

Professor Marianne M. Jennings
W.P. Carey School of Business
Arizona State University

Ethics, Contracting, Contractors, Rules, Codes, and More Ethics

Ethical Lapses

Student loan lenders: Sallie
Mae and 17 universities
Adelphia
Boeing
Cendant
Computer Associates
Tyco International
General Electric
Global Crossing
Merrill Lynch
Enron
Qwest
WorldCom
Royal Shell
Nortel
Krispy Kreme
Refco
UnitedHealth Group
Merck
Chiquita
World Bank
AT&T
Titan
BP
Madoff Investment
Securities

Xerox
Kmart
Citigroup
Lucent
ImClone
Arthur Andersen
HealthSouth
Royal Ahold
Parmalat
Apollo Group
Marsh & McLennan
AIG (twice)(Putnam)(Mercer)
Fannie Mae (twice)
KPMG (twice)
GM
Options scandals (200 companies)
HP
Universities and travel
Siemens
Countrywide Financial
Société General
Milberg Weiss
Bear Stearns

Some Sample Fines

Boeing	\$615 million
Tenet	\$725 million + int. = \$900 M
Columbia/HCA	\$1.7 billion
AIG	\$1.5 billion
Marsh McLennan	\$850 million
Fannie Mae	\$400 million
KPMG	\$465 million
Tyco	\$750 million
Cardinal Health	\$600 million
Pharmas	\$2.4 billion
Prudential	\$2.5 billion
UnitedHealth Group	\$915 million
Wachovia	\$144 million
Siemens	\$5.8 billion
UBS	\$18.6 billion
LG, Sharp, and Chunghwa	\$585 million
Merrill	\$10 billion
Citi	\$7.3 billion
Eli Lilly	\$1.5 billion

The Phases of Contracting and Ethics

- ‡ The Bidding
- ‡ The Negotiations
- ‡ The Contract Terms
- ‡ The Performance
- ‡ Government Relations
- ‡ The Change Orders
- ‡ The Payments and the Billing

Doing the Bidding

Checks and Balances and Introspection

Begin with bribery and head into price-fixing and reverse bidding

Hitting close to home

The Eleven Con Ed Supervisors

- ! Awarded clean-up contracts on the basis of gifts
- ! Gifts included Giants tickets, Blackberry Curves, watches, sunglasses and payments between \$1,000 and \$5,000
- ! Most of the work awarded was at Ground Zero or as a result of a steam-pipe explosion in 2007
- ! *"I am disappointed, but hardly surprised."*
 - New York assemblyman on the indictments

Halliburton and its KBR subsidiary

- ⚠ \$10-\$15 million “success fees” paid to a consultant for each successful contract awarded to KBR
- ⚠ Top executive entered a guilty plea and said the practice dated back to the 1980s
- ⚠ Halliburton has spun off KBR

Siemens, the Bribes, and the Countries

COUNTRY	PRODUCT	BRIBES PAID	DATE
Russia	Medical devices	\$55 million	2000-2007
Argentina	Identity cards project	\$40 million	1998-2004
China	High-voltage transmission lines	\$25 million	2002-2003
China	Metro trains	\$22 million	2002-2007
Israel	Power plants	\$20 million	2002-2005
Bangladesh	Mobile telephone works	\$5.3 million	2004-2006
Venezuela	High-speed trains	\$16.7 million	2001-2007
Russia	Traffic control systems	\$0.75 million	2004-2006
Vietnam	Medical devices	\$0.5 million	2005
China	Medical devices	\$14.4 million	2003-2007
Nigeria	Telecommunications projects	€4.2 million	2003
Iraq	Power station	\$1.7 million	2000
Italy	Power station	€6.0 million	2003
Greece	Telecommunications	€37 million	2006

**Reinhard Siekaczek, former Siemens employee,
largely responsible for Siemens accounting system
that hid bribes for 5 years**

*“People will only say about Siemens
that they were unlucky and that they
broke the 11th Commandment. The
11th Commandment is: ‘Don’t get
caught.’”*

**Reinhard Siekaczek, Siemens executive
in charge of accounting for bribes**

*"We thought we had to do it.
Otherwise, we'd ruin the
company."*

**Reinhard Siekaczek, former Siemens
executive in charge of accounting for bribes**

*“It was about keeping the business unit
alive and not jeopardizing thousands
of jobs overnight.”*

*“I was not the man responsible for the
bribery. I organized the cash.”*

**Reinhard Siekaczek, former Siemens
executive in charge of accounting for bribes**

"I would have never thought I'd go to jail for my company. Sure, we joked about it, but we thought if our actions ever came to light, we'd get together and there would be enough people to play a game of cards."

Siemens: The Language of Institutionalized Corruption

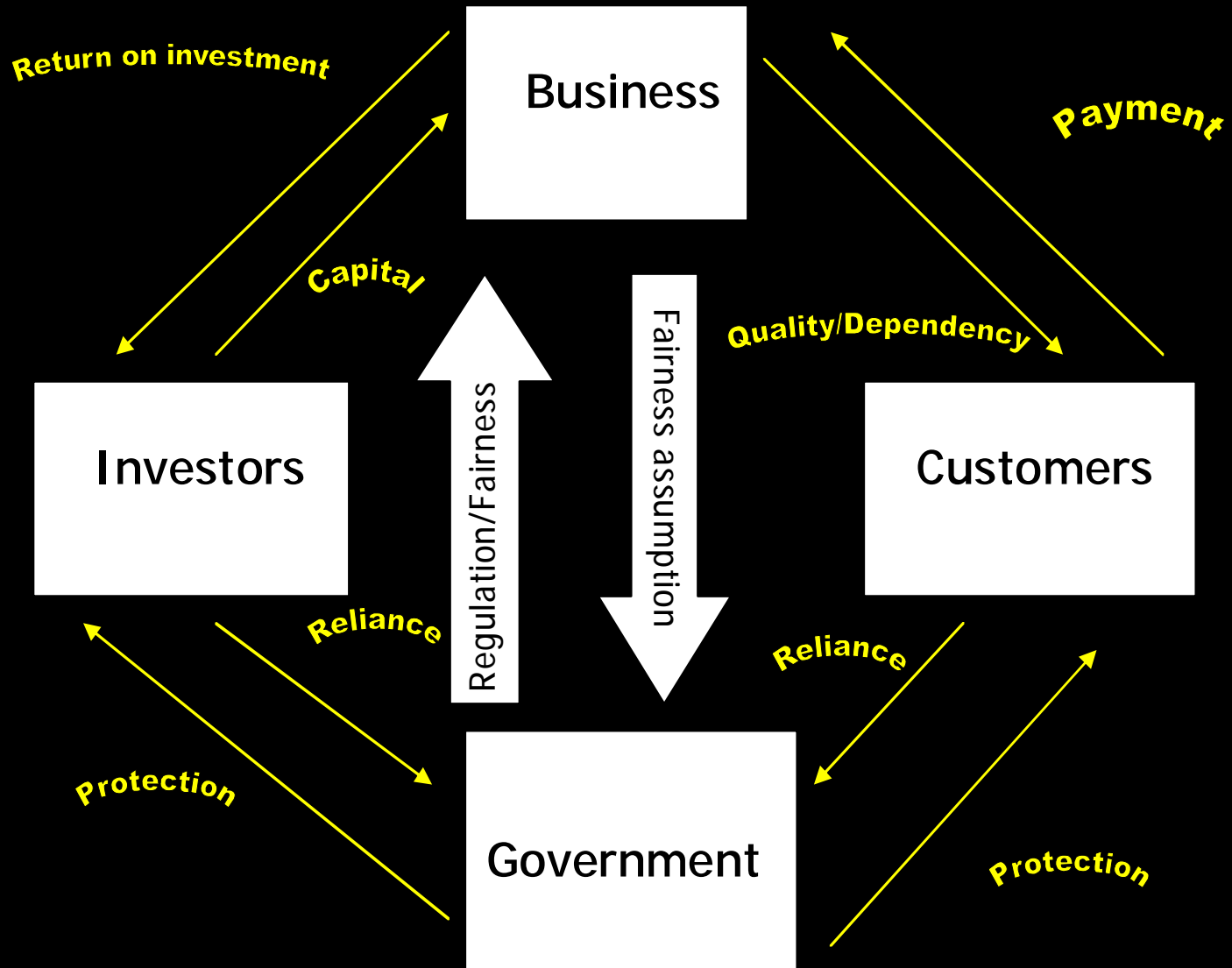
- ⚠ Useful money: accounting term used for bribes paid
- ⚠ Bribes budget: Amount planned each year for payments; determined on a country-by-country basis
- ⚠ BCAs: business consultant agreements (contracts with consultants who funneled money to government officials; Siemens had 2,700 such contracts)

**Lori Weinstein, U.S. Justice Department prosecutor
who oversaw the Siemens bribery case**

*“Crimes of official corruption
threaten the integrity of the
global marketplace and
undermine the rule of law in host
countries.”*

The Role of Ethics in Economic Systems

- ⌚ The Speed of Trust
- ⌚ The costs of verification
- ⌚ Interrelationship between and among ethics, trust, investment, and long-term success



Corruptions Perception 2008

- i Denmark
- i New Zealand
- i Sweden
- i Singapore
- i Finland
- i Switzerland
- i Iceland
- i Netherlands
- i Australia
- i Canada
- i Luxembourg
- i Austria
- i Hong Kong
- i Germany
- i Norway
- i Ireland
- i United Kingdom
- i Belgium
- i Japan
- i USA
- i Santa Lucia
- i Barbados
- i Chile

- i Somalia
- i Myanmar
- i Iraq
- i Haiti
- i Afghanistan
- i Sudan
- i Guinea
- i Chad
- i Equatorial Guinea
- i Congo, Democratic Republic
- i Zimbabwe
- i Uzbekistan
- i Turkmenistan
- i Kyrgyzstan
- i Cambodia
- i Venezuela
- i Sierra Leone
- i Guinea-Bissou
- i Gambia
- i Congo Republic

The Story of AES in Kazakhstan

- ⚡ Miners dug coal in freezing temperatures
- ⚡ Took tea breaks every other hour to warm up and then went right back to digging
- ⚡ High technical abilities
- ⚡ It took only 5-7 AES managers to supervise 6,500 Kazakhs
- ⚡ Customers paid on time, even with 20% rate increases in some years

Peter Löscher, current CEO of Siemens

“Operational excellence and ethical behavior are not a contradiction of terms.”

December 2008, following Siemens paying nearly \$1 billion to the US government to settle charges of violations of the FCPA

Dangers of Reliance on Bidding Short-Cuts

- ⚠ Loss of skills needed for competition
- ⚠ Not a unique strategy
- ⚠ Nonsustainable strategy

Price-Fixing

- ❗ Britain's Office of Fair Trade charged 112 firms with illegal price fixing on building projects
- ❗ 37 firms have implemented controls and asked for leniency from the government
- ❗ "Cover pricing" – using a high bid with the owner then turning to other bidders who were even higher; winner splits the proceeds with its rivals
- ❗ *"Putting in a high bid to avoid winning the work is not an infringement of competition."*
 - Construction Federation of Great Britain

Some Flags in Bidding Fraud and Price-Fixing

- ! Unsuccessful bidders hired as subcontractors
- ! Related parties and common ownership
- ! Phantom subcontractors
- ! Profile of the fraudsters
 - § 30% are women (2% for crimes in general)
 - § Older and more religious
 - § No substance abuse problems
 - § Happens even with quality companies

Reverse Bidding

- ⋮ Arose in on-line bids for commodities
- ⋮ Difficulties with application to construction
- ⋮ The irony of higher pricing
- ⋮ Contractors pre-qualified, but subs?
- ⋮ Is it bid shopping?
- ⋮ The short-cuts used to get to lower prices and issues of quality
 - § Work history
 - § Experience
 - § Qualifications
- ⋮ Checks and balances required to provide assurances that subcontractors are really in
- ⋮ Rebids required because of above difficulties
- ⋮ The time extensions

Contractor Views on Bid Shopping vs. Reverse Auctions (2004)

- ❗ 94% agree or strongly agree that bid shopping is unethical (64% on strongly)
- ❗ 84% agree or strongly agree that reverse auctions are unethical
- ❗ GSA sees it as real-time competition
- ❗ U.S. Army Corps of Engineers concludes that it affects quality
- ❗ Many organizations see it as a hard bid process that is transparent (lowest gets contract regardless of quality)

Association of General Contractors of America

In fact, the construction process is fundamentally different from the manufacturing process. Manufactured goods are subject to little or no variability or change in manufacture or application. Construction projects, on the other hand, are inherently variable. Each is subject to the unique demands of the project, such as the needs, requirements, personnel and budgetary criteria of the owner, site conditions, design features and parameters, and the composition of the project team.

Jurassic Park Ethics

Could I do this? -- The Codified Society

Legalisms, litigiousness and its costs

Should I do this? -- The Ethical Society

- ⓘ Spend more time asking "Should we?" not "Could we?"

Hallmark/Westland Meat

- Supplier of the Year – Federal National School Lunch Program

Hallmark/Westland Meat Co.

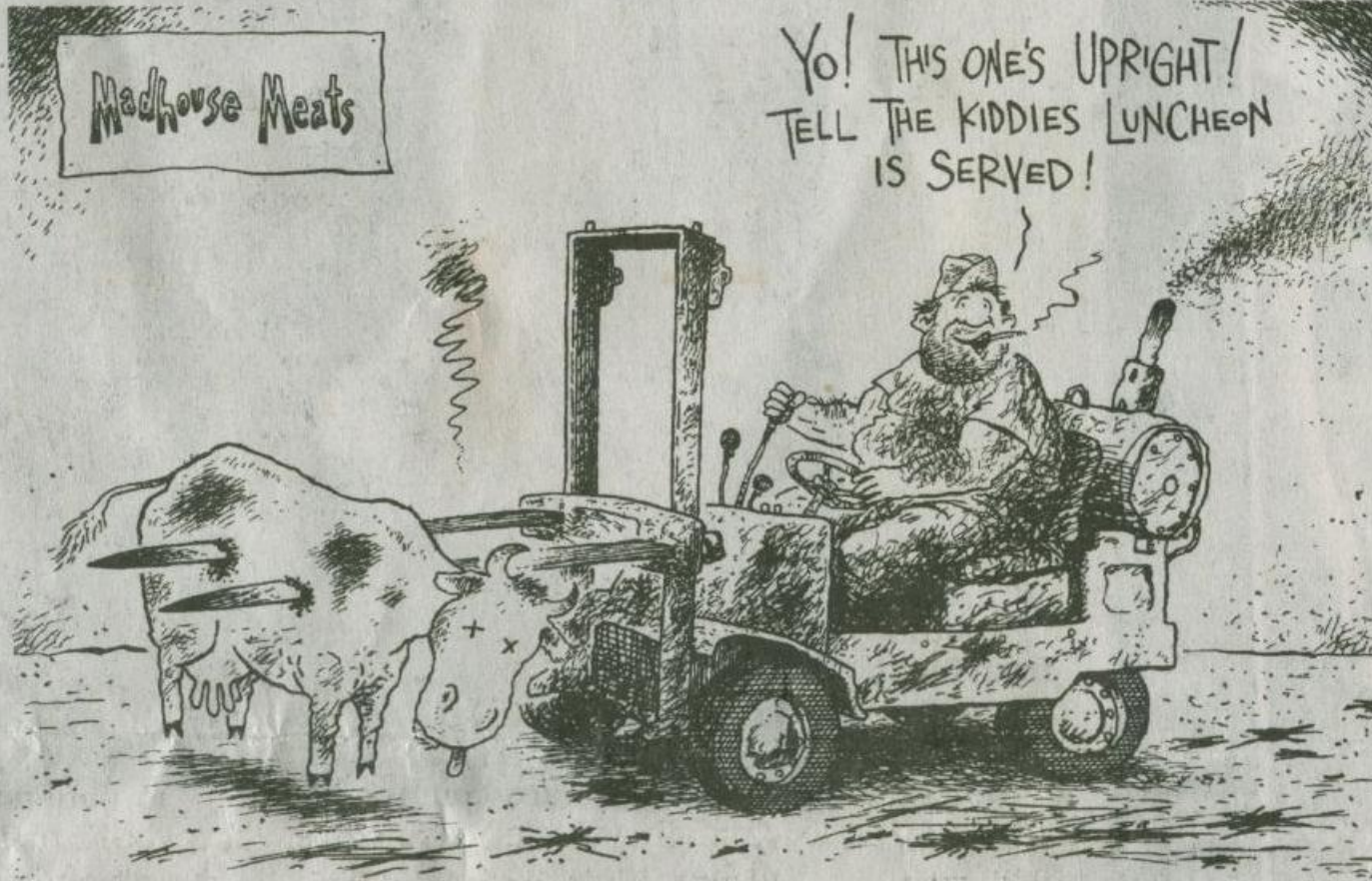
*"The video just astounded us. Our jaws dropped .
.. We thought this place was sparkling
perfect."*

Anthony Magidow, General Manager

David Kesmodel and Jane Zhang, "Meatpacker in Cow-Abuse
Scandal May Shut as Congress Turns Up Heat," *Wall Street
Journal*, Feb 25, 2008, pp. A1 and A10.

2-24-08

WK 2



Tony Auth The Philadelphia Inquirer, Universal Press Syndicate

The Negotiations

It's all a poker game – we are all lying to each other.

Business Bluffing:
Is it done? Is it ethical?

Albert Carr

What word did the American Dialect Society name as the word of the year for 2006?

Truthiness!

"the quality of preferring concepts or facts one wishes to be true, rather than concepts or facts known to be true"

"what feels like the right answer as opposed to what reality will support"

The Survey on Lying

- 52% said lying was never justified
- 66% said lying could be justified
- 65% would lie to save someone's feelings
- 40% said they'd never lied or cheated
- 10% of the 40% said they had told a lie in the past week
- 40% said it is "okay" to exaggerate a story "to make it more interesting"
- 33% said it is "okay" to lie about your age (only to make yourself younger, though, not for purposes of drinking age)
- 33% said it is "okay" to lie about being sick to take a day off

AP Poll, June 23-27, 2006

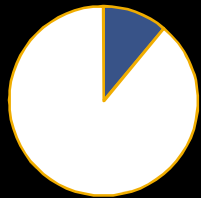
Is everyone really lying? Cheating?

A Look At Your Future Work Force

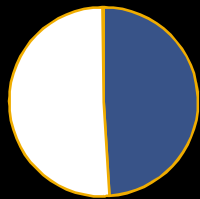
- 64% of high school students cheated on an exam in the last year at least once
- 62% have lied to a teacher in the past year
- 82% have copied another's homework
- 82% have lied to their parents in the past year
- 42% have lied to save money
- 30% stole from a store in the past year
- 26% admitted lying on their answers to the survey

Josephson Institute 2008

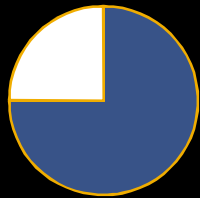
Cheating in College



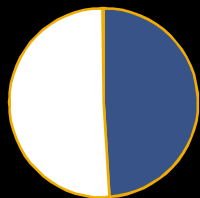
11% reported cheating in 1963



49% reported cheating in 1993



75% reported cheating in
2003/2005/2006



50% graduate students reported
cheating (2006)

Work: Résumé puffing into deception

- i 50% had false information
- i The false information was material: degree; job title; previous employment
- i Examples
 - § *Wall Street Journal* on officers and board members
 - § Dean of Admissions at MIT and the 28-year-concealment
 - § West Virginia University and the governor's daughter's MBA

**What happens when those numbers
reach 100%?**

The Demands of Introspection

Thinking About Your Role

i Individual ethical issues

§ The bidding

§ The conflicts

§ The invoices

§ The payments

§ The quality

§ The safety

Thinking About Your Role

- i Company ethical issues

- § Practices that are engrained

- § Culture that does not permit dissent

- § Nature of meetings and discussions

- § Without dissent, you are stagnating

"We have to spend \$40 billion and we don't even have enough staff to supervise the spending."

Thinking About Your Role

- i Industry ethical issues
 - § The willingness to go along
 - § Pay to play
 - § 'We are all lying to each other.'
 - § Cost over-runs; efficiencies; public funding, etc.
 - § The Danger of the Sandbox

The A-Rod Explanation

"I knew we weren't taking Tic Tacs. . . . I wanted to prove to everyone that I was worth, you know, and being one of the greatest baseball players of all time."

Alex Rodriguez on his steroid use from 2001-2003

S & P Congressional report

“Rating agencies continue to create [an] even bigger monster — the CDO market. Let’s hope we are all wealthy and retired by the time this house of cards falters.”

Standard & Poore’s analyst on mortgage-backed instruments and their ratings

We all think we are ethical.

- i None thought their ethical standards were lower than those of their peers in their organization (1%)

Society of Human Resource Managers

Why do we all think we're the most ethical person in the room?

1. We are not talking about it with others.
2. We have rationalized, labeled, and defended ourselves into believing we are ethical.
3. We're doing so well that we equate performance with ethics.
4. We're doing so well that we are offended when ethical issues are raised.
5. The failure to internalize and reflect.

"Have you ever met anyone who said, 'I am not to be trusted. You shouldn't do business with me.'?"

Some examples from the industry

- ❗ Contractors charged \$90 per day for equipment on one project and \$90 per hour on another project because there was less supervision on the latter project
- ❗ Billing for fuel in excess of what the truck's tank would hold
- ❗ Extra materials that make their way into contractors' personal projects
- ❗ Falsehoods: "Buy American" violations, undocumented workers, EPA certificates and compliance, false insurance certificates
- ❗ Padded tools budgets (check delivery)

Guess who said it?

"Ethical standards and practices in the workplace are the pillars of successful employment and ultimately the benchmark for a strong business."

Franklin Raines, former CEO of Fannie Mae (ousted in 2005)

- Final report on what went wrong concludes: “[management was] manipulating earnings and creating an “unethical and arrogant culture””

“Being 99% honest is no longer enough.”

Former U.S. Senator and presidential candidate

John Edwards

Guess Who Said It?

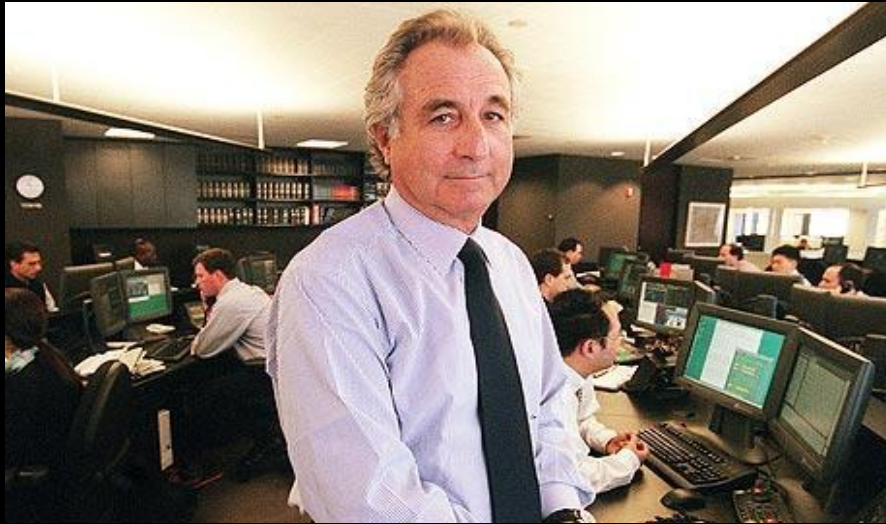
"I have done absolutely nothing wrong."

**Rod R. Blagojevich, former
governor of Illinois**

Guess who said it!

“In today’s regulatory environment, it’s virtually impossible to violate rules.”

Bernie Madoff



A Few Quiz Questions

What CEO said, "We are the good guys. We are on the side of angels." and "We are doing God's work here."?

Jeffrey Skilling – while CEO of Enron

Guess Who Said It!

“Go after the men who seek out prostitutes.”

**Eliot Spitzer, 2004, as New York
Attorney General**

Another Quiz Question

What company had a 64-page,
award-winning code of ethics?

ENRON

Guess who said it

"The tunnels are safe. They are quite safe, and it is outrageous and irresponsible to suggest otherwise."

Project engineer for the Big Dig, before the collapse of one tunnel that killed a passenger in a car and the resulting conclusions of auditors and engineers that no one could vouch for the structural soundness of the tunnels

John Christian

The Contract Terms

Maximizing All That We Can

The Rationalizations

“That’s the standard contract.”

“Everybody else does it.”

What is right is right even if no one is doing it.

What is wrong is wrong even if everyone is doing it.

- Source unknown

Lowell Cohn, writer on his vote for the Baseball Writers' Hall of Fame

! *"I think his numbers merit inclusion and, if he cheated, so did others in his era."*

§ Mr. Cohn, a writer who votes in the Baseball Writers' of America's Hall of Fame, changed his vote in favor of Mark McGwire

Asking and Knowing But Not Acting

! *“How much of this sort of stuff do they do? I mean, how much cooking goes on in there?”*

▪ *John Houldsworth, former CEO Cologne RE (entered plea)*

! *“They’ll do whatever they need to [do to] make their numbers look right.”*

▪ *Richard Napier, former General Re executive (entered plea)*

▪ *Anthony Biacno, “In Trial of Former General Re Executives, Taped Calls Play Crucial Role for Both Sides,” New York Times, Jan. 17, 2008, p. C3.*

Rationalizing, Not Analyzing

- ⌚ "If we don't do it, someone else will."
- ⌚ "It doesn't really hurt anyone."
- ⌚ "If you think this is bad, you should have seen . . ."
- ⌚ "That's the way it's always been done."
- ⌚ "That's the way they do it at _____."
- ⌚ "It's a gray area."

So, we make it all gray!

- ⚠ Why is it important that it be gray to you?
- ⚠ Is it legally gray?
- ⚠ Is it ethically gray?
- ⚠ Is it a good-faith disagreement?
- ⚠ What if it's not a gray area?
- ⚠ Does everyone believe it's a gray area?
- ⚠ Interpretation vs. loophole vs. nondisclosure of relevant information

Watch the “warm” language: The Labels

- ⓘ “Cooking the books.”
- ⓘ “Copyright infringement”
- ⓘ “Manipulated appraisal”
- ⓘ “Changed the numbers”
- ⓘ “Backdating Options”
- ⓘ “You lied”
- ⓘ “Financial engineering”
- ⓘ “Managing earnings”
- ⓘ “Smoothing earnings”
- ⓘ “Getting results”
- ⓘ “Peer-to-Peer file sharing”
- ⓘ “Got a second opinion”
- ⓘ “Pro forma adjustment”
- ⓘ “Deseasonalized the data”
- ⓘ “Periodic look-backs”
- ⓘ “No, I misremembered.”

Watch Your Language!

- ⚠ "The employee stole from inventory."
- ⚠ "He was accepting cash for political favors."
- ⚠ "Bribes"
- ⚠ "Suspended from school"
- ⚠ "Conflict of interest"
- ⚠ "The employee showed poor judgment."
- ⚠ "He was just accessible."
- ⚠ "Useful expenditures" (Siemens)
- ⚠ "Restricted"
- ⚠ "It wasn't so much a conflict of interest as it was a confluence of conflicting motives."

Some Examples

- ⚠ Adding \$500,000 to the price of a contract and then splitting that amount with the manager/owner
- ⚠ Construction managers adding payments or additional amounts to contracts in exchange for gifts

The Performance

Rounded Corners

The Quality Issue

- ❗ 42% of contracts awarded in Iraq were canceled at the end of 2008 because of shoddy workmanship and poor quality
- ❗ \$50.8 billion in projects, with 70% of the money paid out and fewer than one-half of the projects near completion
- ❗ Some contracts had cost over-runs but nothing had been built

The Speed of Trust and the Costs of Verifying

- ⚠ Construction monitors on projects
- ⚠ Looking for fraud and abuse; often uncover inadequate materials, testing, and compliance
- ⚠ Monitors on the construction monitors are now common

Ethics at Work

KPMG 2000 Survey

- i 76% of employees observed a high level of illegal or unethical conduct at work in the past 12 months
- i 49% of employees observed misconduct that, if revealed, would cause their firms to "significantly lose public trust"

KPMG 2005 Survey

- i 74% of employees observed a high level of illegal or unethical conduct at work in the past 12 months
- i 50% of employees observed misconduct that, if revealed, would cause their firms to "significantly lose public trust"

KPMG 2008 Survey

- 74% of employees observed a high level of illegal or unethical conduct at work in the past 12 months
- 50% of employees observed misconduct that, if revealed, would cause their firms to "significantly lose public trust"
- 74% feel pressure to "do whatever it takes"

Ethics at Work 2008

- ! 9% of employees feel they have an ethical culture at work

Ethics Resource Center

Rounded Corners on Safety

- ⚠ The New York City change to make safety rules applicable to 10 stories (it had been 13)
- ⚠ Resistance from the industry
- ⚠ One visit netted 8 violations against the contractor and 4 against subcontractors
- ⚠ The harness rule and the man on the 10th floor who fell and was killed

NASA and Their Decisions

" . . . And I have to think that subconsciously that even though you don't want it to affect decision-making, it probably does."

"I don't know . . . I would like to think that the technical issues and safety resolving technical issues can take priority over any budget or scheduling issue."

NASA employees on why safety problems were minimized or ignored

FAA and Safety

- ⚠ FAA inspectors Bobby Boutris and Douglas Peters and the flatlining

- ⚠ Findings of IG

"Mr. Boutris and Mr. Peters are not wide-eyed reactionaries who carry a grudge for some perceived injustice. They are honest, hardworking men, proud of what they do, and they attempted to work within the system to have their concerns addressed."

Opening up Communication

- ⚠ Only 3% of employees use hotlines and anonymous methods to raise issues
- ⚠ The unscheduled time (MBWA)
- ⚠ The flatter organization
- ⚠ How do you start meetings?
- ⚠ Do you draw out those who are quiet about issues and during meetings?

The Sandwich Effect

- ⓘ Those at the top assume employees would tell
- ⓘ Those at the bottom assume that those at the top don't want to hear about it

What Employees Won't Do and Why

- 65% DIDN'T REPORT (1999)
- 37% DIDN'T REPORT (2003)
- 41%-50% DIDN'T REPORT (2005)
- 45%-60% DIDN'T REPORT (2006)
- 42%-60% DIDN'T REPORT (2008)
- § 96% feared being accused of not being a team player (same 1999 and 2003)(80% 2006)
- § 81% feared corrective action would not be taken
- § 75%-88% (2006)
- § 68% feared retribution from their supervisors
- § 49%-64% feared retaliatory action (2006)

(SHRM)

The Indictments

- ⓘ Manslaughter charge for owner of a company for his failure to place the statutorily required shoring of sides of a trench
- ⓘ Owner had been warned by his supervisor and replied, "Don't worry about it."
- ⓘ Worker was suffocated when the trench collapsed

The Relationship Between Law and Ethics

- ⚠ The law as the minimum, not the maximum, standard of behavior
- ⚠ The difference between “could” and “should”
- ⚠ Interpretation and loopholes
- ⚠ Shortcuts on shoring, overhead protection, equipment maintenance
- ⚠ The Loopholes
- ⚠ “Prudent” vs. “Permissible”
- ⚠ Only 68 criminal cases under OSHA since its inception

The Story of Sandler O'Neill: Reputation and the Long Term

"Fifteen years from now, my son will meet the son or daughter of one of our people who died that day, and I will be judged on what that kid tells my son about what Sandler O'Neill did for his family."

Jimmy Dunne III

Sole surviving senior partner from 9/11/01 WTC attacks

One of 17 survivors out of a firm of 83

Government Relations

Cozy and Otherwise

Government Issues

Illinois – Gov. Ryan
Illinois – Blago
Baltimore's mayor
Detroit's mayor – Kwame Kilpatrick
San Diego -- \$1.1 billion pension fund deficit; skimming to meet city budget
Connecticut – Gov. Rowland
Chicago – Mayor's office and contracts
Embezzlement – BLM
Former Delay aides and guilty pleas
Abramoff
Duke Cunningham -- \$2.4 million from defense contractors
State crime labs and scandals
Tom DeLay
Clark County Commissioner and the My Tai concession
Philadelphia mayor and the pay-to-play contracting system
Darlene Druyun and Boeing
HR director of JeffCo County and the \$32,000 in personal expenses on county credit card
Governors engaged in business relationships with those who receive state contracts
BLM chief in Monterey doctoring invoices to embezzle
USDA employees and the \$100K for visas
Dept. of Interior and forged documents
Graduation rate manipulation
VECO and Alaska officials
Ted Stevens, former senator, Alaska
BLAGO
Ethics officer for U.S. Marshall
Rep. Charles Rangel, taxes, donations
Timothy Geithner and the SS taxes

Oil for food UN scandal
Post-Katrina corruption in contract awards
Iraq contract awards
Rob Reiner using his favorite companies for California commission contracts and political purposes
Arlen Specter's aide's spouse gets earmarked funds
Arizona State treasurer investigation for conflicts: Maricopa County assessor and conviction: \$400 per low-income loan to seniors
Mike Espy
Henry Cisneros
Taser and the law enforcement officials
Colorado and the \$1,500 office chairs
Contributions for changing the no-touching rule at San Diego strip clubs
Scottsdale School District and the bids
New York assistant principal who gave his son the answers to 35 questions on the Regents' exam
Kerik and employment of illegal immigrants
DMV employees who gave out licenses in exchange for cash
William Jefferson and the cold cash
Eliot Spitzer, former New York governor
David Paterson, New York Governor
Justice Department and monitors
U.S. Postal Service and the dinners
The docs, research, and drug firms facility

Relationships with Inspectors

- ⚠ Waiving physical inspection of the cranes
- ⚠ The labs not doing the testing on the concrete: slump and compression tests were falsified during the construction boom
- ⚠ Seattle: The light rail subcontractor who falsified documents on the strength of the steel casings

Relationships with Government Officials

- The Bronx borough president who did not pay an architect for the design on his summer home, but the architect's project received a favorable zoning change

Conflicts and Magnitude

“This is not like a guy taking \$500 for a zoning change. This is selling a U.S. Senate seat.”

Chicago Alderman Brian Doherty

Judy Keen, “Blagojevich case is a blot on Chicagoans’ pride,” *USA Today*, December 11, 2008, p. 5A

Birmingham, Alabama

- The sewer tunnel beneath the Cahaba River
- Total cost was \$3.2 billion or 100 times the sewer department's annual budget
- Customer rates went up 300% in 8 years
- County commissioner accepted \$2,619 in Salvatore Ferragamo "goodies" and a \$1,400 Manhattan spa day from a financier for the project
- 22 indictments and 21 convictions
- Those financing the project and those working on it conspired to keep it going as long as possible

The Assessment of an Outsider on Birmingham

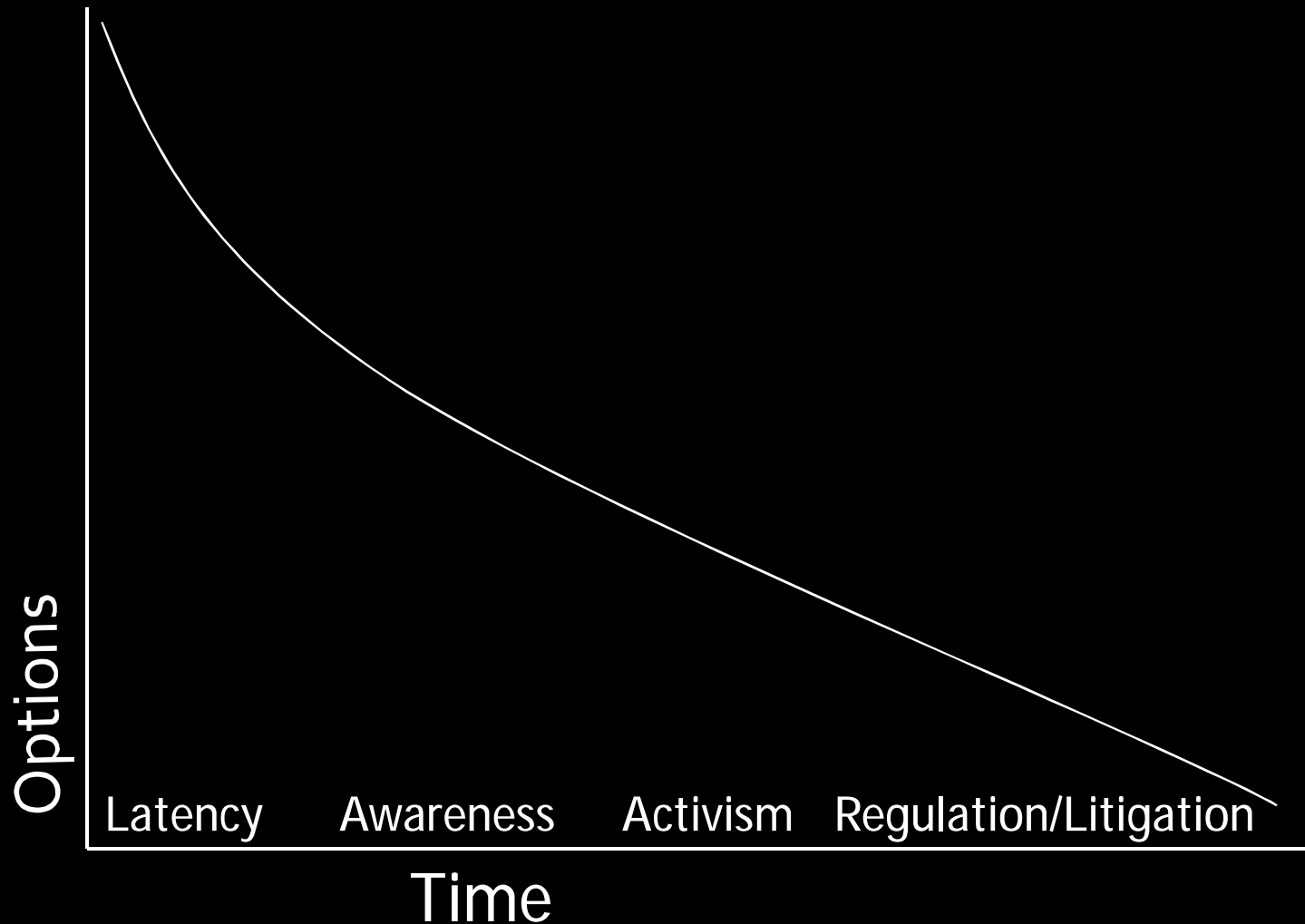
“Some of these deals just made no sense or were not done effectively. There was every indication that they were done principally to run up the fees.”

Ethics and Leadership

- ! Leadership is the ability to see around corners
- ! Leadership is the ability to see the problem before others
- ! Leadership is the ability to fix the problem before it becomes a headline
- ! *"But I have to . . ."*

Social/Regulatory/Litigation Cycle

Public
Moves
the
Cycle



The Change Orders

Of Hostages and Delays

Change and Fraud; Fraud and Change

- ❗ 2008 estimate is that fraud amounts to 10% of gross revenues in the industry
- ❗ Inadequate documentation on requests for changes and for payment
- ❗ Inadequate explanations for changes: the Problem of Collusion
- ❗ Guaranteed Maximum Price and Design Build
- ❗ Lump sum vs. time and material
- ❗ Failure to disclose that some changes result in cost savings

Questions to ask yourself

- ⚠ Could I see this coming?
- ⚠ Was it disclosed in the bidding? The negotiations?
- ⚠ What is the timing?
- ⚠ What about the additional payment? What is the actual cost?
- ⚠ Do I have documentation?

Draw Your Lines

- ⌚ Stick to them
- ⌚ Take action consistent with those lines
- ⌚ The value of a personal and company credo
- ⌚ Group Think and the Asch Studies

Value-Based Decision-Making

Some Absolutes: Categories of Ethical Breaches

- Taking things that don't belong to you
- Telling the truth
- Hiding or Divulging Information
- Taking Unfair Advantage
- Engaging in Personal Decadence
- Unfair Conduct
- Violating the rules of the organization
- Avoiding false impressions
- Conflicts of interest
- Condoning unethical conduct
- Balancing Personal Lives and Work

Defining the Issue: Define Dilemmas by Values, Not Circumstances

Avoid the either/or conundrum and its
false security

1. The ease of resolution vs. The long-term implications
2. Failure to define the issue properly

An example of not defining the issue properly: Short-term blinders; failure-to-see-consequences blinders

"We had to pretend a customer was having a problem with a brand-new product. Our mission was to decide whether to immediately scare all customers who had purchased the product by issuing a wide-scale red alert or wait and first try to find the cause of the problem."

*Shahin Kahn
Chief Competitive Officer
Sun Microsystems*

The Seduction of Habit

George Lefcoe , former commissioner of the Los Angeles County Regional Planning Commission on his retirement and the seduction of public office.

"No Second Chance"

"You slip-slide into evil, he thought. You cross the line for just one moment. You cross back. You feel safe. You change things, you believe, for the better. The line is still intact. Okay, maybe there's a smudge there now, but you can still see it clearly. And the next time you cross, maybe that line smudges a little more. But you have your bearings. No matter what happens to that line, you remember where it is. Don't you?"

Harlan Coben, Chapter 32

Simple Tests for Resolving Ethical Dilemmas

Categorical Imperative

How would you want to be treated? Are you comfortable with a world with your standards?

Christian principle: The Golden Rule

Do unto others as you would have them do unto you. Luke 6:29-38

Thou shalt love thy neighbor as thyself.

Luke 10:27

Confucius:

What you do not want done to yourself, do not do to others.

Aristotle:

We should behave to our friends as we wish our friends to behave to us.

Resolving Ethical Dilemmas

Islam:

No one of you is a believer until he loves for his brother what he loves for himself.

Hinduism:

Do nothing to thy neighbor which thou wouldst not have him do to thee.

Sikhism:

Treat others as you would be treated yourself.

Plato:

May I do to others as I would that they should do unto me.

Judaism:

What you hate, do not do to anyone.

Buddhism:

Hurt not others with that which pains thyself.

***TREAT PEOPLE THE WAY YOU WANT THEM TO
TREAT YOU.***

Front Page of the Newspaper Test

Contemplating any business act, an employee should ask himself whether he would be willing to see it immediately described by an informed and critical reporter on the front page of his local paper, there to be read by his spouse, children and friends. At Salomon we simply want no part of any activities that pass legal tests but that we, as citizens, would find offensive.

Warren E. Buffett
Acting Chairman
upon Salomon, Inc.'s
ethical collapse

Jennings' National Enquirer Model

Make up the worst possible headline you can think of, because that's what you are going to get.

Blanchard/Peale

- a. Is it legal?
- b. Is it balanced?
- c. How does it make me feel?

Laura Nash Model

1. Are you confident that your position will be as valid over a long period of time as it seems now?
2. Could you discuss your decision with your supervisor, co-workers, friends, family?

The Payments and the Billing

They'll never catch this.

The Tricks of the Trade

- ⚠ Holding off on paying subs and suppliers
- ⚠ Falsifying lien waivers to use cash on other projects
- ⚠ Unusual paperwork submitted for payment
- ⚠ Changes in time records
- ⚠ Missing weight tickets
- ⚠ Not disclosing overpayments
- ⚠ Not reporting invoice mistakes

Pressure: Probability from the Financial Analysts Institute

$$P = f(x)$$

x = amount of money involved

- ⌚ The discovery of the relationship between maintenance and botulism
- ⌚ The relationship between safety and incentive programs

Peanut Corp of America

*"The cost is costing us huge \$\$\$\$
Desperately need to turn the Raw
Peanuts on our floor into money . . . We
have other peanuts on the floor that we
would like to do the same with."*

Stewart Parnell, CEO of Peanut Corporation of America, e-mail sent January 19, 2009 on findings of salmonella in the company's product. The company has declared Chapter 7 bankruptcy.

Stanford and Benchmarking: The government as a dumb customer

Overhead funds from federal grants used for

- § \$3,000 cedar-lined closet for Kennedy's home
- § \$2,000 flowers
- § \$2,500 grand piano refurbishing
- § \$7,000 sheets
- § \$4,000 wedding reception
- § \$184,000 yacht depreciation

The Language of An Ethical Breach

December 18, 1990

"What was intended as government policy to build the capacity of universities through reimbursement of indirect costs leads to payments that are all too easily misunderstood. Therefore, we will be reexamining our policies in an effort to avoid any confusion that might result. At the same time, it is important to understand that the items currently questioned, taken together, have an insignificant impact on Stanford's indirect-cost rate."

The Language of An Ethical Breach

December 18, 1990 (cont'd)

"Moreover, Stanford routinely charges the government less than our full indirect costs precisely to allow for errors and allowances."

From a university statement

The Language of an Ethical Breach

January 14, 1991

"I don't care whether it's flowers, or dinners and receptions, or whether it's washing the table linen after it's been used, or buying an antique here or there, or refinishing a piano when its finish gets crappy, or repairing a closet and refinishing it -- all those are investments in a university facility that serves a whole array of functions."

From an interview with the Stanford Daily

The Language of An Ethical Breach

January 23, 1991

"Because acute public attention on these items threatens to overshadow the more important and fundamental issue of the support of federally sponsored research, Stanford is voluntarily withdrawing all general administration costs for operation of Hoover House claimed for the fiscal years since 1981."

University statement

Evolutionary Progress

February 19, 1991

"I am troubled by costs that are perfectly appropriate as university expenditures and lawful under government rules but I believe ought not be charged to the taxpayer. I should have been more alert to this policy issue, and I should have insisted on more intensive review of these transactions."

Remarks to alumni

More Progress

March 23, 1991

“Our obligation is not to do all the law permits, but to do what is right. Technical legality is not the guiding principle. Even in matters as arcane as government cost accounting, we must figure out what is appropriate and act accordingly. With respect to indirect-cost recovery, we pursued what was permissible under the rules, without applying our customary standard of what is proper . . .”

Remarks to alumni

Kennedy's Demise

July, 1991

"It is very difficult for a person identified with a problem to be a spokesman for its solution."

Donald Kennedy
Letter of Resignation

The Attitude Survives

"We took a beating. It was sufficiently bad that after the hearings and during the summer of 1991, it became clear to me that there was so much faculty concern about the ruckus and whether Stanford would continue to be a target for this kind of thing that I decided that if you're part of a problem, you can't be part of a solution and so I resigned. I think that steadied things down considerably. It wasn't any fun to do that. It was not any fun to take a certain amount of newspaper abuse in connection with it. Stanford's recovered nicely. We're still not paid the indirect cost rate I think we are entitled to under articulated government policies, but the sequelae to the whole furor, I think, made it plain to everybody that Stanford hadn't engaged in any wrongdoing."

Donald Kennedy, interview in 2000

Watching Out for the Fog That Hampers Ethics