

Preventing Runaway Ethics



Erin Perales
NAPPA, June 25, 2015

The Missing Dollar



Three men go into a motel. The desk clerk said the room was \$30, so each man paid \$10 and went to the room. A while later, the desk clerk realized the room was only \$25, so he sent the bellboy to the three guys' room with \$5. On the way, the bellboy couldn't figure out how to split \$5 evenly between three men, so he gave each man \$1 and kept the other \$2 for himself.

Now, each person paid \$10 and got back \$1. So they paid \$9 each, totaling \$27. The bellboy has \$2, totaling \$29. Where is the remaining dollar?

Behavior is Context-Dependent

- Business Decisions
- Ethical Decisions



Cognitive Priming



- 1999 Study with 2 groups
- Manufacturer in an industry that emits toxic gas
- Emissions requirement
 - Scrubber equipment costly
 - Small fine for noncompliance
- One group is told make a business decision
- One group is told to make an ethical decision
- Both groups are told to make mental checklists to help with their decision-making
- Opportunity to cheat

Who cheated?



Business Decision Group

- Goals
 - Be competent
 - Be successful
 - What might I gain?
 - How will it affect my future?
- Ethical fading occurs where one is cognitively primed to focus on business goals, regardless of moral upbringing

Ethical Decision Group

- Goals
 - Is this fair?
 - Is it right?
 - Will people be hurt?

Client-Lawyer Relationship

Rule 1.13- Organization As Client

ABA Model Rules of Professional Conduct, Rule 1.13, states in part (emphasis added):

(a) A lawyer employed or retained by an organization *represents the organization* acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a *violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization*, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization.

What could go wrong?



Perverse Incentives



Pinto Fires

- Rear end collision leaked fuel and exploded into flames
- Memo calculating cost of reinforcing rear end (\$121 million) versus potential payout to victims (\$50 million)
- Engineers discovered problem in preproduction crash tests, but company decided to proceed anyway



Sears

- Management gave auto mechanics a sales goal of \$147/hour to increase speed of repairs
- Mechanics met goal by overcharging for services and “repairing” things that weren’t broken

Recipe for Disaster

- Rewarding results rather than high-quality decisions.
- Compare an employee who makes a poor decision that turns out well and is rewarded for it with an employee who makes a good decision that turns out poorly and is punished.
- Rewarding unethical decisions because they have good outcomes will have disastrous consequences over the long term.

Law of the Hog





- * Management at a Northwest lumber mill saw that profits had declined, even though productivity and quality remained constant.
- * A consultant was brought in to evaluate the workforce for a potential management training program.
- * The consultant interviewed employees and concluded that they were angry and felt powerless. They thought management always demanded more, and even when they delivered, management was harsh, arbitrary, and disrespectful. The employees basically felt powerless to protect themselves against the powerful. So.....

“Feed the Hog!”

So, when the boss would leave the work area, the workers would take perfectly good veneer and throw it into the hog. Because the hog was used for chopping up scrap, when someone would grind up good veneer, it hurt the productivity numbers and the boss would get in trouble.

Bottom Line:

“If you want to get even, you feed the hog.”

Discretionary Effort

- In fact the most common form of “feeding the hog” is when employees react passively to bad treatment – they just don’t give their all or maybe they withhold information that could be essential to a decision.

Doing wrong to help others



“Because we *like* you!”

- Frauds are usually considered to be perpetrated by people driven by financial incentives. But psychologists and economists say there is another possible explanation: Human beings commit fraud because human beings *like* each other.
- We like to help people, especially those with whom we identify. When we help people, we really don't consider what we are doing as unethical.
- Lamar Pierce, an associate professor at Washington University in St. Louis, points to the case of emissions testers. Emissions testers are supposed to test whether or not a car is too polluting to stay on the road. If it is, they're supposed to fail the car.

Let's hear it for the little guy!

- Pierce's team collected hundreds of thousands of records and tracked the patterns of individual inspectors, monitoring the cars they approved and the cars they denied.
- They found that “somewhere between 20 percent and 50 percent of cars that should fail are passed — are *illicitly* passed.” But it's the type of car that passed that really caught their attention.
- Based on their research, if you pull up in a fancy car — a BMW or Ferrari — and your car is polluting the air, you are likely to fail. But if you pull up in a Honda Civic, you have a much better chance of passing.
- Why? Research shows that when we empathize with others, we want to help them. Emissions testers, who make a modest salary, likely see a Civic and identify with the driver. They feel empathetic and want to help, so the car passes the emissions test.
- The researches concluded that the testers commit fraud not out of greed, but because they are *nice*.

“You I like, you. . .not so much”



Incrementalism

- Stanley Milgram – Lethal ZAP Level
- Ambiguous half-truth on the resume
- Padding the expense report
- Rounding up billable hours by a half-hour (then an hour, then two hours, etc.)
- Reporting higher losses on insurance claims
- Recommending unnecessary services

It's no big deal, right?

Compliance professionals often face the claim that they are overly concerned with trivial problems: a late report, a missing signature, an inappropriate expense of a small amount.

From a compliance perspective, these are more than broken rules, they are the top of a slippery slope.

Good people do bad things

- Data derived from the National Business Ethics Survey, National Government Ethics Survey, and National Nonprofit Ethics Survey, confirms that fraud is prevalent in organizations.
 - 49% of the survey respondents report observing misconduct on the job.
 - 36% of those who observe misconduct opted not to report what they had observed to their management.
 - Of the 64% who did report what they observed, 15% of those experienced retaliation.

The Fraud Triangle

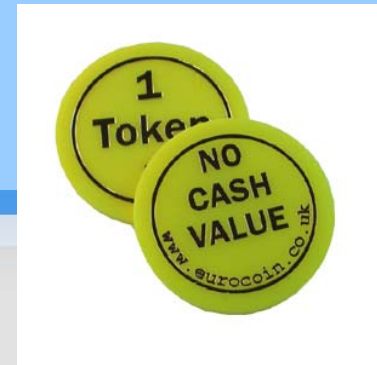


Predictable Fraud

The fraud triangle suggests that fraud is not only possible, but is actually predictable in circumstances where three preconditions exist: motive, opportunity, and rationalization.

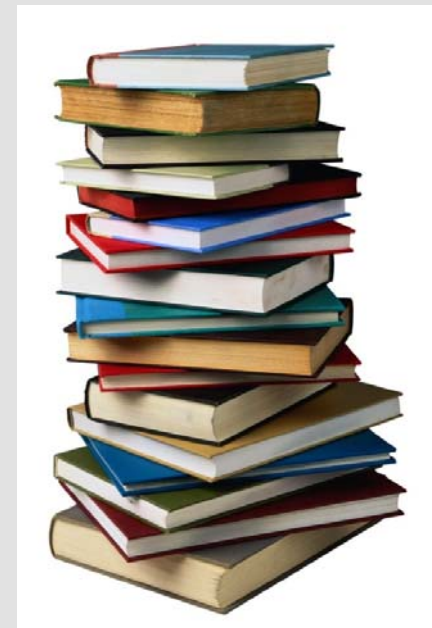
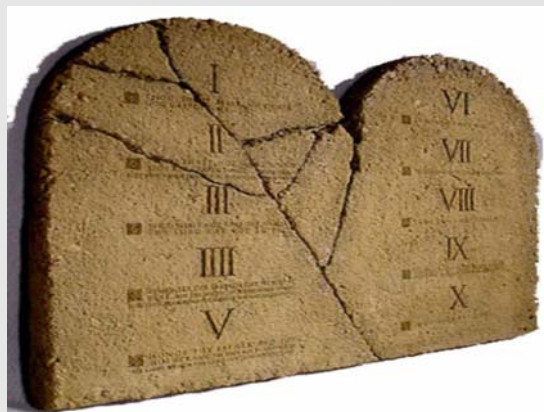
- **Pressure or Motive** - the moving force or drive that causes an individual to act in a specific fashion or towards a specific goal.
- **Opportunity** - presence of circumstances that are conducive to and/or consistent with the action being considered.
- **Rationalizations** - the lies we tell ourselves to give us permission to do what we know is wrong.

Cheating



Dan Ariely:

- Math tests and the Ten Commandments
- The Ten Commandments and 10 books you read in high school
- Distancing: Coke, money, tokens



1.69	1.82	2.91
4.67	4.81	3.05
5.82	5.06	4.28
6.36	5.19	4.57

- Test subjects (usually college students) are given a sheet of paper with 20 different matrices and told to find in each of the matrices two numbers that add up to 10.
- They have five minutes to solve as many of the matrices as possible, and they get paid based on how many they solve correctly.
- For some subjects, the test makes it possible to cheat on the matrix task with the "shredder condition." The subjects are told to count their correct answers on their own and then put their work sheets through a paper shredder at the back of the room. They then report how many matrices they solved correctly and get paid accordingly.



What happens when they compared scores for the people in the control condition and those in the shredder condition?

- In the control condition, most people solved about four matrices in five minutes.
- In the shredder condition, everyone suddenly and miraculously gets smarter, claiming to solve an average of six matrices—two more than in the control condition.
- The overall increase results not from a few individuals who claim to solve a lot more matrices but from lots of people who cheat just by a little.

Thou shalt not . . .

Next, the subjects were asked to recite the Ten Commandments before they took the test.

Result?

It turns out that it eliminated the fudge factor completely. Ariely reported, “It’s not as if the people who are more religious or who remember more commandments cheat less. In fact even when we get atheists to swear on the Bible, they don’t cheat afterwards. So it’s not about fear of God; it’s about reminding people of their own moral standards.”

Strong Reminders of Morality



- In an experiment on 450 participants, they asked half to recall the Ten Commandments and the other half to recall 10 books they read in high school.
- The subjects who recalled the 10 books showed the typical widespread but moderate cheating.
- No cheating was observed in the group that was asked to recall the Ten Commandments.
- In another variant, students were reminded of their schools' honor codes instead of the Ten Commandments, and the result was no cheating.
- The researchers highlight the obvious implications for the real world, saying that ethics lectures and training seem to have little to no effect on people, reminders of morality—right when they are making a decision—appear to have an outsize effect on behavior.

Distancing



- One thing that increased cheating in the experiments was to make the likelihood of a monetary payoff more "distant," in psychological terms.
- In one variation of the matrix test, the researchers tempted students to cheat for tokens (which would immediately be traded in for cash). The students cheated twice as much as those lying directly for money.
- The idea was that if people are placed one step away from money, they cheat more.

Role Models

- Study: students complete a task on which they could cheat in order to earn more money. Upon seeing cheating by a student from their own school—wearing university paraphernalia—students were more likely to cheat themselves.
- Seeing a student from a rival school cheating had the opposite effect. Students became less likely to cheat, indicating that when the cheater is one of *them* instead of *us*, bad behavior can affect the prevailing ethical standards.



What can you do?

- Most important – help create an ethical environment starting with a positive “tone at the top” and organization-wide core values and policies to which all employees have buy-in. Involve the managers in all your divisions and consider bringing in outside experts.
- Raise the probability that your organization will operate to high standards of what is right, fair and good in all of your dealings, both internally and externally.

Identify the Conduct

Start by identifying opportunities for unethical or fraudulent conduct in your system.

The National Business Ethics Survey looks at employees lying to other employees and external stakeholders, benefits violations, falsifying time and/or expenses, document alteration, misrepresenting financial records, bribing public officials and insider trading, and employees who are reluctant to report the misconduct they observe.

Question the Status Quo

Ask yourself questions:

- What are you doing to make it easier and safer for your employees to report misconduct when they observe it?
- What are you doing to create a high level of employee confidence that when they do report ethics issues, those issues will be addressed and the reporting employee will not experience retaliation?
- How might you reduce employees' motivation for workplace misconduct based on trickery or deception, or even with the goal of "helping" others?
- How can you address the way employees might silently sabotage your organization and purposely feed the hog?

“All that is necessary for the triumph of evil is that good men do nothing.”


~ Edmund Burke

It's Only a Game: Ethical Lessons from Sports

James H. Salvie, General Counsel, Massachusetts Teachers' Retirement System



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What we'll do today

- Part 1 Cheating in sports**
Gamesmanship vs. sportsmanship, and rationales for cheating
- Part 2 Cheating in pension administration**
How trustees "cheat," and rationales for cheating
- Part 3 The commonality of rationales**
Counter rationales: what works, and what doesn't

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Part 1: Cheating in sports 3




Gamesmanship vs. sportsmanship

Two ways to approach a contest:

- **Gamesmanship**
 - All that matters is winning
 - Bending, evading, breaking rules
 - It's only cheating if you get caught
- **Sportsmanship**
 - How you play is essential
 - Principles and process over results

Part 1: Cheating in sports 4



Gamesmanship: Rationales for cheating in sports

- **To level the playing field**
 - Just to be competitive (at an elite level), I need to cheat
 - Pro cyclists: Tyler Hamilton
 - A-Rod
- **There's no harm**
 - I would have won anyway
 - Deflategate/Spygate
 - Lance Armstrong (and his supporters)

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Part 1: Cheating in sports 5



Gamesmanship: Rationales for cheating in sports


- **The rules are arbitrary and inconsistent**
 - They should be ignored
 - Malcolm Gladwell
 - What's the difference between taking steroids and Tommy John surgery?
- **The Belichick doctrine:** Bending the rules, or slight cheating, is part of giving it your all (just don't be obvious!)
 - Fake injuries to draw foul calls
 - Pine tar

Part 1: Cheating in sports 6



A little philosophy...

- **Utilitarianism (John Stuart Mill) underlies gamesmanship**
 - Rules divorced from results are "paternalistic"
 - If breaking a 'rule' leads to more happiness and social utility, it's ok
 - Killing Hitler would be a good idea
- **Kantianism (Immanuel Kant) underlies sportsmanship**
 - Some actions, like murder, theft, are absolutely prohibited, even where they can lead to more happiness
 - Killing Hitler is still killing, and therefore wrong




Part 2: Cheating in pension administration 7

Cheating in pension administration

Three common ways to violate ethical rules in pension administration
(from Restatement of Trusts, 3d, sec. 78)

- 1) Accepting things of value from someone who can benefit from your actions (comment d(1))
 - For example, meals and golf
- 2) Representing interests of "day job" on the Board (comment e)
- 3) Self-dealing, or taking action to benefit those close to you (comment c)
 - For example, pay to play, or nepotism




Part 2: Cheating in pension administration 8

Common rationales

- 1) **Accepting things of value from someone who can benefit from your actions** (comment d(1))
 - Do you really think I'm going to change a vote because he bought me a hamburger?
 - Everyone does it, it's part of building a relationship
 - If the manager is beating all his benchmarks, why does it matter that he paid for a round of golf?

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Part 2: Cheating in pension administration 9

Common rationales

2) Representing interests of "day job" on the Board (comment e)

- Sure I'm speaking in the City's interest, but it happens to be what I think
- Sure I'm speaking in the City's interest, the union reps do it too
- I'm on the Board by virtue of my position. Am I supposed to forget my "real" job? What if others don't do that?



Part 2: Cheating in pension administration 10

Common rationales

3) Self-dealing, or taking action to benefit those close to you (comment c)

- Sure we hired my brother-in-law, but he's qualified for the job
- Political access often does not involve a *quid pro quo*. Isn't "*quid pro quo*" all that the rules should be concerned with?
- The fund isn't going to go broke if I extend that "due diligence" trip to Ireland by a couple of days

The commonality of rationales

- Rationales for cheating in pension administration and sports fall into the same broad categories
 - To level the playing field
 - There's no harm
 - The rules are arbitrary and inconsistent
 - The Belichick doctrine (bending rules, slight cheating)



Common rationales

To level the playing field

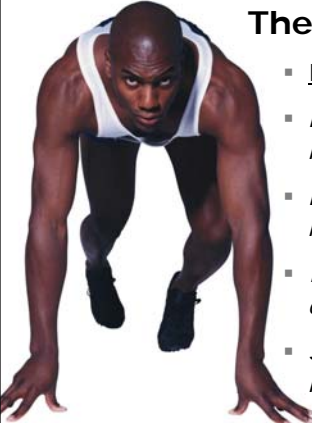
- Just to be competitive (at my level), I have to cheat
- *Everyone does it, it's part of building a relationship*
- *Sure I'm speaking in the City's interest, the union reps do it too*

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Part 3: The commonality of rationales 13

Common rationales




There's no harm

- I would have won anyway
- *Do you really think I'm going to change a vote because he bought me a hamburger?*
- *Everyone does it, it's part of building a relationship*
- *If the manager is beating all his benchmarks, why does it matter that he paid for a round of golf?*
- *Sure I'm speaking in the City's interest, but it happens to be what I think*
- *Sure we hired my brother-in-law, but he's qualified for the job*
- *The fund isn't going to go broke if I extend that "due diligence" trip to Ireland by a couple of days*

Part 3: The commonality of rationales 14

Common rationales

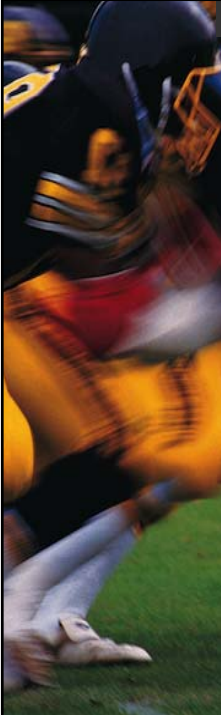


The rules are arbitrary and inconsistent

- What's the difference between steroids and Tommy John surgery?
- *Do you really think I'm going to change a vote because he bought me a hamburger?*
- *If the manager is beating all his benchmarks, why does it matter if he paid for a round of golf?*
- *I'm on the Board by virtue of my position. Am I supposed to forget my "real" job? What if others don't do that?*
- *Political access often does not involve a quid pro quo. Isn't "quid pro quo" all that the rules should be concerned with?*

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Part 3: The commonality of rationales 15

Common rationales

**Belichick doctrine:
Bending rules, slight cheating**

- Fake injuries, pine tar
- *Everyone takes meals, it's part of building a relationship*
- *The fund isn't going to go broke if I stretch that "due diligence" trip to Ireland by a couple of days*




Part 3: The commonality of rationales 16

The commonality of rationales: What does it tell us?

- If all cheating stems from same motivations, involves same rationales, are there common "counter rationales" that stop it?
- **Problem:** On the individual level, each of these rationales is often true
 - The Pats really would have won anyway!
 - Would you have cheated in Tyler Hamilton's shoes?
 - **Result:** Trying to argue or persuade an individual to follow the rules is often fruitless
- How does a lawyer stop it?

Part 3: The commonality of rationales 17

How do they stop cheating (or try to) in sports?



- In culture of *gamesmanship*, ethics comes from **outside force**
 - Ethics board, courts, **you**, in pension administration
 - Threat based – more cameras, more tests, sanctions
 - Do you have the power/opportunity of an umpire or referee to impose and enforce rules?
- In culture of *sportsmanship*, ethics comes from **within**
 - Sportsmanship culture: Individual must be willing to sacrifice his/her possible results to ensure credibility of entire process
 - This comes from leaders, the “clubhouse”

Part 3: The commonality of rationales 18

Fostering a culture of sportsmanship: What do your leaders have to do?



- Sportsmanship is about how the game “ought” to be played (gamesmanship: how it “is” played)
- Everyone has to be on board
 - Someone who’s “getting away with it” undermines effort
- Leaders challenge themselves and others
 - How would you feel if this is on the 10 o’clock news?
 - Would you advise your child to do this?

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The logo for Duane Morris, featuring the name in a white serif font on a dark blue rectangular background. The background of the slide is a light green with a subtle, wavy pattern.

Conform and Comfort: Ethical Traps for Fund Counsel

National Association of Public Pension Attorneys Legal Education Conference
June 2015

presented by
John A. Nixon, Partner
Duane Morris, LLP

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“Two of our four helicopters were hit by ground fire, including the one I was in. . . .”

“. . .I don't know what screwed up in my mind that caused me to conflate one aircraft with another.”

What were Brian Williams' duties as an anchor?

- Assemble facts;
- Determine context;
- Evaluate facts within context; and
- Communicate information with objectivity.

News Anchor

Assemble Facts

Determine Context

Apply Facts in
Context

Communicate with
Objectivity

Legal Advisor

Assemble Facts

Determine Law

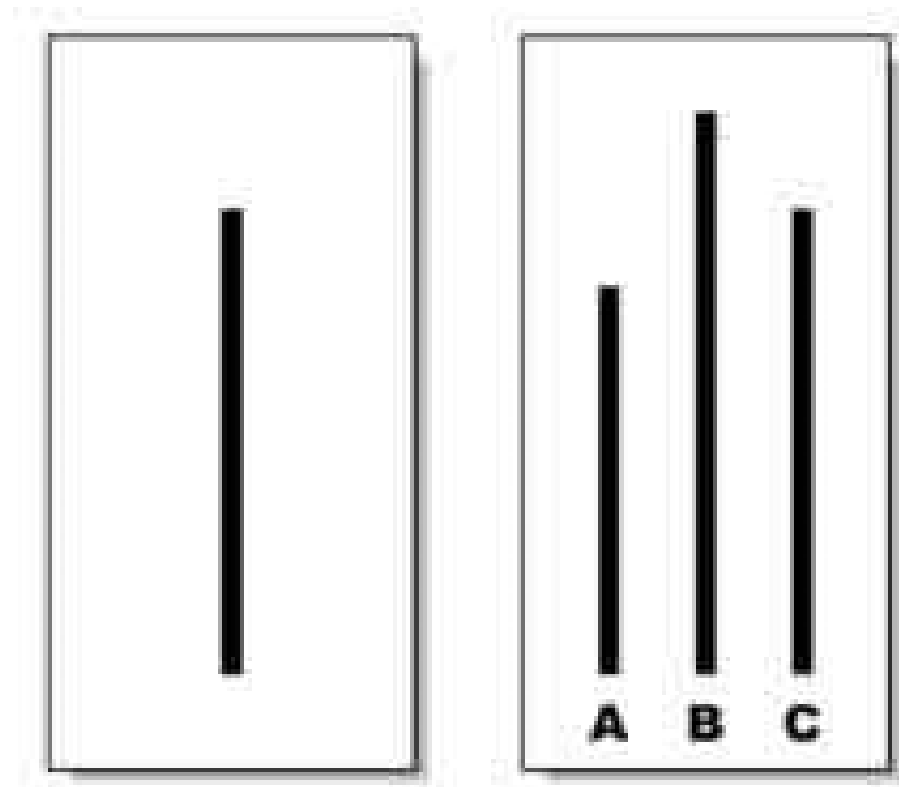
Apply Facts to Law

Advise with
Objectivity

Why did he lie?



Conformity Experiment - Solomon Asch (1951)





Factors Affecting Conformity



1. Size of Group
2. Difficulty of Task
3. Status of Majority Group

Source:

McLeod, S. A. (2008). Asch Experiment. <http://www.simplypsychology.org/asch-conformity.html>

From Conformity to “Getting Comfortable”

“The reference to “comfort” aptly captures the point that most decisions we make are driven by intuition and feelings as much (or more) than explicit deductive or inductive reasoning.

. . .The reference to process signaled by the word “get” further suggests that there is a motivational goal being pursued, a preference in favor of the client’s stated intentions to which the lawyer’s mind is trying to work its way.”

Donald Langevoort. *Getting (Too) Comfortable: In-House Lawyers, Enterprise Risk, and the Financial Crisis* (2011)

¹⁰http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1156&context=fwps_papers

ABA Rules of Professional Responsibility Rule 2.1 Advisor

In representing a client, a lawyer shall exercise independent professional judgment and **render candid advice**. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation.

ABA Rules of Professional Responsibility Rule 2.1 Advisor

Comment 1:

A client is entitled to straightforward advice expressing the lawyer's honest assessment. Legal advice often involves unpleasant facts and alternatives that a client may be disinclined to confront. In presenting advice, a lawyer endeavors to sustain the client's morale and may put advice in as acceptable a form as honesty permits.

However, a lawyer should not be deterred from giving candid advice by the prospect that the advice will be unpalatable to the client.

CONFORMITY:
Everything
looks right.

COMFORT:
Everything *feels*
right.

Historical Expectations of Position

“We’ve
ALWAYS
done it this
way...”

“Our old GC
never had a
problem with
that...”

Contemporary Expectations of Enterprise

“Staff will
revolt if we
take that
position . . .”

“The [] really
needs you to get
on board here . . .”

Avoiding the Traps

- Reinforce your unique role within the enterprise.
- Establish the expectations of your client.
- Seek assistance from those who recognize your position.
- Seek assistance from those outside the influence of the enterprise.
- Communicate *discomfort* both specifically and within context.

QUESTIONS?