Compliance with the law does not comprise our entire ethical responsibility, it is a minimum, absolutely essential condition for performance of our duties.
- (3) Promote a positive work environment.
- (4) Work safely.
- (5) Keep accurate and complete records.
- (6) Record costs properly.
- (7) Strictly adhere to all antitrust laws.
- (8) Know and follow the law when involved in international business.
- (9) Follow the rules in using or working with former government personnel.
- (10) Follow the law and use common sense in political contributions and activities.
- (11) Carefully bid, negotiate, and perform contracts.
- (12) Avoid illegal and questionable gifts or favors.
- (13) Steer clear of conflicts of interest.
- (14) Maintain the integrity of consultants, agents, and representatives.
- (15) Protect proprietary information.
- (16) Obtain and use company and customer assets wisely.
- (17) Do not engage in speculative or insider trading.

To ensure complete and effective implementation of its ethics and compliance program, Lockheed Martin has created a corporate-wide ethics and business conduct organization. The

Office of Ethics and Business Conduct is responsible for the overall administration of the Corporation's ethics and business conduct program. The Vice President of Ethics and Business Conduct and business area executive vice presidents have appointed business area ethics directors while business unit ethics officers have been appointed by their respective business unit presidents in consultation with the Office of Ethics and Business Conduct. The business unit ethics officers report directly to their business unit presidents. Ethics officers are responsible for coordination and oversight of ethics programs and processes and serve as primary points of contact between the business unit and the Office of Ethics and Business to assure effective implementation of ethics awareness and reporting processes. The ethics officers advise and support business area executive vice presidents and business unit presidents in evaluating ethics issues and establishing and enforcing ethics policies and practices. In addition, ethics officers initiate investigations into allegations of misconduct and assure appropriate review and disposition, to include coordination necessary for discipline or corrective action.

Important components of the Corporation's self-governance program are its reporting and information hotlines, or "HelpLines." Ethics officers and confidential ethics helplines are available to all employees at both the operating business units and corporate level. Employees are urged via training, in the code of conduct, and by poster to use these resources without fear of retribution whenever they have a question or concern that cannot be readily addressed within their work group or through their supervisor. It is Lockheed Martin policy to foster a free and open atmosphere that allows and encourages employees to make inquiries, express work-related concerns regarding ethics issues, and to report business ethics violations or violations of law, regulations, policies, or procedures without fear of retribution or retaliation

for making such reports or inquiries. Posters placed on bulletin boards throughout the Corporation identify the appropriate ethics officer by name, provide a photograph, and include his or her telephone number, as well as toll-free Helpline numbers.

Ethics awareness and compliance training of each employee is an essential element of the Corporation's self-governance program. Training programs are centrally developed and locally administered and are designed to ensure that all employees are sensitive to ethical issues and standards. Moreover, the training programs are designed to ensure that all employees are aware of applicable laws, regulations, and standards of business conduct both in general and as they pertain to the employee's specific job function, as well as the consequences both to the employee and the company that may result from violations.

A key element of Lockheed Martin's ethics and business conduct program is a requirement that each employee receive live ethics awareness training from his or her supervisor on an annual basis. In 2000 and 2001, the training tool was *Ethic Daily*, a *USA Today*-style newspaper. *Ethics Daily* training focused on the application at work of the ethics principles of honesty, trust, respect, integrity, responsibility and citizenship. During the training, employee teams analyzed selected scenarios, styled as newspaper articles, and patterned on real workplace situations that occurred in the Corporation. Employees developed appropriate actions based on an article's facts, identified the applicable ethical principles that these actions entailed, and created headlines to describe the article. Managers and supervisors, who personally conduct the training for their employees, facilitate ethics awareness training sessions. The training begins with the Lockheed Martin Chairman and Chief Executive Office conducting training with his senior staff. Ethics awareness training then cascades from the top down to the business areas and business units throughout the Corporation.

The Corporation believes that for its ethics program to be effective, supervisors and managers must link their dialogues on performance to reminders about the Corporation's values emphasizing mission success, teamwork, and a commitment to the highest standards of ethical business conduct. All employees at Lockheed Martin are part of the ethics program, and supervisors and managers are responsible for leading the annual ethics awareness training sessions.

Compliance training related to business conduct is the complement of ethics awareness training in the Corporation's self-governance program. Compliance training is developed and implemented locally based on broad guidance from corporate elements. Designated corporate staff ("responsible executives") are charged with ascertaining training needs in their areas of responsibility, ensuring that compliance areas are identified, and that appropriate training materials and curricula are developed and implemented. The corporate responsible executives name corporate subject matter experts to support the compliance effort.

Every three years, corporate elements as well as business areas and business units, develop or update a compliance training plan tailored to their respective organizations, consistent with guidance from the Office of Ethics and Business Conduct. Each business unit names its own responsible officials and subject-matter experts for each area identified for training. To ensure that each employee is knowledgeable about applicable laws, regulations, and standards of business conduct pertinent to his or her particular job function, the plans include a training matrix detailing the training to be provided, how it will be conducted, who will receive the training, and how it will be tracked and reported.

Compliance training is provided locally at business units through a number of delivery options, including: interactive multimedia CD ROM's, web-based training modules,

desktop/laptop compatible training modules, linear videos, all-hands meetings, staff meeting discussions, classroom training, training bulletins, and pamphlets. Business units have the flexibility to determine which combination of delivery options offers the most effective and efficient manner in which to conduct compliance training. Training modules on CD-ROM and available for web-based delivery include, among others, Antitrust Compliance; Drug-Free Workplace; Environment, Safety and Health; Export Control; Foreign Corrupt Practices Act; International Military Sales; Sexual Harassment; Truth-in-Negotiations Act; Procurement; Material Costs; Kickbacks and Gratuities; Product Substitution; Organizational Conflict of Interest; Software License Compliance; Government Property; Insider Trading, and Procurement Integrity.

In an effort to increase the efficiency and lower the costs of compliance training, the Corporation has implemented a Web-based tool called Qwizard. Qwizard allows employees to take compliance training quizzes, the same quizzes taken at the end of a CD-ROM training module, on-line at their desks. Qwizard enables employees who know the material in the CD-ROM modules to reduce significantly the amount of time they spend on recertification compliance training without compromising the Corporation's ability to say with absolute certainty that employees demonstrate the compliance knowledge and competency they need.

The Corporation believes that continuous reinforcement of the commitment to ethical business conduct is an essential component of its self-governance efforts. To that end, there are frequent ethics columns in *Lockheed Martin TODAY*, the corporate-wide newspaper. Each *TODAY* ethics column focuses on current activities of the Office of Ethics and Business Conduct or addresses issues of general interest. A periodic guest ethics column by corporate executives is published as tangible evidence of senior management's involvement in and

support of the ethics process at the Corporation. Moreover, current ethics and compliance related materials and items of interest, together with links to other ethics sites, are available to employees not only on the Corporate Business and Ethics Conduct Office's website, but on a variety of websites maintained or supported by Lockheed Martin company ethics offices across the Corporation.

Two final elements are essential to Lockheed Martin's self-governance program. First, internal audit each year creates an audit plan for and audits the Corporation's operations for compliance with its ethics and compliance program. This audit effort is in addition to internal audit's more traditional compliance-related focus on management control systems and contract compliance. Included in this audit coverage is a review of the Corporation's progress in completing compliance training requirements. Second, as part of its self-governance program, Lockheed Martin has adopted a policy of voluntarily disclosing to responsible authorities (in most cases the DoD Office of the Inspector General and the Department of Justice) violations of law or significant employee misconduct. Lockheed Martin has found that employee awareness and appreciation of the Corporation's policy to disclose improper behavior to the government is an extremely effective method of communicating to employees the unequivocal nature of the Corporation's commitment to ethical behavior and is a powerful deterrent against improper behavior.³²

³² The Organizational Sentencing Guidelines reward self-reporting and cooperation, U.S.S.G. § 8C2.5(g), and require, as part of an effective program to prevent and detect violations of law, that a corporation adequately discipline an employee responsible for a violation of the law. U.S.S.G. §8A1.2. (n.3(k)(6)). Companies confronted with employee misconduct are becoming increasingly willing to disclose that misconduct to government law enforcement agencies and to cooperate with the government's investigation of the employee. See "Pollution Case Highlights Trend To Let Employees Take the Rap," *The Wall Street Journal* (October 9, 1997) at B8. In response to *The Wall Street Journal's* article, one commentator has advised that turning against an employee may not always be the optimal course of action for a company, as the company may need the cooperation of such employees for its defense and casting individual employees aside may hasten their turning

V. Conclusion

Like many corporations, Lockheed Martin Corporation has taken responsibility for self-governance because it is the right thing to do and because ethics and compliance programs are a good business practice. Lockheed Martin's self-governance program goes beyond a mere focus on rules that is associated with many compliance programs, to a broader focus on ethical values and conduct as a way of business. In doing so, Lockheed Martin seeks to prevent employee misconduct before it happens and thereby successfully measure up to the intense scrutiny and high standards to which the government, shareholders, industry, and the public hold Lockheed Martin in all its operations.

Lockheed Martin's efforts in that regard were formally recognized on September 8, 1998, when the American Society of Chartered Life Underwriters & Chartered Financial Consultants announced that it had awarded to Lockheed Martin Corporation its 1998 American Business Ethics Award ("ABEA") in the public company category. Awarded annually since 1994, the ABEA recognizes companies from three categories -- public company, private company, and small business -- that demonstrate a firm commitment to ethical business practices in everyday operations, management philosophies, and response to crisis or challenges.

against the company. Richard M. Cooper, "Is It Always Smart for a Company to Let Employees Take the Rap?" *Business Crimes Bulletin*, Vol. 4, No. 9 (October 1997) at 1.