RAYTHEON
LECTURESHIP IN
BUSINESS ETHICS

Keepers of the Corporate Conscience: The Role of the Board in Ethical Oversight

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CENTER FOR
BUSINESS ETHICS

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BENTLEY
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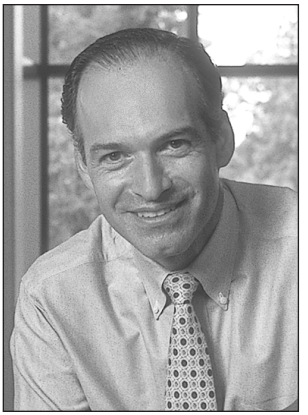
BENTLEY is a business university. Centered on education and research in business and related professions, Bentley blends the breadth and technological strength of a university with the values and student focus of a small college. Our undergraduate curriculum combines business study with a strong foundation in the arts and sciences. A broad array of offerings, including MBA, Master of Science and certificate programs at the McCallum Graduate School, emphasize the impact of technology on business practice. Enrolling approximately 3,900 full-time undergraduate, 335 adult part-time undergraduate, and 1,300 graduate students, Bentley is located in Waltham, Massachusetts, minutes west of Boston.

The Center for Business Ethics at Bentley College is a nonprofit educational and consulting organization whose vision is a world in which all businesses contribute positively to society through their ethically sound and responsible operations. The center's mission is to give leadership in the creation of organizational cultures that align effective business performance with ethical business conduct. It endeavors to do so by the application of expertise, research, education and a collaborative approach to disseminating best practices. With a vast network of practitioners and scholars and an extensive multimedia library, the center provides an international forum for benchmarking and research in business ethics.

The center helps corporations and other organizations strengthen their ethical culture through educational programming such as the Raytheon Lectureship in Business Ethics.



The Bentley community was honored to welcome Jamie Gorelick as the third Raytheon Lecturer in Business Ethics. Ms. Gorelick's career has spanned the legal, policy and corporate landscapes, but she is best known for her service on the 9/11 Commission. Ms. Gorelick, who is an independent member of the board of directors of United Technologies Corporation, explored the role of boards in promoting ethical corporate cultures.

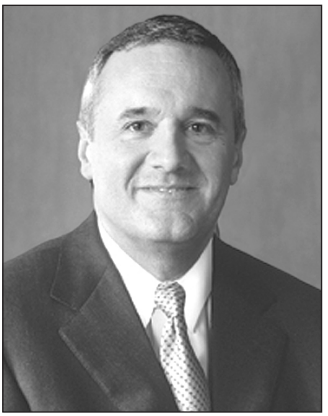
A commitment to ethics and social responsibility — in our scholarship, in the classroom, in student life, and in the way we do business — is central to Bentley's mission as a business university. We believe it is possible to teach ethics, but only if it becomes a way of life on campus. Our students and faculty live and breathe these issues through a host of pioneering programs, sponsored by a campus-wide Alliance, comprising the Center for Business Ethics, the Institute for Women in Leadership, the CyberLaw Center, the Bentley Service-Learning Center, and the Bentley Diversity Initiative.

For over a quarter century, the Center for Business Ethics (CBE) has been an international leader in this field and the driving force behind the infusion of ethics and social responsibility into every facet of Bentley life. The Raytheon corporate leader lecture series, founded and organized by CBE, is a hallmark of this Bentley-wide commitment. With Raytheon's valued support, I am confident that our students and faculty will continue to draw inspiration, understanding and new insight from these dialogues.

Joseph G. Morone
President
Bentley

The Raytheon Lectureship in Business Ethics at Bentley College is made possible through the generous support of the Raytheon Company. Raytheon is an industry leader in defense and government electronics, space, information technology, technical services, and business aviation and special mission aircraft, with annual revenues of more than $20 billion. The company employs 80,000 people worldwide. Raytheon aspires to be the most admired defense and aerospace systems supplier, through its world-class people and technology. It has built a reputation for adhering to the highest ethical standards in the industry. The lectureship series aims to illuminate and promote ethical values and conduct in business, highlighting best practices in corporations throughout the United States.

Learn more about Raytheon online at *www.raytheon.com*.



Ethics in business is about so much more than following rules. Fundamentally, it is a matter of creating the right culture in our organizations, so that people have the ability and support to make decisions that are not only effective but are consistent with the values and principles we hold dear. Raytheon has worked very hard in establishing an ethical business culture that is accepted by our employees and woven into the fabric of the ways in which we work. Our continued growth and profitability depend on it.

Raytheon has supported the Center for Business Ethics at Bentley College for many years, and our sponsorship of its Lectureship in Business Ethics is an important commitment for the company. We recognize the enormous value of the leadership given by the center for nearly 30 years, to promote ethical business practices and cultures in the United States and around the world. And ethical leadership – illuminating and inspiring conduct that is instinctively ethical – is what the Raytheon Lectureship in Business Ethics is about. The series brings to Bentley College highly respected corporate leaders of companies that have a manifest and deep-rooted commitment to doing business in the right way. They will share insights and ideas and engage in discussion about how the business community can and should achieve ethical excellence. I look forward to many fine lectures.

William H. Swanson
Chairman and Chief Executive Officer
Raytheon Company

UNITED TECHNOLOGIES CORPORATION employs 205,700 people, operates in more than 180 countries and territories, and is the 50th largest U.S. company as ranked by *The Wall Street Journal*. In 2004, UTC revenues were $37.4 billion. UTC is a global technology corporation with a long history of pioneering innovation in aerospace, helicopter design, climate control, elevator design and hydrogen fuel cells. All of UTC's businesses have access to one another's ideas and technologies, which promotes technological creativity throughout the corporation. The UTC companies include Otis Elevator, Carrier heating and air conditioning, Chubb fire protection, UTC Power, Pratt & Whitney aircraft engines, Sikorsky helicopters and Hamilton Sundstrand aerospace systems.

JAMIE GORELICK'S career has spanned the legal, public policy and corporate landscapes. She in an independent director of two companies: United Technologies Corporation, a $37 billion corporation that provides high technology products to the aerospace and building systems industries throughout the world; and Schlumberger, Ltd., a $11.5 billion company that is the leading oilfield-services company supplying technology, project management and information solutions in the international oil and gas industry.

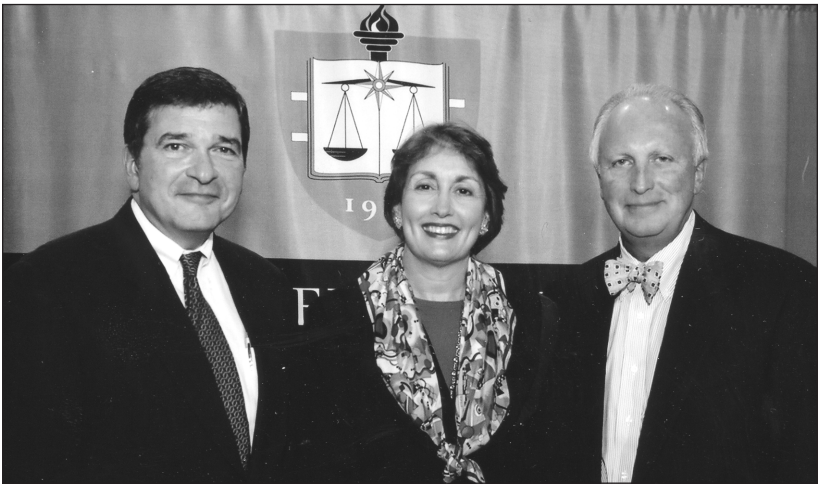
Ms. Gorelick practices law in the international law firm Wilmer Cutler Pickering Hale and Dorr LLP. Over the course of her career, she has represented diverse corporate interests including General Electric, Lockheed Martin, Teledyne, Pfizer and Aetna — as well as organizations like National Public Radio and the American Red Cross — in complex civil and criminal litigation, internal corporate investigations and counseling on issues at the intersection of law, policy and governance. As one of Washington's best-known litigators, Ms. Gorelick has represented corporations and individuals on a wide array of problems, particularly in the regulatory and enforcement arenas. Her leadership in the bar was recognized by her election as president of the District of Columbia Bar in 1992.

In her practice, Ms. Gorelick brings to bear both government and corporate experience. She was one of the longest serving Deputy Attorneys General of the United States, the second highest position in the Department of Justice. In that role, she supervised all of the litigation and law enforcement divisions of the department, including all of the United States Attorneys Offices. She also served as the chief operating officer of

this complex and multi-faceted agency with more than 100,000 people and a budget of more than $18 billion. At the conclusion of her tenure, she received the department's highest award, the Edmund J. Randolph Award. Ms. Gorelick came to Justice from the Department of Defense, where she was General Counsel. There, she structured the department's involvement in the consolidation of the defense industry in the 1990s. Her service to the department was recognized with the award of the Secretary of Defense Distinguished Service Medal. Earlier in her career, Ms. Gorelick was vice chair of the Task Force on the Audit, Inspection and Investigation Components of the Department of Defense. She was also assistant to the secretary and counselor to the Deputy Secretary of Energy, which also presented her with the Secretary's Outstanding Service Medal.

Over the course of her career, Ms. Gorelick has been on numerous government boards and commissions. She was a member of the bipartisan National Commission on Terrorist Attacks Upon the United States (the "9/11 Commission"). She is currently a member of the CIA's National Security Advisory Panel and has previously served on President Bush's Review of Intelligence, President Clinton's Advisory Committee to the Presidential Commission on Critical Infrastructure Protection (which she co-chaired with Senator Sam Nunn) and many others. Between her government service and her tenure on the 9/11 Commission, Ms. Gorelick was vice chair of Fannie Mae, the country's largest source of housing finance.

Ms. Gorelick gives generously of her time to many nonprofit organizations, serving on the boards of The John D. and Catherine T. MacArthur Foundation; the Washington Legal Clinic for the Homeless; the Carnegie Endowment for International Peace; and the Supreme Court Fellows Commission, among others. She is a Counsellor of the American Society of International Law, a Trustee of the Urban Institute and a member of the Council on Foreign Relations.



(left to right) Patrick J. Gnazzo, Vice President — Business Practices, United Technologies Corporation; Jamie Gorelick, Partner, Wilmer Cutler Pickering Hale and Dorr LLP and Board Director, United Technologies Corporation; W. Michael Hoffman, Executive Director, Center for Business Ethics, Bentley.

Keepers of the Corporate Conscience: The Role of the Board in Ethical Oversight

THE RAYTHEON LECTURESHIP IN BUSINESS ETHICS
AT BENTLEY COLLEGE

Thursday, October 14, 2004

Jamie S. Gorelick
Partner, Wilmer Cutler Pickering Hale and Dorr LLP
Board Member, United Technologies Corporation and Schlumberger, Ltd.

I was delighted to have been asked to make these remarks. I come to the topic of the board's role as the keeper of the corporate conscience from two different perspectives. First, I am a lawyer whose firm — Wilmer Cutler Pickering Hale and Dorr — has done many of the internal investigations for boards whose companies, like Enron and MCI, have experienced problems in the last five years. We also help companies across corporate America implement the laws and regulations that passed in response to those scandals. Secondly, I am a director of two great companies — United Technologies and Schlumberger — that live and thrive in this "post-Enron" environment. For both of these reasons, the subject of the board's

role in corporate ethics is one that interests me a great deal. And I am glad to know it interests you enough to invite me here to share some thoughts on the subject.

First, let me say that the title of this speech should end in a question mark. Why? Because, in the first instance, "the keeper of the corporate conscience" is management. While it is true that the board is the ultimate backstop, the ethics and values of a company — to quote Michael Ruettgers, who gave this lecture last year as the Chairman of EMC — "flow from the commitment, action and credibility of its leaders." So, before discussing the board's special role in ensuring the ethical conduct of corporate life, I want to lay the predicate for that role, which is what senior corporate leaders can do to promote ethical behavior.

The employees of ethical companies do not engage in ethical behavior because they have been given a Code of Conduct. Rather, they embrace the underlying values in such a code because they are part of the culture that surrounds them. How do they discern that culture? As the Chairman of Raytheon, William Swanson, said in introducing his company's sponsorship of this lecture, ethical leaders lead by example. They create a culture of collegiality, of honesty and of curiosity — so that issues are raised in a forthright way, without fear of retribution or ostracism. To make sure that they have the culture they think they have, they survey their employees to find out their views and, importantly, their perceptions of the ethics of the company. They, in Swanson's words, "beg for the bad news," and communicate that they are strong enough to take the criticism and hear the concerns. Ethical leaders are self-confident enough to want transparency, to welcome questions, to encourage debate. They know that if they are not ethical, others will not follow them. They know that if they are ethical, their employees will charge up any hill behind them.

So, Codes of Conduct are just a starting point for the CEO of an ethical company. My partner Paul Brountas, who has counseled hundreds of companies in the course of his long career, has written a book called *Boardroom Excellence*, with a foreword by Senator Paul Sarbanes. Paul writes of the CEO as ethical leader:

> While new laws, rules, and regulations may serve as guidelines for the creation of public trust and confidence in the corporation's accounting and disclosure systems and compensation practices, the corporation will not earn that trust and confidence unless it is led by a proactive CEO who believes in corporate integrity and ethical behavior, acts ethically, talks explicitly and repeatedly within the corporation of the need to promote integrity, denounces overreaching and makes believers of the corporation's officers, employees, customers, suppliers and advisers.

Employees know if their company is ethical, because they can see it in how they are treated and in how customers are treated. They see it in the corporate response to environmental, health and safety obligations. They see it in corporate investment in the education of employees. They see it in the private decisions that business leaders make. And they will believe that what is written in a code of ethics is the real code by which the company lives when they see ethical decision-making in action: when customers and business partners are treated honestly; when financial objectives are achieved with due appreciation for legal, public policy and ethical standards; when integrity is a core competency reflected in recruiting and promotion; and when the company is honest with itself about its own shortcomings.

At United Technologies, Chairman and CEO George David has brought a passion to this subject. In his public and private dealings, he teaches by example. And he has incorporated ethical commitments into the everyday life of the company. Let me give three examples. UTC has embraced the toughest environmental standards, reducing hazardous waste by 85 percent since 1990 and air emissions by 95 percent. It has set, and is on target to achieve, dramatic reductions in water and energy consumption. These commitments are tracked as aggressively, and reported as regularly, as key financial commitments. Achievements are celebrated. So, the communities in which UTC manufactures Otis elevators, Carrier air conditioners, Pratt & Whitney aircraft engines and Sikorsky helicopters can measure for themselves the social responsibility of the company.

So too can its employees. Recognizing that the best job security is a good education, UTC's CEO led the establishment of the Employee Scholar Program — an award-winning commitment to the employees of UTC — which pays all the tuition for any employee (even one who is laid off) to attend any accredited school and pursue any line of study; upon successful attainment of a degree, the company gives the employee $10,000 in stock. So far, 14,000 degrees have been earned and another 13,000 employees are in school today. The company has invested a remarkable $400 million in this program to date. Employees take the measure of this company when they see this program in action.

In 1992, well before compliance was a household word, UTC established an ombudsman program that responds to confidential inquiries and comments from employees. There have been 60,000 inquiries since initiation. Countless of them have resulted in changes and improvements in the way the company operates. When a problem is found, it is acknowledged and addressed. The company's compliance programs are global commitments that employees, business partners and customers can see.

These are just examples of the way in which a company can weave a sense of ethics and morality into the fabric of its everyday life.

It is important to acknowledge that high ethical standards are hard to achieve. Human beings are not perfect. In any city of 100,000, there are going to be some bad actors and so it is with a company of 100,000 employees. In addition, dilemmas present themselves regularly. What do you do with the strong performer who has a taste for the blandishments that suppliers are willing to provide? What do you do with the business opportunity that requires not looking too deeply into what makes a certain foreign business partner so successful? What do you do when the market is telling you that it likes your competitor's embrace of a business model that you consider to be phony? What do you do when a new employee brings with him information that can be used to the detriment of his former employer? The way that a company struggles with, and responds to, such questions reflects — and indeed creates — the ethical fabric of the enterprise.

Training that explores difficult questions like these in an interactive way helps a great deal. Compensation systems and promotions that reward ethical behavior can work miracles. A CEO who talks about the company's values in multiple business contexts makes an impression. Exposing the company's weak spots to employee scrutiny emphasizes that the company does not think it is perfect. When Schlumberger CEO Andrew Gould saw behavior he did not like, he talked about it at employee forums to raise the level of consciousness within the company worldwide. He uses both positive and negative examples in his everyday interactions with employees and the company's leadership.

But what if these helpful characteristics and actions are missing? How does a board know and what should it do? In my view, the board has two roles: one systemic and the other cultural. A board does not and should not run the company. Its job is to ensure that appropriate systems and the right people are in place, and to oversee and monitor management's performance. That is the systemic role. It also has a cultural role. It has to create within itself a culture in which the important questions are brought to the boardroom table and addressed in a forthright way. It needs to encourage that same forthrightness throughout the company.

Let me focus first on the systemic. The systems that can be used are well known, though they are not always well executed. Let me address two: the selection and compensation of the CEO, and the review of the company's compliance practices.

The selection, review and compensation of the CEO are among the board's most critical functions, especially in their impact on the ethical conduct of the company. The CEO and his or her team set the tone for the company and can hugely

affect the corporate culture. Employees will take note if the CEO welcomes contrary views, and if the CEO cares about corporate values. As my partner Paul Brountas writes:

> The most important responsibility of the board is to hire, fire, and set the compensation of the CEO.... Corporate responsibility begins with the CEO.... The board's role is to monitor and supervise the company's culture and ensure that the CEO is sending the company's management team and employees the right message.

The board needs to carefully consider and clearly articulate its goals for the CEO and it needs to structure compensation so that it is aligned with those goals. For values to be a priority, they must be measured and rewarded.

Straight talk between the CEO and the board is also critical, whether it is when the CEO meets with the board as a whole or in executive session — or when the lead (or designated) director relays the views of the board members on the CEO's performance and approach. Critical mid-course corrections on an array of issues can be made in this way. If the board feels that the CEO is not properly communicating the values that the board wishes to see, this is a very immediate way to let him know.

The compensation committee needs to operate independently and will often need the services of its own compensation consultant, so that its decisions are fully informed and independent of management. Since these decisions are so central to the role of the board as a whole, the chair of the compensation committee has a special responsibility in keeping all board members apprised of the committee's actions and approaches. This must be a subject of discussion and consensus among the full board.

During periods of transition, the board's role is even more important as the board can ensure that core corporate values survive the end of one CEO's tenure and the beginning of another's. Powerful messages are sent in the anointing of an internal candidate or the selection of an external candidate. Employees, customers and investors will take a message from the selection of a candidate with a strong moral and ethical compass — as they will from the selection of one who does not. The board, both through its compensation committee and as a committee of the whole, must fully engage. This means discussing what the directors want to see in a CEO, assessing the candidates, and structuring a transition process.

The other significant contribution that the board can make to strengthening the ethical moorings of a company is through its audit committee, which should be

fully engaged with the company's internal and external auditors, its counsel and its compliance personnel. The mere fact that a presentation is about to be made to the audit committee focuses the attention of management on potential problems. The regular reporting cycles for each of the reporting groups should ensure board involvement in the checks and balances that permeate the corporate environment. But the reporting can have a mind-numbing quality unless the committee members: (a) have an appetite for it; (b) understand the substance of what is presented; and (c) ask good questions. Here, as with the compensation committee, full and frank discussion is absolutely critical.

While the oversight of the internal and external auditors has long been a function of the audit committee — though perhaps not in the detail or with the rigor of what occurs today — oversight of the compliance function is new to many companies. Also, in the past, the focus of audit committees was on problems that surfaced in the audit process. Now, the focus is more affirmative, to ensure that there are robust audit and compliance programs that protect the company and meet all regulatory requirements. The committee needs to ask whether the compliance and audit systems define the risks to the company and direct needed audit and compliance attention to those risks. The committee must satisfy itself that information about problematic practices flows up to both management and the board, and that whistleblowers are protected from retaliation. The committee needs to know that the company has both a system for detecting illegal or unethical behavior and procedures whereby questionable conduct can be reported. The committee must feel comfortable that the code of conduct indeed represents the company's values.

These procedures do not themselves ensure ethical behavior. Compliance can be done by rote or it can be done for real. The board needs to assure itself that the ethical training for employees is working. It can do this with surveys and through informal contacts with employees. Another way to test the strength of an ethics program is to take a hard look at any wrongdoing that is uncovered to make sure that management looked at the root causes and did everything it could to prevent, detect and punish improper conduct. Sitting on the boards of UTC and Schlumberger, I have been impressed with the unflinching response of management in the face of misfeasance. It is clear that these companies are committed to the tenets of their ethics programs even when faced with the loss of a superior performer or a significant contract. Another test of the strength of an ethics program is whether it imposes the same requirements around the world. If it does, as both of these companies do, that is evidence that the ethics program is permanent and part of the company's culture.

I have described two board functions — managing the relationship with the CEO and overseeing the compliance and audit activities of the company — that have changed substantially over the last decade. These two systemic elements are critical to the ethical tone of the company, but neither can be undertaken unless the board members themselves are comfortable speaking freely and frankly with each other.

So now let me address the second role of the board in the ethical equation. A strong board culture is critical to the ethical posture of the company. Board members need to trust one another and they need a sense of shared mission. Boards increasingly use executive sessions, board retreats and other mechanisms to encourage members to build relationships and to develop a level of comfort in freely expressing their views. The resulting cohesion permits disagreement that does not devolve into confrontation. In the absence of such cohesion — a unity of purpose within the board — disagreements are divisive rather than constructive.

As a lawyer, I want to say a word about the special role that counsel can play in helping both management and the board in the challenging work of building and sustaining an ethical culture. Companies that integrate their lawyers — whether they are inside the company or outside — into the critical decision-making processes can benefit from the close working relationships that result. There is more likely to be the honest dialogue about legal, regulatory, policy and ethical issues when there is such integration. By contrast, the lawyer who is viewed as the obstacle — the lawyer who merely reviews plans that are already set or the lawyer who is not viewed as a trusted counselor — will not add nearly as much to the ethical ballast of a company. It takes a confident manager and a confident lawyer to fill these roles, because both must understand the lawyer's special obligations to raise issues until they are resolved appropriately. But companies that have lawyer-client relationships like these are more likely to prosper in a world filled with ethical minefields.

Today, more than ever, the stakes are high. Ethical values are not just nice to have; they are critical to a company's prosperity. Just in the last year, a major merger was scuttled because in one corner of the company to be acquired, bribery was winked at. A well-regarded financial institution lost the right to do business in a major foreign market because its conduct was thought not to comport with local ethical standards. Huge fines are announced daily. Careers have cratered. Shareholder value has been lost.

On the other side of the ledger are those companies whose employees are motivated by being part of a well-regarded institution; companies that have the cultural resilience to address problems with strength and clarity; companies whose customers and shareholders trust that they will be dealt with fairly.

There is a great deal that board members can do to ensure that their companies are on the right side of that ledger. They need to embrace both the systemic and the cultural challenges. They need to ensure that the right systems are in place and that, when management is tested, its instincts are right. They need to make sure that the company has the right leadership and that that leadership has the proper incentives. They need to make sure that the processes are in place to help all of the employees make ethical decisions.

The board can also bring to bear its diverse talents to be a sounding board for CEO and senior management. Board members — who spend most of their professional time outside the corporation — can see and understand the larger landscape in which the company functions and they can bring those diverse perceptions to bear. They can cross-pollinate the company with ideas from other business and professional settings. They can counsel and prod management. They can encourage frank and unflinching discussions of hard questions.

So, let me answer in this way the question I posed at the outset: whether and in what way the board may be the keeper of the corporate conscience. Day in and day out, the ethical decisions and the fabric of the company's values are in the hands of the CEO and the company's management. But, the board plays a critical role. While it does not sit on the company's shoulder reminding it to do the right thing, it can help build, encourage and fortify the company's own conscience, mindful, as it is, of its responsibility to shareholders as well as to the other communities that the company serves.

Thank you.

Below are highlights from Jamie Gorelick's question and answer session with Bentley students, faculty and guests.

Question:

At a typical board meeting, how much time does the board devote to explicitly ethical issues? And what proportion of its scrutiny is of a negative sort, looking at lack of compliance, malfeasance, and the problems caused by unethical business conduct? And conversely, does the board talk about people who model exemplary ethical behavior?

JAMIE GORELICK:

Of necessity, we spend a great deal of time making sure that the proper systems are in place. At UTC, we want to make sure that our Vice President of Business Practices, Pat Gnazzo — from whom you have heard today — and his colleagues are doing their job, that we have skilled internal and external auditors, and that the compliance function is working. We spend time hearing the complaints that emerge from the hotline process and otherwise that might suggest a problem. And we look to see what management's response has been. If management has been unflinching in dealing with a problem and willing to give up business benefits in the face of questionable or unethical activity, that gets good feedback and praise from the board.

On the question of how much time we spend on affirmative aspects, let me describe ethical values a little more broadly. There is a reason I gave the examples of our environmental, health and safety program at UTC, and the extraordinary investment in our employees. The reason, in my opinion, is that the language of ethics is spoken broadly in the affirmative actions of good corporate citizenship. It is also spoken in the language that George David might use when he says, "We could get this contract if we did X, but I don't think that's the right thing to do and we're not going to. Our competitor may be doing that; we will not." People see that and they hear that. If pressed, I would say probably two-thirds of the time is spent on the "belts and suspenders"— making sure we are doing everything we need to do — and perhaps one-third of it on matters that are more affirmative and forward-looking.

Question:

You said that the role of the board of directors is systemic and that one of its obligations is to put the right people in place. With that in mind, what qualities or values would you look for when interviewing and selecting a new CEO? I know it

can be hard to identify a candidate's true values — people may say what you want to hear in interview — and once they are hired it can be difficult to remove them.

JAMIE GORELICK:

You're so right. Recruiting a CEO from within the organization can be a lot easier than bringing someone in from the outside because, usually, that person has a pretty long track record in the company. They know a lot of people, and a lot of people know them. People develop reputations because they can be observed in a thousand ways. That's why I said what I did about the code of ethics: it's only words. People know that someone is an ethical person when they see her in private, making a good decision that no one is necessarily going to review. But they can see whether she has made the ethical choice. They also know when they see how an executive treats others, how he treats the lowest employee, how he thinks about that person's future or his education, how he worries about the environment. Those are examples a leader sets, and there are ways to measure this. One way is the "360" review whereby everyone who reports directly to a particular person, and the people to whom he reports, is asked to submit anonymously their assessment of his performance according to certain criteria. You get a lot of good information that way.

Now the problems are more frequent, I think, when someone is brought in from outside and is less of a known quantity. When you are calling for references, too often you don't get the kind of honesty, quite frankly, that you might like. That is why I think most companies would rather take the somewhat less sexy internal candidate, who is a known quantity, than the apparent star from outside. Judging people's character is an extraordinarily difficult thing. My advice would be to look to the concrete. What has the person done? What are the observations of people who have been in a position to see the candidate in action?

Question:

You have been talking about how management sets an example for employees. The fact still remains that there are unethical companies out there but it is difficult to legislate ethical behavior. A company has to want to do the right thing. How can you ensure that unethical companies actually turn the corner and become ethical?

JAMIE GORELICK:

Well, there are lots of pressures right now on companies to do the right thing even if they don't want to. Sarbanes-Oxley [the Sarbanes-Oxley Act, 2002] has put in

place any number of procedures for people to make complaints and reports on a confidential basis. It has put an obligation on lawyers, if they see something problematic, to raise the issue. It has changed the way in which boards are selected and imposed the requirement of independent directors in critical functions. I'm sure the many lawsuits against board members have made them sit up and take notice when they're in the board meeting, and that they ask harder questions to make sure that they understand precisely what is being presented. I'm not going to stand here and tell you that these developments mean that companies no longer face ethical challenges. But they're an improvement, I think. I know there have been many complaints across corporate America about how onerous these obligations are. However, by and large, I think they are very good and very healthy. I'm not claiming they are prescriptions for perfection but I do think the tone in the board room, the mood in corporate America, and the pressures from shareholders are having a good effect.

MICHAEL HOFFMAN:

How has UTC responded to one particularly significant aspect of the new regulatory environment: the requirement of Section 301(4) of Sarbanes-Oxley that the audit committee of the board now is responsible for overseeing an internal reporting system whereby employees can get concerns to the board directly? I know some corporations have tried to handle this by going through the ethics office. I wondered how UTC is handling this.

JAMIE GORELICK:

Well, we consider ourselves, quite modestly, to be a leader on this. I consider Pat Gnazzo to be an example for others to follow. The ombudsman system that we've had since 1992 enables employees and others to raise issues, either confidentially or not, as they choose. Sixty thousand inquiries is a huge number of inquiries to receive. Other companies that are just starting with these processes are getting perhaps three, four or a dozen; but at UTC it is now in the fabric of the company. A lot of people would say, "Gee, there must be a lot of problems in that company if the ombudsman has 60,000 inquiries." But many of the inquiries relate to routine concerns between employees and their immediate supervisors, or questions about their health care plan, for example. But some of them raise substantive issues, and I think it is a terrific system because it lets the information flow. Earlier I put forward the notion that a good CEO begs for the bad news. You really want to know what's going on underneath you.

MICHAEL HOFFMAN:

Just to follow up very specifically: can an employee get a concern of his or hers to the board directly?

JAMIE GORELICK:

Yes, it goes through the ombudsman but we get it. We don't get each of the 60,000 inquiries unfiltered, but we get the ones that raise substantive issues.

MICHAEL HOFFMAN:

That's the point I'm trying to make. They are filtered.

JAMIE GORELICK:

They are filtered only to the extent that the board does not need to review issues that an employee might have about his health care coverage, but should focus on the substantive ethical issues.

Question:

This may not be something that you get involved with specifically, but Pat Gnazzo may know. When people send in a résumé for jobs at UTC or Schlumberger, are those résumés checked for accuracy?

JAMIE GORELICK:

Yes, I believe so. In both companies on whose boards I sit, there's a process for checking.

Question:

I have a question about diversity. I know there was a major study done in Canada suggesting that boards that are diverse in terms of gender, background and ethnicity, tend to be more ethical, especially in terms of raising more questions of management. Yet it seems that most U.S. boards — especially the smaller companies, though maybe not the Fortune 500 — have very few women or minorities. So I'd like to ask, do you really think diversity encourages better business ethics on boards? Secondly, do you think that under Sarbanes-Oxley and the more recent regulations we'll see more women on diverse boards?

JAMIE GORELICK:

Yes and yes. I think that diversity — not only gender and race diversity, but diversity in points of view — is very helpful. I think that is the trend, particularly since boards now have so much need for independent directors. When you see how many women are coming up through the ranks and reaching senior positions, and how many now are being elected to boards, it's actually quite encouraging. I'm not familiar with the study you mention, but any time you get a broader or more robust conversation, you're going to have a better company.

Question:

I was glad to hear you speak about the role of the board in establishing a strong culture in the organization. Recently, there have been a number of articles in the *Wall Street Journal*, the *New York Times*, and the *Washington Post*, about your role as vice chair of Fannie Mae, specifically as it relates to the corporate culture. One of the issues, if I'm not mistaken, was executive compensation — specifically the fact that bonuses were tied to attaining a certain level of earnings per share. That has recently come under attack. The report [of the Inspector General of the Department of Housing and Urban Development] indicated that the board and management maintained a corporate culture that emphasized stable earnings at the expense of accurate financial disclosures, and there were other similar findings within the report. The SEC is now looking into Fannie Mae and some of their reporting practices as well. What happened at Fannie Mae? If earnings restatements prove necessary, will the ethical response be the return of bonuses paid out on earnings which are shown not to have existed?

JAMIE GORELICK:

I don't know the answer to the last question, and I suppose it's well down the line. And I can't speak to the underlying facts other than what is currently in the public record. What is in the public record is that there was a dispute over the proper accounting treatment of amortization, which the company says was appropriate under GAAP and which the regulator says was not. The company says its accounting treatment was supported by its outside auditor and has submitted it to SEC for its review. I guess we'll just have to see what comes out of it. The finance group was not in my chain, and so I'm really not able to elaborate on anything that you've read in that regard. Secondly, I always thought that the finance professionals at Fannie Mae were very ethical and highly skilled — and that's what I also heard from outside observers. Thirdly, I never saw any pressure from the CEO or anyone else to do anything improper that would affect earnings per share. Fourthly, tying some element of compensation to earnings per share is routine in

America. You can question whether that is the right thing to do, but it is the way most companies operate. Earnings per share is one of the factors that almost every board in America considers when it is setting management compensation and also management goals — one way of aligning with the shareholders' interests.

MICHAEL HOFFMAN:

At around the same time that Sarbanes-Oxley was enacted, the New York Stock Exchange amended its listing requirements such that companies wanting to be listed must have adopted and disclosed a code of business conduct and ethics for directors, officers and employees. As far as their board is concerned, I know that a lot of companies are simply asking the board to sign on to the company's general code. I have reservations about whether this is an effective approach. What do you think?

JAMIE GORELICK:

I think most companies would say that it is important for the alignment of the board and of the company's employees for employees and board members to have the same code of ethics. I don't know of a company that has two codes. In my opening remarks, I mentioned the particular need for honest discussion at the boardroom table. I don't think you need to write that down. That is a pact among the individual members to be honest, frank and forthright with each other.

Question:

Could you please tell us how you came to be appointed to the 9/11 Commission? Can you also tell us about any of the dilemmas you encountered while you were on the Commission?

JAMIE GORELICK:

We were 10 — five Democrats and five Republicans — appointed by the most partisan people in Washington at one of the most partisan times in our government's history, and we were all partisans in our own ways. So how is it that we came to operate in a bipartisan way? I think that, despite the wonderful things that have been said about the substance of our hearings and the substance of the report, the most salient message to the American people has been that, yes, it is possible to work toward a common goal with a unity of purpose in a bipartisan way. We tried our best, frankly, to shame the rest of the government into doing the same thing. It wasn't always easy. We were at this for 20 months. We were locked together in a small room for hundreds of hours. We worked through really difficult issues. We

looked at the facts together. We interviewed witnesses together. We interviewed experts together. We debated questions together. We paired up to question witnesses. We argued over process: Do we subpoena the President of the United States? How important is it for all of us to see a certain set of intelligence materials? Is it possible for us to delegate to one or two of us? These were hard, hard issues for 10 people who didn't know each other to answer collectively.

Let me tell you how I think this cooperation came about, and what I think are the lessons. Then I'll spend a minute on the difficulties. First, we had great leadership. Tom Kean of New Jersey and Lee Hamilton of Indiana are fabulous leaders. Each was a partisan in his own fashion, but they promised each other that there would never be a partisan vote, and there never was. In fact, there were precious few votes. They both listened patiently and let each of us have our say, which was very important.

Secondly, the victims' families created enormous pressure on us to find the facts and behave ourselves, and to be unrelenting in finding out what happened and sharing that with the nation. Thirdly, for most of us this was our last 'big thing,' and we wanted to do it right.

Finally, we built very strong personal relationships. When you sit in a room with people for hundreds of hours, going over facts and arguing about their interpretation, there is a bonding that is bound to occur. I think that bonding intensified when I was personally attacked by the Attorney General in the course of one of the hearings. My fellow commissioners just rallied around me. We became more cohesive after that, because we saw it as an attack on the whole Commission.

There were partisan pressures on all of us. There were some people in my party who would have liked to have made a partisan issue out of the Administration's failure to produce evidence. They would have liked nothing better than to have served subpoena after subpoena on the President of the United States. There were people on the other side who wanted to pressure us not to have Condoleezza Rice testify, not to have the President and Vice President testify. We developed our own set of values and decided what we wanted to do. I think it came out in the right place.

Question:

A company the size of UTC or Schlumberger invests and does business in countries all over the world. Business ethics is not regarded seriously — if at all — in many of these countries. How does a company, at the board level, judge the human rights record of a country's government? What factors are taken into account?

JAMIE GORELICK:

Both United Technologies and Schlumberger do operate in many parts of the world. Schlumberger, being in the oil and gas services business, operates in some difficult parts of the world. You have to make judgments about whether your presence is a help or a hindrance; whether your presence is a danger to your employees. In general, the attitude of U.S.-based multinational companies is that commerce and industry are good, both for them and for the countries in which they invest. Sometimes you're confronted with a corrupt or brutal regime and you simply make the decision that this is not the place for our company to invest. Countries that have threatening or corrupt leadership do harm to their people in many ways, and that's one of them.

Question:

The amendments to the Federal Sentencing Guidelines for Organizations, likely to go into effect on November 1 [2004], require for the first time that boards of directors have ethics and compliance training. I think this is a whole new dimension for ethics officers, for the field of business ethics, and in many cases the boards of directors themselves. How far has UTC progressed in its thinking on this, and what your own thoughts on the issue?

JAMIE GORELICK:

Forward-thinking boards have already taken training of all sorts, including ethics training. Most of it is done through an expert who comes in, or the directors go to a course or to a university for training. I find it to be very useful. You step out of your role. You have somebody who is very well educated, very thoughtful, prodding you on what you should be doing, what you should be thinking about, and the questions you should be asking. You come into the boardroom the next time renewed and with a broader perspective. I think it's terrific. It adds time — just as a doubling of the audit committee's obligations has done. As a consequence, most directors are taking on fewer board obligations. I think that it is the right thing to do. So, training is very helpful, sentencing guidelines or not. It is a best practice and shareholder groups are asking about it. The feedback has been good, so I see this as a very positive development.

Thank you.

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