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Loophole Ethics

Abstract: *Codes of conduct are statements that commit organizations, industries, and professions to particular moral values and beliefs, and define appropriate behaviour for employees and professionals. This chapter explores how codes of conduct can affect the moral reasoning and behaviour in the workplace. On the one hand, they clarify the scope of action available to decision-makers, but on the other hand, they can incentivize people to identify and exploit loopholes in the codes. When organizations structure ethics around a set of codes defining appropriate behaviour, it can create an unforeseen and unwanted form of creativity. Loophole ethics is the activity of remaining loyal to the letter of the code of conduct, and assume that anything the code is silent about, is morally acceptable. The International Federation of Accountants operate with a code of ethics that is 162 pages long. It increases with each new edition, and the main reason for this development seems to be that since the last edition, some accountants have identified and exploited a loophole. Instead of operating with codes of conduct of increasing complexity, professionals and organizations should leave more room for the use of personal and common judgment.*

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One practical approach to ethics in organizations is to formulate a set of codes, rules, or guidelines to define appropriate and expected behaviour from employees. A merit of the code-based approach is that everybody can in principle know up front what is morally required and expected of them at work. Whenever they are in doubt, they can consult the code of conduct and find guidelines there about whether they can accept a particular gift from a supplier, invite a customer to a dinner and pay the expenses, participate in decision-making where a friend or relative is one of the stakeholders, and so on. Codes of conduct can help to clarify the boundaries between morally right and wrong in concrete cases, and also generate consistency in how employees and professionals behave towards each other and stakeholders in the outside world. An organization with an established code of conduct can reduce subjectivity and contingency in decision-making.

The code-approach is nevertheless problematic. Detailed codes tend to signal that the ethical issues have been thought through, once and for all. What remains to do is to live by the codes, consulting them whenever one is in doubt. In reality, however, each new situation can demand ethical reflection, based on the realization that the codes may be silent about the issue at hand. There is a considerable risk that people interpret the silence to mean that anything goes.

The purpose of this chapter is to explore how a code-based approach to ethics in organizations can have the unfortunate side-effect that decision-makers adopt a loophole mentality that is likely to lead to more rather than less immoral behaviour. Loophole ethics is the practice of looking for an exploiting the options the code of conduct does not explicitly mention or deem unacceptable.

Loophole ethics is a phenomenon that often occurs in sports (Kvalnes and Hemmestad, 2010). A story about the American ice hockey player Sean Avery can serve as an example. On April 13, 2008, his actions on the ice in a match for his team New York Rangers led to a rule change and also a principled discussion about the nature and purpose of rules and codes. During a match against the New Jersey Devils, he placed himself in front of Martin Brodeur, the opposing goalkeeper. With his back to the play, Avery stared at Brodeur and waved his stick and his hands in front of the goalkeeper's face, in an attempt to distract him and block his view. During these proceeding, one of Avery's team mates came up to him and seemed to try to push him away, apparently unhappy with this attempt to give the Rangers team a better scoring chance. Avery

continued until the attack broke down, went down the ice to participate in the preparation for another siege on goal, and in the following move actually scored.

Avery could defend his act of blocking the goalkeeper's view by claiming that he broke no rule by doing so. He would be right. No rule of ice hockey forbids a player from distracting the goaltender the way he did. However, that changed the day after the match. The ice hockey authorities made a swift response, by introducing a new rule. Collin Campbell, National Hockey League director of hockey operations, said in a statement that:

An unsportsmanlike conduct minor penalty will be interpreted and applied, effective immediately, to a situation when an offensive player positions himself facing the opposition goaltender and engages in actions such as waving his arms or stick in front of the goaltender's face, for the purpose of improperly interfering with and/or distracting the goaltender as opposed to positioning himself to try to make a play.¹

With the new rule in place, any player who attempts to copy Avery's tactic would receive a two minute sending off. The rule quickly got a name after the man who initiated it, as The Sean Avery Rule.

Sean Avery's method of distracting the goalkeeper could not be sanctioned on April 13, 2008, since he did not break a particular rule. The situation changed on April 14, 2008, when the new rule was in place. A loophole had been identified though Avery's action, and was then promptly removed. One potential consequence for the ice hockey authorities is that other players will also look for loopholes, in the shape of ethically doubtful alternatives that strictly speaking do not violate any rules. By responding to Avery's action the way they did, they inadvertently provided further support for loophole ethics.

What is the alternative? Michael McGeough, an experienced ice hockey referee, claimed that he could and would have penalized Avery even without the new rule (Paumgarten, 2008). In his eyes, what Avery did was unsportsmanlike conduct. A less experienced referee may think that he has no right to sanction Avery's distractions, in the absence of a concrete rule. The ice hockey authorities also seemed to share this view, since they found it necessary to introduce a new rule. They could instead have supported the claim from the experienced referee, and agreed that even without a specific rule it was possible to sanction Avery's action. That way they could have signalled that the participants

in their sport – players, referees, coaches and others – cannot expect the rules to provide explicit answers in every case. Each participating individual needs to make his own judgements about the choices he faces, and should not use the absence of explicit rules stating that the option is wrong, as a justification.

Curling is a sport that has integrated the application of personal judgment. When two teams match up and start to compete, they do so without the active presence of a referee. The players settle minor disputes between themselves, using common sense. In the unlikely event of a major dispute, the players can call upon a referee from the stands, but the normal situation is that the match of curling starts, unfolds, and ends without any interference from a referee. Other sports can take note of how curling has placed the exercise of personal judgment at the core of its activity.

Worries about the emergence of loophole ethics in organizations belong under the heading of how detailed codes of ethics provide incentives to the people who adhere to them. The philosopher Thomas Pogge has given a general account of the nature of loopholes in ethics, and his approach can help us to clarify the issue at hand. Its starting point is to acknowledge that the concrete ways we think about ethics can have good and bad effects, judged by the same ethical standards. We can thus ask ourselves: “Have we organized our moral commitments in a way that reflects, and helps effectively achieve, what by their own lights matter?” (Pogge, 1992, p. 80). If the answer is no, we have good reasons to reconsider the ways we think about moral issues, and our ethical approach.

Fair play evidently matters in sports (Loland, 1998, 2002). It is a serious flaw in the organization of ethical thinking in sports if it provides incentives for unfair play. According to Pogge, we cannot establish that it has such a flaw simply by showing that some individuals happen to be misguided into unfair play as a result of being exposed to our current system of moral commitments. They may simply be foolish people who fail to grasp the incentives in a proper and reasonable manner. The relation between the code and the conduct must be tighter in order to establish that we are in the presence of a loophole:

A loophole only exists if the connection between the code and the regrettable of the conduct it encourages is tight in two respects. First, the relevant incentive must be an ideal one, so that the code can be said to *guide* agents towards the regrettable conduct. Second, the conduct must be regrettable in itself, rather than in virtue of any further effects it may bring about, however predictably. (Pogge, 1992, pp. 83–84)

Does the Sean Avery example meet the two requirements for being a loophole case? His conduct can be interpreted as an example of unfair play, as suggested by referee Michael McGeough, and thus regrettable by the ethical standards of sports. It is regrettable in itself, so it meets the second criterion. Is it, in addition, the case that the code guides Avery towards the unwanted conduct he engages in? Does the code provide incentives to stand in front of the goalkeeper and distract him?

We can reflect on these questions in the light of a distinction Pogge draws between two kinds of incentives: Compliance incentives and reward incentives. With the former, the sole motivation to act in a particular way comes from the commitment to adhere to the code. When Avery distracts the goalkeeper, it is not an action motivated by a wish to adhere to the code of conduct within ice hockey. The code does not provide him with a compliance incentive to act that way.

Reward incentives are active when adherents to a code of conduct “are motivated by other, code-independent interests of theirs insofar as these can be pursued without violating requirements of the code. Here a code encourages conduct by affecting the official pay-offs: eligibility for benefits or liability to burdens” (Pogge, 1992, p. 82). Avery had a reward incentive to distract the goalkeeper. The interest to have one’s team win is a standard interest of players, and Avery pursued this interest within the scope defined by the rules that were in place on April 13.

The rule-based approach to ethics in sports is in danger of encouraging unfair play not due to its specific content, but through its form. When we organize moral commitments in comprehensive codes of conduct, people it can lead people into thinking that all they need to do is to stay clear of any alternative that the code explicitly singles out as morally forbidden. Thus, they have reward incentives to act in ways that are regrettable and bad, even according to the ethical outlook that allows them to act in that manner.

Ethical rules and regulations do not necessarily lead people to look for and exploit loopholes, but there is a considerable risk that they may promote and encourage actions that even according to the rule-makers themselves are regrettable. I have explored how this phenomenon can occur in the relation between insurance companies and their customers. Dishonest behaviour from customers can be a loophole response to detailed, small print insurance documents (Kvalnes, 2011). One way to avoid loophole ethics can be to rely less on detailed rules, and more on personal judgment and practical wisdom. This approach does not allow

the agent to justify his actions simply by pointing to the fact that there are no rules explicitly defining his choice as wrong.

A rule-based approach to ethics has a strong foothold in many professions and organizations. The accounting company Arthur Andersen had Enron as its client. Both companies collapsed, and the accountants came under criticism for their close personal and economic ties to the people they were controlling (Nanda, 2002i). They had not actually violated the code of conduct for the profession, but behaved unwisely. The response from the profession itself and the financial authorities has been to formulate more detailed ethical rules and regulations for accounting. The Enron case exposed loopholes in the Code of Ethics for Professional Accountants (CEPA).² A former Enron accountant has admitted that the loophole mentality was part of the cognitive setup in the working environment. They complied with the rule-based framework, and found creative and dubious solutions not mentioned as unacceptable in the rules. "All the rules create all these opportunities. We got to where we did because we exploited that weakness" (McLean and Elkin, 2003, p. 142). After the Enron downfall, the loopholes were identified and removed by adding new codes. At the beginning of this century the CEPA document consisted of 98 pages. In the recently revised version from 2014 it has been expanded further, to 162 pages.

Critical voices within the finance sector have started to argue that the preferred rule-based approach may not only be insufficient as a response to ethical challenges, but may also make matters worse, by encouraging what I have labelled as loophole ethics. The critics recommend a change from a rule-based to a principle-based approach (Somerville, 2003; Satava et al., 2006). There is a call for guidance through a limited set of general principles, rather than through comprehensive and detailed rules. One advantage of such a move can be to limit the scope of reward incentives. The agent's personal interests will remain intact, but he will now have a harder job defending and justifying a choice to pursue them in the light of the code's silence on the matter. A move away from comprehensive codes towards a limited set of general principles changes the logic of the justification requirement. You now have to take more of a personal stand in the process of justifying your choice. It is not enough to scan the code in search of explicit mentions of the options you have available.

Organizations, professions, and authorities face a common challenge in taking steps to avoid loophole ethics. In accounting, the strategy of adding new rules to make the overall code more comprehensive has

had the unfortunate side-effect that people act as if the relevant moral thinking has already been performed by the rule-makers. In sports, the tendency to rely on rules is not yet as strong as in the accounting sector. People within sports can look to accounting if they need a concrete scenario of what lies ahead if they take the rule-approach further, and continue in the pattern suggested by the authorities in The National Hockey League, by constantly expanding on the rules.

Moral reasoning in organizations needs to strike a balance between written rules and codes on the one hand, and wise personal and communal judgement on the other. Shorter and more general codes leave more room and responsibility to the individual decision-makers to apply their own judgement to the case at hand. Such codes signal to the decision-makers that they need to use their common sense to figure out what is right and wrong in the situation they face. The problem with this approach in organizations can be the appearance that common sense is not so common anymore. The general idea can be that moral outlooks tend to be more fragmented and disparate than they used to be, and codes of conduct are the best tool to compensate for that. We cannot take for granted that people interpret and judge situations similarly, and consider the same aspects of it to be morally relevant. Differences in cultural background, and generational and gender difference add to the moral confusion. When top management in organizations have doubts like these, codes appear to offer the most promising solution. Eagerness to compensate for an apparent lack of common sense and judgement can then create a foundation for loophole ethics.

Notes

- 1 <http://sports.espn.go.com/nhl/playoffs2008/news/story?id=3346729>.
- 2 <http://www.ifac.org/publications-resources/2014-handbook-code-ethics-professional-accountants>.



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