
By Andrew W. Singer

It was only a matter of time before business ethics programs came to grips with the Cyberage. If there is any doubt that this is happening, one need look no further than Northern Telecom, Ltd. (Nortel), the large Toronto-based telecommunications company. Nortel recently posted its Code of Business Conduct on the Internet.

Surely this is one of the first postings of this sort. What would compel a company with 22,000 U.S. employees to put its code on the information highway?

The short answer is that the company aims to reach out beyond its current employee base—to suppliers, customers, shareholders, and even prospective employees.

An ‘under-served’ market

Nortel believes that when it comes to corporate ethics initiatives, suppliers are generally an “under-served” market, explains Megan C. Barry, Senior Ethics Advisor, Business Ethics, Northern Telecom, Ltd., Nashville, TN. “In negotiations, suppliers often don’t know about our code of conduct.” They may be inclined, as a consequence, to offer gifts that Nortel employees simply can’t accept.

The hope, then, is that when suppliers call up Nortel’s “Home Page” on the World Wide Web and click the Code of Conduct “hyperlink” that they will be quickly put right.

The code has been on the Internet since December 1995. It is not possible to determine how many people have accessed it since then because it is one of several ‘links’ on the “home page.” But about 35,000 computer users “hit” the home page in its first six weeks. The hope is that with so “so many hits,” a fair number have accessed the code, says Barry.

Nor are Nortel suppliers the only target of the code. “We want people to know what we stand for,” says Barry, including prospective employees and customers. A mailing to all of the company’s customers clearly would be “more cumbersome”—and expensive. Hence the Internet option.

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Revising the Code

Northern Telecom, with some 60,000 employees worldwide, has had a Code of Business Conduct since the early 1980s. The code was revised in 1989, but the result of that effort was “more of a legal document,” recounts Barry. Meanwhile, the company had “started to look at ethics from a more pro-active viewpoint.” The new goal was to communicate with employees and suppliers “before they had done something wrong.”

Thus the need for another code revision. This process, which went on through much of 1995, featured extensive focus group sessions in which employees were asked what they wanted to see in a code.

The 36 focus sessions were conducted by Barry and two outside consultants. Sessions typically lasted about one and a half hours with fifteen to twenty individuals attending each session. Usually these were middle managers—the most likely segment to experience the ethical “crunch.” “Often they are the most vulnerable,” having to deal with questions like gifts from suppliers and tasks like apprising customers on progress in meeting deadlines.

The focus sessions were conducted in diverse locales, including Canada, Mexico, France, the United Kingdom, the U.S., and Asia.

The company used its internal “quick mail” in the development process as well, placing drafts of the code on its internal mail system. Nortel received 200 employee responses from this. Some suggestions were incorporated in the code, such as the need to address more questions about software copyright infringement. With so many employees working at home, the issue of copying software for personal use became an issue, recalls Barry. In all, six drafts of the code were placed on the internal mail system.

The most important thing to emerge from the focus sessions was that employees wanted the company to be seen “living the commitment,” says Barry. That is, they wanted the company to live up to its commitments and ethical standards on a day-to-day basis.

What was the biggest change from the 1989 code? A question-and-answer section was one significant departure. Here the company addressed ethical concerns likely to arise on a day-to-day basis, such as “Can I work outside Nortel on weekends?” or “Can I photocopy materials for a charitable event?” (See box for some sample questions.)

All told, the revised code took about a year to develop. As recounted in a January 1996 letter to employees from Nortel CEO Jean C. Monty, the revised code was “shaped by the input of more than 1,000 Nortel employees.”

Toward a ‘paperless organization’

Still, why place the code on the Internet? Given the explosion of Internet technology, the company decided that the best way to tell customers, suppliers, shareholders and other stakeholders about the company’s standards was to “put it on the Web.” While Barry has seen ethics codes for trade and professional associations on the World Wide Web, she has yet to see one for an individual corporation.

“We’re a very environmentally conscious organization,” continues Barry, and one goal is to move, as far as possible, toward becoming a “paperless organization.” It isn’t coincidental here that the Nortel senior vice president who is responsible for the business ethics function, Marga-
ret Kerr, is also responsible for environmental issues. Electronic dissemination of the code is seen as one further step toward starting people to think along “paperless” lines. In any event, hard copies of the code were sent to Nortel’s U.S. employees in January.

The Internet-based code is not identical to the internally-disseminated code. It doesn’t contain the question-and-answer section. “We didn’t think suppliers would care about questions like, “Is it okay if I work on the weekends?” The electronic code drew several responses from suppliers and customers in the first weeks. These were not so much to report ethical problems, but to say, “Wow!”

An uptick in contacts
Since the code was placed on the Web—and hard copies mailed to employees—the company has seen a “huge increase” in the number of calls to both its internal and external ethics hotlines. Nortel has a separate phone line for customers who wish to report wrongdoing anonymously. This is managed by Pinkerton Services. “We’ve had an Alert Line for years, but now it’s changed to the Advice Line.” They had a total of about 250 calls in the first six weeks after the code’s dissemination.

What are the nature of hotline calls? They range from “serious concerns about possible fraud to ‘my wife works for a supplier. Is that a conflict of interest?’”

Is the business ethics office overwhelmed by the number of calls? “We’d sure like more resources,” answers Barry, with a laugh. “But we ramped up for this.” The company had expected more activity with the publication of the new code.

Sexual harassment handled by Human Resources
Some items of interest about the code itself:

The company notes that “It is Nortel’s policy that Human Resources be involved in any suspected case of sexual harassment?” Why does the company warn that HR will be involved? Because such cases “have to go forward by law,” answers Barry. Some people may call just to blow

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From Nortel’s Code of Business Conduct:

**Q.** I recently had to pay $100 to get our equipment through customs quickly. Since the company doesn’t pay bribes, should I report this as a meal or an entertainment expense?

**A.** No. You should accurately report the sum as a “facilitation payment” on your expense voucher. Remember, though, that in some countries such payments are illegal. If you are not certain that facilitation payments are legal in the country in which you are working, contact the Legal Department or the Business Ethics function immediately.

**Q.** My brother-in-law is starting a business and has offered a terrific price for some of the company’s business. Can Nortel purchase from my brother-in-law’s company?

**A.** It is possible for the company to purchase from your brother-in-law’s firm, but you must declare the relationship to your supervisor immediately. You must also take care not to try to influence the bidding process nor the company’s negotiation with your relative.

**Q.** My manager keeps making embarrassingly personal remarks to me and asking me out to social events outside of work hours. I consistently refuse these invitations, and have made it clear that these attentions are not welcome—but it doesn’t seem to make any difference. Is this sexual harassment? What should I do about it?

**A.** Yes, it is sexual harassment. You should report the matter directly to Human Resources or the Business Ethics function. For more information on Nortel’s sexual harassment policy, contact your local Human Resources department.
How and Why Wall Street Changed the Rules

by Robert Sobel

Arguably the most important but barely noted transformation in American finance concerns the personnel populating the desks at the investment banks. During the past half century blatant bigotry in hiring and promotion have become unfashionable in this slice of America. (By bigotry I refer to the practice of using criteria having nothing to do with the job, such as race, religion, national origin, and gender, in allocating rewards.)

Peruse the annual reports of public investment banks and the officer rosters of the non-public ones. Stroll through offices and look at names on doors and faces in the halls. Do this for a while and you will become aware of the rise of African-American, Latino, Oriental and female professionals in these organizations. Foreign-born personnel too, and not the old varieties. In the 1950s the foreigners invariably were English, Canadian, or French. Now more are from India, Pakistan, and Taiwan.

Women were never absent from the offices as typists and clerks, but now they are in on the deals too. At one time Wall Street was white during the day and black at night, when the cleaning crews took over. Now there are black faces around the tables during daylight hours.

This isn’t to say the industry has become a model of tolerance; one still encounters bankers, usually elderly, who would like to replace the glass ceiling with one of concrete. But they are increasingly uncommon.

The proper lineage

A generation ago investment bankers who operated out of the more distinguished “white shoe” banks were Ivy Leaguers with fathers and uncles there before them. Morgan partners tended to be Princeton men, and as late as 1965 almost half were in the Social Register. First Boston had a Yale image and Dillon Read bankers came from Harvard and Princeton.

Those old timers accommodated individuals with the requisite smarts but the wrong lineage, which usually meant Jews who, if they had the right connections, might hope for a spot at Goldman Sachs, Lehman Brothers, or Kuhn Loeb. Or they might go to one of the secondary and tertiary houses, which in those days meant Salomon Brothers, or Ira Haupt. There one might find graduates of the municipal university, or more likely, individuals who had never seen the inside of a college. “We weren’t high school dropouts,” said one old-timer at Salomon with no little pride. “We were elementary school dropouts.”

The most powerful Wall Streeter of the 1940s, Goldman Sachs’ Sidney Weinberg, had left school in the eighth grade with little more than a letter from his teacher at P.S. 13. Weinberg got a job as assistant to the janitor at Goldman Sachs, where he caught the eye of the partners. Weinberg’s success was the exception, but he opened the door to the non-traditional graduate.

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The Establishment bankers and the others would cooperate during business houses, but go their separate ways afterwards. In the 1920s and 1930s Otto Kahn of Kuhn Loeb was one of the half dozen most powerful and honored Wall Streeters. He also headed the Metropolitan Opera, which took his money and advice but refused to sell him a box. Weinberg’s successor at Goldman Sachs, Gus Levy, was “Mr. Wall Street.” But Levy was not invited to social gatherings thrown by the Protestant Establishment. As recently as the 1960s, Lew Glucksman, the ace trader, partner, and future CEO at Lehman, was blackballed by 17 members of the Century Association, some of whom probably would have been delighted to have him on their business teams. “I don’t know 17 people there,” said Glucksman, who certainly knew why he had been barred.

The investment banks in the days of Kahn, Levy, and Glucksman were closed and friendly affairs. The infant son of a senior partner would occupy an office at the firm 21 or so years later. Non-family members often were sons of friends of partners. Their world seemed so snug and permanent. Bankers expected to remain at the same concern for life. Commissions were fixed and customers and clients were loyal. There were no hostile takeovers. The broker’s exam was on a par with the written section of the test to get a driver’s license. People knew their places. Such was life in that noncompetitive world, where one’s golf score was as important as the profit statement. There was a name for what they were engaged in: “relationship banking.”

1960s: Beginning of the end

The beginning of the end for this environment came at the conclusion of the bull market of the 1960s, when earnings declines triggered a reexamination of procedures at the banks. With the first whiff of deregulation in the 1970s came profit declines that made many brokers and bankers redundant. This prompted consolidation of banks and brokerages. Personnel raised in the cozy atmosphere of the 1950s and 1960s were now uprooted, fired, or obliged to work with individuals from different cultures. In the process the old stability was jolted.

Now Wall Street banks came to appreciate that brains were a scarce commodity, an awareness hastened by the degradation of American education in the 1970s and 1980s. There was an oversupply of grads, but an increasing shortage of creative, intelligent, well-trained, and disciplined young people.

Refusing to hire people because of bigotry was coming to be recognized as bad business. Alan “Ace” Greenberg, who rose to head Bear Stearns, said, “I look for PSD degrees—poor, smart, and a deep desire to be rich.” As Peter Passell of the New York Times put it, “Sharp elbows and a working knowledge of spreadsheets suddenly counted more than a nose for sherry or membership in Skull and Bones.”

This isn’t to say discrimination disappeared, but rather one paid a price for it, which could run into the tens of millions of dollars. And the banks kept score more carefully than ever before.

This meant that by the 1970s, nephew Jonathan with his Princeton degree in English Lit, might get a start where Uncle Fred was CEO, but if he hoped to be more than a glorified “gofer,” he had to get a graduate degree in finance from Columbia or N.Y.U. And he had to worry more about the firm’s balance sheet than a par four on the ninth hole, because he was being nudged out of contention by newcomers with a different pedigree. It was one thing in 1950 to reject someone with a B.B.A. from C.C.N.Y. or one of those dropouts, quite another in 1975 to turn down an M.B.A. from Wharton or Harvard.

Michael Milken, who more than anyone else came to symbolize that generation, faced this situation when he worked at what then was Drexel Harriman Ripley, a declining force but one with an impeccable white shoe tradition. There was the Wharton M.B.A., the son of Bernard Milkovitz, a Milwaukee-born accountant whose own parents had been immigrants, at a bank with few Jews. An anti-Semite there wanted him fired. “Let me ask you something,” replied an officer. “Milken on a modest capital base is making money, while your high-grade...”

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‘Sharp elbows and a working knowledge of spreadsheets suddenly counted more than a nose for sherry or membership in Skull and Bones.’
Wendy’s: Serving Up Ethics To Franchisees

By Tim C. Mazur

If you picked one measure to differentiate good corporate ethics programs from bad, it might be how confident the ethics officer can be that an employee will “do the right thing” when confronting a serious problem, whether that means honoring the law or calling her supervisor. While the obvious path to this goal is employee education, a lot of what goes into this measure is the company’s ethical climate, or the perception in and out of the company of how much leeway employees have to make truly ethical decisions.

In this light, most ethics officers would more than pleased to work for Wendy’s International, Inc. (Dublin, OH). When people think of Wendy’s they often picture Dave Thomas, the restaurant chain’s affable, grandfatherly founder and nationally recognized spokesperson. When asked, customers, the media, and employees alike perceive Wendy’s as an ethical company, often due to Thomas.

When workers are not ‘employees’

This last constituency, employees, presents a challenge for Wendy’s and its new Ethics Information Office (EIO). Of the 150,000 employees who work for “Wendy’s,” two-thirds are not Wendy’s employees. The paradox? Franchises. Like most members of the quick-service-restaurant (QSR) industry (“fast-food” is not the phrase of choice among industry members including McDonalds, Burger King, and Hardee’s), Wendy’s owns only 30 percent of its namesake restaurants; the rest are run by franchisees.

Wendy’s individually contracts with hundreds of franchisees, some of whom own one store, others hundreds. All are independent businesses. While Wendy’s isn’t liable for these businesses under most laws, including the federal Sentencing Guidelines for Organizations, its reputation is at stake.

This poses a challenge for Steve Warren, Vice President of Corporate Affairs and head of Wendy’s EIO. “I see the newly enhanced ethics portion of each franchise relationship the same as other parts of that relationship,” explains Warren, a former franchisee. “Legally we cannot, nor do we want to, control those businesses. On the premise that Wendy’s success and their success are intertwined, we’ve designed our ethics program to serve our corporate stakeholders, including the independent business arm of the company, our franchisees.”

As with any franchise arrangement, Wendy’s can contractually hold franchisees to some standards—e.g., appearance, menu, food preparation—but not others, including ethics. “Just like the quality of our food and service, the first step is for our 45,000 employees to adhere to high ethical standards. As we honor the standards day-to-day, the 100,000 franchise employees will see the benefit and themselves choose to meet the same standards.” To help these independent employees, Warren and his EIO colleague, Joni
Laura, Manager of Corporate Affairs, will send each franchisee the new *Standards of Business Practices*, along with a tailored written presentation. In addition, any member of “Wendy’s extended family” can call the EIO and request training, advice, or other services currently available to Wendy’s employees.

“I think the best ethics program is one that motivates employees to do the right thing without threat of termination or some other punishment,” says Warren. “That is the opportunity our franchisees present us: we have little or no control over their behavior, yet Joni and I are being encouraged to reach out and invite them to honor Wendy’s ethical standards.”

**A senior management committee**

The motivation behind Wendy’s recent ethics effort comes from its growth and changing customer demographics. “In 1994 there were concurrent proposals to establish standards for individual stakeholder groups, so the Board decided to bring the initiatives together under one ethics umbrella,” Warren reports. A perceived need to review the corporate conduct code, partly inspired by the Sentencing Guidelines, coalesced in the first-ever assembly of a Wendy’s senior management committee, consisting of leaders from the company’s eight core departments. “Wendy’s is proud of its record of department heads spending more time doing their jobs than in meetings, but we saw from the beginning that the ethics effort was one initiative that crossed all corporate lines equally. Therefore, the Board broke precedent and recommended assembling them,” comments Warren.

The committee proceeded cautiously, committing to a year of weekly meetings toward completing an historical assessment of the organization’s values and, finally, a plan for the ethics effort. First step: establish the EIO. For its leader, the committee sought someone who understood the internal workings of Wendy’s corporate culture and how to balance the dual goals of honoring compliance obligations while communicating a wider ethics message. Warren, who had managed diversity issues for Wendy’s, was hired. Laura followed a few months later.

Together the EIO and the committee wrote *Standards of Business Practices*. The guidelines manual is distinctive in its colorful, dynamic presentation. “If the purpose of a document distributed among all employees is to communicate a message, we chose the style and format that would be the most inviting to our relatively high percentage of young employees. What use is a guidelines manual if employees don’t read it?” asks Warren. The 40-page booklet covers the important issues from antitrust to the Foreign Corrupt Practices Act, but it does so with generous use of pastel graphics and an informal style, including an introduction that reads, “Here are some guidelines . . . .”

The EIO showed drafts of the booklet, pilots of its training model, and other program elements to different management teams. The feedback received raised several missing issues and also earned buy-in from key leaders. It also revealed a surprisingly low awareness among employees of current compliance standards.

With feedback in hand, the guidelines manual and then the ethics awareness training program were finalized. Next came the question: Who should deliver the training to the 45,000 employees—trainers from the HR department, each employee’s supervisor, or the ethics office?

Warren, confronted with these three choices, opted for a fourth: department heads. “When we realized the value of creating that first senior-management committee,” he explains, “we chose to follow through and train our 150 department heads throughout the company to personally deliver the ethics message.” One obstacle, though, was that Wendy’s employees are spread among 5,000 sites—so there would be few, if any, opportunities for department heads to fulfill their responsibility via one large presentation. “I would say this and similar logistical challenges were and continue to be the biggest barriers we have to overcome,” adds Warren.

Each department head will spend a day learning the ethics training model in a train-the-trainer session. The subsequent training that they deliver will result in every Wendy’s employee participating in 2.5 hours of ethics instruction. Both sessions involve Wendy’s-specific cases that help employees learn how to solve problems using the guidelines manual and Wendy’s corporate values.

**Younger, transient employees**

If one considers franchises a distinct challenge for Wendy’s and other QSR companies, another is the high percentage of young, transient employees. The industry has a constant inflow and outflow of operations employees,
each of whom has the same legal rights as employees of more-traditional corporations. In the latter firms, the desire for long-term employment is a valuable compliance asset. In addition, older employees are generally more experienced in making difficult decisions. Wendy’s, for its part, includes a distinctive ethics segment in new-employee orientation sessions. In addition, the 150 department heads must reach all their existing employees within 90 days of receiving their own (i.e., department head) training, so as to minimize instances where new-hires with ethics training are mixed with a storeful of existing employees who have not received such training.

Wendy’s ethics program includes several other key elements. To complement the EIO’s toll-free help number, the company contracted with The Network [Ethikos, March/April 1995], an outside hotline company, as an option for employees who prefer to speak anonymously with a party independent of Wendy’s. In addition, random and not-so-random solicitations for feedback aim to ensure the program remains responsive to employees and continually improves. Warren sees this factor as his next greatest hurdle. “You’ve got to put as much if not more effort into continual follow-up after introducing the program. If you put yourself on auto-pilot, the program will fade and the whole corporate effort could be lost.”

Next on Warren’s follow-up list is a stream of communication mechanisms, including Wendy’s monthly newsletters, special mentions within quarterly management reports, payroll stuffers, videos, and posters in stores.

“After that,” he continues, “the program is cyclical in nature. We will re-evaluate our work in the light of feedback and keep an open mind to the inevitable change that occurs in ours and all business. The bottom line is: You’ve got to keep the program current.”

**Institutional components**

Wendy’s ethics program consists of four institutional components. First is a Board-level Audit Committee with eight members (four internal and four external). Second is Wendy’s Ethics Committee, the current name of the former senior management committee, which meets regularly to ensure the program progresses as planned and meshes with Wendy’s strategic plans. Third, the EIO maintains the program (including responding to requests and delivering new-employee orientations), processes feedback, and pursues multiple opportunities for follow-up communication. The fourth component is The Network.

When asked what he knows today about business ethics that he didn’t know before this assignment, Warren answers that “Ethics impacts every fiber of the organization. I used to be like so many others; I discarded ethical concerns as ‘HR issues.’ Now I know that every employee, from janitor to CEO, has the power to influence the ethics of Wendy’s every day.”

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**A Changing Wall Street . . . Continued from page 5**

Milken stayed on. His tormentor left. Not because that officer was a fine, decent individual, who believed in the American Dream. No, he wasn’t overly concerned with justice and morality, but rather the bottom line.

In the summer of 1979 Dillon Read, the quintessential Establishment bank, was staggering under losses incurred as a result of a debacle in Ginnie Mae trades. Luis Mendez, formerly managing director at Morgan Stanley, was brought in as a consultant.

Mendez had fled Cuba in 1962, and arrived in America penniless and friendless. He had a Latin accent and a fierce temper, was overweight, wore the wrong suits badly, and had a sense of humor that puzzled the staid types that occupied the corner offices at Dillon Read. But Mendez could get the job done, so he rose rapidly, to the point where he was seriously considered as the next CEO.

**Talent and performance rewarded**

The Milken and Mendez experiences were dramatic and visible, but not unusual. Today clean-cut, brainy, Ivy League-trained African-Americans, women, Latinos, and Asians don’t faze old-line bankers, as they might have a generation or so ago. True, these newcomers are young and
junior, but time will take care of that. In twenty or so years they’ll be in their 50s. Some will be in top management posts. Don’t be surprised if many of the key players of the early 21st century come from these groups.

If there is a lesson in all of this it may be that bigotry can survive and even flourish in non-competitive areas, where the players and judges can’t or don’t keep score. It persists in government and on college faculties, where those in charge can take race, gender, religion, and political stances into account in hiring and promoting, and accept a friendly and comfortable mediocrity that can’t be quantified. It no longer is prevalent on Wall Street, which can’t afford the luxury of bigotry.

This really is a simple idea. President Clinton may have wanted a Cabinet that looks like America, for example, and Yale might proudly hire on the basis of race and gender. They can do so because there are no objective criteria for judging accomplishment in such places. But today no one would want a sports team that looks like America, or hire a banking team selected on the basis of qualities irrelevant to performance. Rather, in Madison Square Garden and on Wall Street, unlike Washington and the campuses, they keep score. It isn’t only on Wall Street, but in all exciting, fast-growing industries. “They’re not interested in your clothes, your style, or when and how you work,” said a researcher at Microsoft, whose personnel resembles the United Nations. “But they’re sure interested in what you produce.” Talent and performance are rewarded there, no matter what its origins.

Bigotry can be expensive in competitive businesses. When those who do the hiring are aware of costs and consequences, and act in their economic interests, they can be driven to becoming agents of change.

The Sentencing Guidelines as a Compliance ‘Road Map’

The Federal Sentencing Guidelines for Organizations, implemented in November 1991, signaled some tough new medicine for corporations. The prescribed fines and penalties for corporate misdeeds far exceeded what preceded them. Because the Guidelines also offered mitigating credits to companies with “effective” compliance programs, however—and even specified seven “minimum” elements in such programs—they offered an opportunity as well.

Some have now taken this a step further. Bank of Tokyo, Ltd., the New York-based subsidiary of the giant Bank of Tokyo, for one, has begun using the Guidelines’s seven elements as a sort of organizing principle for all its compliance programs. The Guidelines are, in effect, a “road map for compliance,” says Herbert L. Thornhill, Jr., the bank’s Deputy Counsel.

A heavily regulated industry

A road map might prove useful in banking, one of the nation’s most regulated industries. Thornhill estimates that 400 laws and regulations apply to banking activities. In recent years, many of these have gone beyond the traditional business of banking, such as rules governing insider trading, export controls, environmental risk, and EEOC regulations.

Moreover, the pace of regulation has picked up in the last five years. The thrift and bank failures of the 1990-93 recession “led to new legislation regulating the banks and financial industry generally and to regulators and prosecutors assuming a tough posture on regulatory matters,” noted Thornhill at the U.S. Sentencing Commission’s recent conference, “Corporate Crime in America: Strengthening the ‘Good Citizen’ Corporation.”

“Since 1990 there have been a flurry of pronouncements in variable laws like environmental law and money laundering. Regulators made the laws more specific.”

There is more pressure even in more traditional areas. Banks must submit to regular examinations to maintain their bank charters. Examiners are now focusing more sharply on compliance issues. Before 1993, the exams were thorough, says Thornhill, but after 1993 “they started to focus more on actual compliance with laws and regulations.”

Similar to the Guidelines

Where, then, do the Guidelines with their seven “minimum” elements of an effective compliance program come
in? The curious thing about the seven elements, or steps, is that they have analogs in other laws and regulations. If a bank has the “seven elements” covered in all its sundry compliance activities, it is probably on the right track.


Procedures, for instance, are the first of the Guidelines’ seven elements: “The organization must have established compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct,” they note.

Supervision is discussed in the second element, i.e., “Specific individual(s) within high-level personnel for the organization must have been assigned overall responsibility to oversee compliance with such standards and procedures.”

And training is covered in the fourth element, i.e., “The organization must have taken steps to communicate effectively its standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required.”

Thornhill notes that “While banking regulators and legislators are constantly telling banks to comply with particular laws, regulations, and directives, the definition [in the Guidelines] provides a clear picture of what an overall compliance structure should look like once it is in place.” This can result in real savings of time and energy. For an institution with a team of only two or three compliance officers, compliance can be a daunting task, he notes.

In an interview, Thornhill declined to relate specific changes that this new “road map” approach took at Bank of Tokyo Ltd. He did comment at the conference, however, that “the Guidelines helped us to see the forest despite the trees. Since we had a clear vision of what a compliance program should be from the start, we were able to conceptualize a vision of the bank’s program and articulate the vision to management and other employees. This made the program easier to sell.”

‘Significant savings’

One side benefit, says Thornhill, is that using the Guidelines as road maps saves money. If one has a haphazard program, managers often don’t know what other managers are doing. One may have a number of people responsible for compliance training, for instance.

At Bank of Tokyo, Ltd., the bank’s compliance activities are now more coordinated, Thornhill told *ethikos*. There’s no overlap. The same group does the coordinating and training for the whole company. Whereas before they might have had five different seminars or videotapes on money-laundering, “Now we can use the best—a seminar that everyone goes to.”

Does that mean there are actually fewer compliance officers? Not exactly. The bank actually has a greater number of managers involved in compliance. Even though Bank of Tokyo has a compliance committee that includes senior people, compliance is seen as the responsibility of everyone in the organization. But there are now fewer individuals involved in coordinating and monitoring compliance. This has resulted in “significant” savings, says Thornhill.

It also offers a more organized and targeted approach. The compliance committee meets regularly and those responsible for compliance are more likely to share information now. “Before they didn’t meet as often,” he says.

“There’s more awareness about compliance as a result of managers being more involved on a daily basis.” With compliance, everyone knows which area he or she is responsible for.

Does Thornhill think that more companies will begin to use the Sentencing Guidelines as a compliance “road map”? “For the banking industry, I would say yes,” he answers. “Banks are already highly regulated. But now as they get into new areas like securities they face even more regulation.”

Many banks sell mutual funds to their retail customers now. Several have been reproached for not disclosing to customers all the risks associated with these products. Mutual fund investments don’t carry FDIC insurance, for instance. As a result, the “SEC is taking more interest” in banks’ activities.

“Yes, it’s a far more intensified compliance environment that we face.” There is likely to be stricter scrutiny of

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Operating an ethics hotline: 
Some practical advice

Should a company contract with an outside firm to operate its ethics hotline?

An outside operation will probably be recognized as a sufficiently “effective” reporting mechanism under the federal Sentencing Guidelines. But an external hotline receives fewer calls than an internal hotline “because the announcement and operation clearly communicate that its purpose is for reporting lying, cheating, stealing and other types of misconduct,” notes Daniel A. Kile of Daniel Kile & Associates (Colleyville, TX). “Another reason for fewer calls is that employees prefer to complain to fellow employees rather than outsiders because of loyalty and team-player issues. Thus, contracting for a hotline is cheaper than operating it internally. But, an external hotline will not be a force in communicating business values and standards.”

Medium and small businesses that are already in close touch with their employees might consider an external hotline, however, opines Kile, because “they only need protection from hidden employee fraud. The needs of a large business are different. There is already less personal touch with employees, and there is a need to penetrate bureaucracies.”

Three typical hotline uses

Kile, former Director of Ethics at Bell Helicopter Textron, Inc., makes these observations in a new book, “Business Conduct and Ethics: How to Set Up a Self-Governance Program.” In a chapter on ethics hotlines, he notes that hotlines typically have three broad uses:

Interpretations. “Employees will be asking for interpretations of business conduct policy.” They will be seeking advice on conflicts of interest, gifts, and entertainment issues, for instance.

Allegations. “Employees will be making allegations about cheating by fellow employees or swindling by management of customers or suppliers. This is the real purpose of a hotline. A hotline employee will need to do an initial inquiry. The focus is whether there is a reasonable basis to believe there is substance to an allegation. Once meeting this threshold, pass it to an internal or external investigative authority. About one third of allegations will prove true.”

General Information. “Employees will be asking for general information or complaining about treatment in the workplace. The general types of calls will range from the rest rooms are dirty to where do I get safety glasses.” Here the hotline operator acts as a conduit, directing concerns to others in the organization, such as the Human Resources department.

Executive oversight

If a company implements an ethics hotline, executive oversight of the hotline operation is crucial. According to Kile, this has five aspects:

First, the executive running the program must safeguard the integrity of the hotline.

‘Employees will be making allegations about cheating by fellow employees or swindling by management of customers or suppliers. . . . About one third of allegations will prove true.’
This involves “direct written procedures and guidance that guard the identity of individuals who provide information and that cause an impartial, objective, timely, and proper examination of allegations.”

In addition to written procedures, the executive must confirm that the system works effectively and efficiently. Secondly, “Set objective standards that measure effectiveness and efficiency,” writes Kile. Set time limits for responding to allegations and requests for information or interpretations. Set a reasonable number as a goal for a maximum number of pending cases. Review the aging of pending cases. Get a statistical sample of the monthly closed cases and review them to see if the issues received full and proper consideration. Talk personally to a random sample of hotline users to find out how they feel about the hotline effectiveness and efficiency.”

A third imperative is “follow up” in order “to guarantee that appropriate disciplinary and remedial action occurs.” If business conduct standards are violated, violators must be disciplined and steps taken to prevent similar violations in the future.

Fourth, the executive must prevent retribution against hotline users. As Kile explains, “The workplace has its own way of taking care of individuals who complain. At times, the individuals who raise complaints—that you must protect from retaliation—are not likable people or good performers. It gets more complicated for unfounded allegations. This is a high-wire balancing act. You need the aid of a good EEO [Equal Employment Opportunity] advisor. In the end, it is a judgment call.” An EEO advisor, he adds in an interview, may “be able to point to other areas to do a full investigation, so you find that needle in the haystack.”

Finally, the executive in charge must ensure that the hotline receives adequate publicity. “Broadcast statistics, answers to questions, and results of examinations,” writes Kile. “See that a hotline uses all forms of media to get the message out. Use news releases, internal publications, official notices, posters, electronic media, training and educational materials.”

Some thought must be given to the hotline number itself. “When initially setting up a hotline telephone, pick a simple number. Four identical or consecutive digits works well. Avoid the devil’s 6’s—some people are superstitious. Telephone numbers using acronyms are difficult for some people to see on the telephone keypad. If running internally, consider naming it something other than hotline. For example, use your business’ name, such as ‘XYZ Line.’”

What sort of traffic should one expect on the hotline? At one major corporation the hotline resulted in contact with about 10 percent of the employee population per year over a five-year period. Other corporations report 6 percent. Obviously, with these high numbers, employees are using the hotline for more than just reporting criminal misconduct.

A ‘substantial authority level’ employee

What about the hotline operator? Even though the individual who operates the hotline should be distinct from the executive who sets policy and oversees its operation, the former should still be a “substantial authority level” employee who knows how to conduct investigations.

What’s the ideal background for a hotline operator? “It could be anyone with good common sense,” Kile tells ethikos. “What you really need is a good listener,” a person who is not judgmental, has some empathy, “but also is clear about the line of reality.”

Kile was asked about common mistakes to avoid when running ethics hotlines. Organizations should avoid treating cases as if “this is the most important thing that ever hit,” he answers, or “elevating a simple contact into a tablet in stone. Once it takes on that aura, it creates reactions throughout the organization. It deters good people from raising questions.”

On the issue of preserving confidentiality and preventing retribution against complainants: The problem is that people who bring allegations are often talking to other people, such as their co-workers. “They’re often identified because they talk to other people,” not because the hotline operator discloses their names. This often “muddies” matters. Kile notes that “the workplace has a way of getting even.”

What can be done? The ethics office should maintain close contact with Human Resources to ensure reviews of people who have raised serious allegations. They should look at annual job ratings, for instance. Are complainants not getting the promotions that might ordinarily be expected? The company might pull a sample of records to see if this is happening.
In the case of an individual who brings a serious allegation, like price-fixing, it is often the case that “everyone knows who the person is. You have to have oversight so the person is not harmed. You may have to agree to things that you don’t like, such as providing job security for eighteen months. Some sort of guarantee.” In a large corporation, there may be other locales to which the individual may be transferred. But the new job can’t be a demotion. It must be a real, challenging position.

In a large company, with 15,000 employees, a guarantee of this sort might have to be made once a year, on average, he suggests. “Yes, you must protect them.”

And it’s also important to “change the atmosphere in the organization.” The price-fixing must end, in other words.

Dealing with false allegations

What about false hotline allegations? “These can be prevented with good procedures.” One can prevent names from ever being known. Is an employee abusing the telephone? A check of telephone records can quickly determine if something is amiss.

An initial inquiry can usually put to rest unfounded rumors without ever having to contact the individual charged. This is a good practice, because if the individual is contacted, he or she may become defensive (e.g., “Who said I did that?”). “Be sensitive to individuals against whom an allegation is made.”

How does one raise the credibility of the hotline operation? Running it efficiently helps. “Don’t rely only on the reports of individuals. Look at the underlying facts. The person bringing the allegations may not have an objective view of the facts.”

The organization should report back to the caller within 30 days. “That person is wondering what’s going on.” If an initial inquiry, which may take seven to ten days, reveals some substance to the charges, “get it over to the people doing investigations. Often this can be done without disclosing names.”

This avoids the problem of the hotline operator being seen as the Grand Inquisitor. “The reason hotlines never worked in the past was that they were in the Security or Internal Audit departments,” i.e., among those who were going to do full-line investigations. It’s important that security or internal audit—or someone else, but not the hotline operator—conduct the investigation. When an investigation is warranted, the hotline operator can inform the complainant, “I’m turning it over to Security.” This way the company avoids the “Snitch-line” syndrome. “The hotline people are not running around talking to people about who is stealing in the company.” At the end, share with the caller the results of the investigation.

What are the most difficult hotline cases? Fairness issues are tough, answers Kile, such as a charge that a manager is favoring one group of employees over another. Yes, these are HR issues and admittedly not part of the classic hotline function, but they are still ethics issues.

Kile likes to explain the hotline function in terms of a weakened car battery. The organization’s “battery” is sometimes drained down. The hotline is like a pair of jumper cables. It may be able to “restart” the engine. “But the hotline can only do so much. Sometimes the organization’s battery has simply expired. Other times, though, it recharges energy back into the system.” As a result the organization may say, “Hey, let’s look at this again.”

Once you jump-start the engine, however, you better make sure the battery is maintained, warns Kile. Underlying problems, where identified, must be addressed.

“Business Conduct and Ethics: How to Set Up a Self-Governance Program,” which sells for $95, is available with a 10 percent author’s discount ($85.50) to ethikos readers from Laura Sperry at Business Laws, Inc., 11630 Chillicothe Road, Chesterland, OH, 44026-9982. Tel: (216) 729-7996.
How Prudential-Bache Fleeced its Flock

By Loren Singer


When one arrives at the last page of Serpent on the Rock, an account of the Prudential-Bache Securities scandal, having waded through a maze of chicanery and deception, one discovers that those who constructed it not only survived, but that at least one of them, James Darr, primus inter pares will continue to profit from it “well into the next century.” It is this and other absurdities that generate the outrage that pervades this account of Bache & Company’s history both before and after its purchase by Prudential Insurance in 1981. It is both tortuous and tortious, this sustained effort to depict the Pru-Bache commitment to the enrichment of its managers, executives and representatives at the expense of thousands of its clients.

That multitude may have been a presence thought to have some power, but it was treated by Pru-Bache as a lumpen proletariat with a vast central purse stuffed with cash that could easily be transferred to other pockets—their own. It appears that all that was needed to bring about this happy result was a lot of persuasive conversation about high returns on safe investments, the whole pitch supported by the implication that investors would be conjoined in an alliance with rock-solid Prudential Insurance.

In the shadow of the Rock

Without the aura that reliable structure cast upon the scoundrels directing Bache, they would never have flown so high or lasted so long. They would have become known as operators of a tin-pot bucket shop flogging another variation on the Ponzi method. They would never have had the time to fleece more than one flock of sheep.

Few of these latter appear; one presumes that there is no need to include more: There is the woman who invested her widowed mother’s $100,000 from the sale of her house in Brooklyn. There is a retired steelworker and his wife who “had a few hundred thousand dollars” after they sold a small apartment building they had rebuilt, and moved to Florida to retire in comfort. Both fell by chance into the hands of Bache representatives who sold them participations in investment products that were alleged to be as “safe as CDs” but earned annual interest of 12-15 percent. Payable monthly.

And to dispel the thought that the investors were the only ones hurt, there is the agony of a Bache representative. Devastated, he stands before a mirror with his .357 Magnum in hand. In fear of his life he had bought two weapons, loaded them with hollow-point ammunition and carried one with him at all times. “Slowly, he slid the tip of the six-inch barrel between his teeth.” Not to worry; he didn’t end his life because of the reverses suffered by his 125 clients. He was, however, treated for disability brought on by job stress. There seems to have been but one suicide among the representatives—that of a man who had a long history of drug use. The thousands of others presumably lived to sell another...
day, pushing investments with perhaps a lower yield and a longer survival time than the limited partnerships that Bache sold “which pooled small investors’ money to buy expensive assets like apartment buildings, oil wells or airplanes” and some other ventures in horse-breeding, computer leasing and heavily discounted bank! loans.

**A surprising acquisition**

Mr. Eichenwald’s labors have been long, arduous, and sometimes almost too painstaking. In putting the book together he has placed more than fifty of the participants in the matrix, followed their maneuvers, documented their transgressions, their willful oversights, their failures in their responsibilities, and their indifference to anyone’s situation but their own. He has reconstructed an exhaustive history of their actions in evading every safeguard their government and their own supervisory agencies had designed to protect investors.

What is most difficult to understand is why Prudential Insurance chose to buy Bache & Company. By 1976, “Bache’s reputation was in tatters.” By the dawn of the 1980s it is described as “a struggling third-tier brokerage already mired in scandal.” Nevertheless, after a search that began in the mid-70s, the company chairman settled on the Bache purchase as part of a plan to transform the insurance company “into the nation’s first financial supermarket.” In 1981 they paid $385 million in order to site the company “on the cutting edge.”

To run it they brought in George L. Ball who, as president of E.F. Hutton & Co., “oversaw a separate and fatal scandal for that firm before abandoning it to take over as chairman of Prudential-Bache.” The former Hutton deputy counsel, Loren Schechter, came too. He was appointed general counsel, a man who “for years failed to notice the evidence of wrong-doing in his midst.” The head of retail was Robert Sherman, known “for his taste for liquor, eye for women and desire for power. . .” James J. Darr remained head of the Direct Investment Group. Former colleagues who had worked with him at Merrill-Lynch, and Josephthal & Company, and associates at Bache knew that he had taken payoffs from clients, and continued to circulate the information. Bache instituted an investigation and cleared him. He was pronounced “‘clean as a whistle.’”

Supervised by these overseers, regiments of subordinates charged off in all directions at once toward disaster: “More than $8 billion worth of risky partnerships packaged by Prudential-Bache collapsed after they had been falsely sold as safe and secure.”

**Why did Prudential Insurance choose to buy Bache & Company, ‘a struggling third-tier brokerage already mired in scandal’?**

Some seven hundred partnerships were created at Pru-Bache, and Mr. Eichenwald reviewed the marketing material and performance of more than 100. He includes a table of their results. Some samples: First Capital Income & Growth XII was aimed at “retirees who want to preserve capital . . . CD buyers” It lost 82 percent of its value. Prudential Acquisition Fund I, “Investment Safety,” lost 87 percent. VMS Mortgage Investors II, “Safety, AAA rated,” lost 100 percent. “Almost everything the Direct Investment Group touched turned to dross.”

**Flaunting their success**

En route to disaster the house flaunted its success in ways that have become all too familiar. The most ordinary and unimpressive executives see themselves as lordlings; they deck themselves in fine clothes, wine and dine each other to excess; shout demands for perquisites, collect fine furniture, and “works of art”, and reward themselves for their achievements at expensive resorts, living life to the fullest in a travel brochure. All on the heavy commissions and fees charged to their un-knowing “partners.” Darr took a trip to London in 1988 with his wife, daughter and her nanny. The cost was more than $50,000. The investors in energy income and growth funds paid for it out of their dwindling resources.

Less than a year later the complex litigation process seeking restitution for Pru-Bache’s thousands of investors began. Despite Mr. Eichenwald’s efforts, only an experienced tort grappler can fathom the procedures followed by a whole new cast of characters. There are lawyers from Atlanta, Houston, Dallas, and Minneapolis who represent not only thousands of individual investors but also the occasional Pru-Bache broker uneasy with his own involvement. There are two mouth-filling law partnerships from Washington appearing for Prudential Securities, the Bache name having been lopped off; the directors of five state securities bureaus; four enforcement officers from the SEC; and arbitrators from the NASD.

Some of the victims took a more direct approach; they picketed Pru-Bache offices with warning signs: “Investors Beware! Pru-Bache Limited Partnerships are a Ripoff.”
The tactic won complete restitution for one woman. She fared considerably better than most of her fellows who wound up in what appears to be a kind of black hole in legal maneuverings in which great bundles of claims are settled on terms all too favorable to a corporate entity. When, for example, Prudential Securities negotiated a deal with a small law firm that specialized in class actions, it agreed to pay $25 million to compensate customers who had invested more than $1 billion. “For every $10,000 they invested, they would receive $200.” The law firm “received $6 million in fees, plus $350,000 in expenses, for minimal work.” Investors in the energy income fund received less than seven cents for every dollar invested. The class action lawyers received more than $22 million in fees.

A law firm that rode to the rescue of individuals involved, managed by the use of computer technology to round up thousands of investors, offering to represent them on a contingency basis; they wound up with 5,800 clients. In comparison with the class-action participant, their settlement “would make the investors whole.” Whether or not fees were included is not mentioned.

Evidently the persistence of the state security regulators in their various actions was the force that brought about Prudential’s final series of agreements. It did not close out all of the actions taken against the company.

“The firm’s projections for the cost of cleaning up the partnership debacle would later rise to $1.4 billion. It was the costliest fraud scandal for any investment house in the history of Wall Street.”

Oddly, the book is provocative not so much because of the exhaustive and exhausting details of misconduct by so many. Most of them, from amateur pandering to expense account chiseling are simply low and all too familiar. What is most troubling is the awareness that even the recent histories of other disasters in other sectors of finance has not seemed to alter the pattern of behavior. Periodically cheats and manipulators rise far beyond their own capabilities to plunder and victimize the defenseless and unsophisticated, and corrupt a process that Mr. Eichenwald notes is “an essential building block of the American economy.”

Nortel . . . Continued from page 3

do off steam. Fine. But if they report a case of sexual harass-ment, “we have to do something.” And they want employ-ees to know that before-hand.

The code also notes that “Discussions and inquiries will be kept in strict confidence to the extent appropriate or permitted by policy or law.” Where can they not maintain confidentiality? “In cases of workplace violence, where someone is threatening to kill someone.” Also in sexual harassment cases. “We don’t enjoy attorney/client privi-lege,” unlike lawyers or even corporate ombudsmen (see ethikos, January/February 1996), says Barry.

The company acknowledges that in the revision process it “benchmarked” its old code against those “of several other corporations, including Bank of Montreal, Baxter, BellSouth, Digital Equipment Corporation, Ford Motor Company, Martin Marietta Corporation, NYNEX, Teledyne, Texas Instruments, and United Technologies Corporation.”

“We looked at companies for the types of issues they were addressing,” as well as the format used. Barry cau-