Taming the Sensible Knave

BY JAMES A. NORTZ

When their business colleagues attempt to justify a questionable business practice, ethics officers, compliance officers and corporate counsel often hear a common refrain: "It's OK. Everyone is doing it. It's the way business is done. Changing our practices by following all the rules would kill our business."

These rationalizations are classic red flags of possible illegal, unethical or, at the least, risky behavior. But this does not make dealing with such circumstances any easier. In fact, these types of institutionalized, and sometimes industry-wide, practices present corporate law departments, compliance and ethics offices, and business professionals with their most significant challenges.

Say, for example, you're with an insurance brokerage firm, and as corporate counsel, you discover that half your company's profits come from "commissions" paid by the insurance firms in exchange for being awarded lucrative insurance contracts. Or, suppose instead that you were with one of the insurance companies that felt compelled to pay such commissions because everyone else in the business was playing the same game, and failure to do so would result in a significant loss of business. Let's further suppose this really is the way business has been done for decades, and your senior executive team and the board were aware of and had approved such activities. What's the right thing to do? What would you do?

This is exactly the situation that both corporate counsel and others at Marsh & McLennan and AIG found themselves in, prior to Eliot Spitzer's highly publicized investigation into such practices. But, as we now know, nothing was done to curb what were clearly fraudulent activities, in which insurance brokers like Marsh & McLennan extorted payments from insurance companies in exchange for throwing business their way, solicited rigged bids and systematically defrauded their clients. Yet the practice had gone on so long, and had become so accepted within the industry, that when Marsh & McLennan's general counsel met with Spitzer's lead prosecutor, he made a plea for understanding that evidenced a complete lack of appreciation for how ethically bankrupt and illegal such activities were. In speaking to the prosecution team, Marsh & McLennan's counsel was quoted as saying: "You have to understand the rich history of our business. You don't understand our business. Don't misinterpret. Please. Please."

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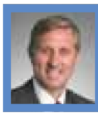
What happened in the insurance business has happened, and continues to happen, in industries around the world. Ten years ago, Wall Street analysts were caught making false statements to investors in order to assist their firms in winning lucrative investment banking deals. For years, thousands of mortgage originators across the country could not resist the lure of easy money by issuing millions of loans to individuals who were known credit risks. Virtually all the rating agencies advanced their business interests by inflating the ratings for mortgage-backed securities. Billions of dollars in fines have been paid by many of the largest and most reputable pharmaceutical and medical device companies, which paid bribes to doctors and promoted their products off-label. When cash is tight, many firms slow-pay their creditors — at least those creditors that lack the economic power to retaliate. Add to this list Enron, Tyco, Global Crossing, WorldCom and the thousands of other firms who have deliberately hidden the ball from shareholders to maintain the value of their publicly traded stock, and a picture starts to emerge of the ubiquity of unethical industry-wide practices that became institutionalized in many of the world's most renowned companies.

To avoid the fate of firms that have been caught and punished for their misdeeds, many companies have created corporate compliance and ethics offices to work with the law department and others to help them operate in accordance with the "highest ethical standards." Nevertheless, even if you have been tasked to perform this important work, you should not underestimate the challenge you will face in getting your company to refrain from engaging in questionable but long-



JAMES A. NORTZ is the director of compliance for Bausch and Lomb. Among other positions, he previously served as a senior advisor for the Ethics and Resource Center, chief compliance officer for Kraton Polymers and vice president, business ethics and compliance for Crompton Corporation. Nortz is also an award-winning columnist for his work with *ACC Docket*. He can be contacted at *james.a.nortz@bausch.com*.

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standing business practices. In addition to the blindness that greed induces in even the best among us, you will likely confront a "sensible knave" culture that is very difficult to reform.

The sensible knave is an invention of the Scottish philosopher David Hume, who famously wrote:

> *"That honesty is the best policy, may be a good general rule; but is liable to many exceptions: And he, it may, perhaps, be thought, conducts himself with most wisdom, who observes the general rule, and takes advantage of all the exceptions."*

Those with a "sensible knave" mentality may lack Hume's eloquence, but they share these sentiments. They say or think things like: "These may not be the rules we'd like to play by, but they are the rules of the game we're in. For our shareholders' sake, we need to play this game hard and play to win." Because the money is good, the economic penalty for changing is real and the likelihood of an enforcement action is often remote, these kinds of attitudes, and the resulting unethical or illegal corporate practices, persist.

Challenging the "sensible knave" mentality is a daunting task, especially when those advocating it are the ones who hired you and control your destiny in the firm. But unless you are comfortable with the idea of becoming a knave yourself, your role as corporate counsel or compliance/ethics officer compels you to do exactly that. When taking on this challenge, I don't recommend falling on your sword, waging a holy crusade or becoming a Dodd/Frank whistleblower. Instead, take the approaches set forth by Joe Badaracco in "Leading Quietly" and Mary Gentile in "Giving Voice to Values" to develop practical strategies to influence your colleagues. In so doing, you will not only have a better chance of keeping your job, you will also greatly increase your prospects of making a meaningful difference.

In deciding whether to seek to reform your company's less savory practices, consider for a moment that even a sensible knave is a knave — one who cynically exploits others and rationalizes violations of fundamental moral principles for personal gain whenever he can get away with it. And remember, this decision will be one of the most important ones you will ever make as a business professional because, like it or not, it will define your individual character, your reputation and your fate.

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