

## Workshop C

# ***ETHICS IN CONSTRUCTION: CHALLENGES AND DILEMMAS***

Presented by

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In the 1990s, the term “ethics” was perhaps overused, but the notions behind it obviously were not. A 1997 survey indicated that some 56 percent of employees felt pressure to act unethically or illegally on the job. Today, many of these ethical lapses have caught up to their perpetrators—all one has to do is turn on the television to hear tales of corporate malfeasance. The names Enron, Arthur Andersen, WorldCom, Global Crossing, and even Martha Stewart all invoke notions of greed and dishonesty. The construction industry, with its low-price mentality, stiff competition, and razor-thin margins, presents a ripe environment for ethical dilemmas. This session examines the challenges of making ethical decisions, from dealings with customers and construction partners to managing employee relations, and the costs of making unethical ones. The impact of the Sarbanes-Oxley Act of 2002 on the construction industry will also be examined.



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The Associated General Contractors of America, the voice of the construction industry, is an organization of qualified construction contractors and industry related companies dedicated to skill, integrity, and responsibility. Operating in partnership with its Chapters, the association provides a full range of services satisfying the needs and concerns of its members, thereby improving the quality of construction and protecting the public interest.

AGC is dedicated to improving the construction industry daily by educating the industry to employ the finest skills, promoting use of the latest technology and advocating building the best quality projects for owners--public and private. A complete list of AGC's products is provided at its bookstore.

As part of AGC of its commitment to provide quality services and products, AGC publishes an expansive array of standard form contract documents and related materials that address the different tiered relationships and project delivery approaches found in today's construction environment, such as general contracting, subcontracting, program management, construction management and design-build.

AGC also provides its contract documents in electronic form through an annual subscription software titled, AGC DocuBuilder® Contract Document Software. This software application, which allows you easily to create, amend and customize AGC standardized contract documents saves time and expense with its advanced features and allows you to avoid the frustrations of paper documents. DocuBuilder® can be installed on a network and enables users to e-mail the documents if they have Adobe Acrobat.

**Michael C. Loulakis**  
**President**  
**Wickwire Gavin, P.C.**

Mr. Loulakis is copresenting Workshop C, "Ethics in Construction: Challenges and Dilemmas," on Tuesday. He is president of Wickwire Gavin, P.C., a Vienna, Virginia, law firm that concentrates on representing domestic and international clients on construction-related matters. His legal practice focuses on representing members of the construction industry, including owners/developers, sureties, contractors, and design professionals.

His diverse background includes contract administration advice; review of procurement and contracting documents; contract drafting and negotiations; preparation, negotiation, analysis, and defense of contract claims; resolution of claims through litigation, arbitration, and other ADR methods; and establishing risk management policies and project delivery methods. Mr. Loulakis is a national speaker on these and other issues and holds an IRMI Words of Wisdom (WOW) award. He is the author of numerous publications, including several recent books on design-build titled "Design-Build for the Public Sector" (Aspen Publishers 2003), "Design-Build: Planning Through Development" (McGraw Hill 2001), and "Design-Build Contracting Handbook," 2nd Edition (Wiley Law & Business 2001). Mr. Loulakis is also the author of "Design-Build Lessons Learned," which is a series he has published each year since 1995 that examines case law on design-build projects reported upon in a given year, as well as a widely acclaimed interactive CD-ROM program titled *Construction Project Delivery Systems: Evaluating the Owner's Alternatives*, produced and distributed by A/E/C Training Technologies.

Mr. Loulakis is a member of the Board of Directors of the Design-Build Institute of America (DBIA) and served as Chairman of DBIA's Manual of Practice Committee. He had principal responsibility for drafting the DBIA Contracting Guide and DBIA's standard form design-build contracts and subcontracts. Prior to joining Wickwire Gavin in 1979, Mr. Loulakis was a practicing engineer with a Boston, Massachusetts, area geotechnical consulting firm.

He received a bachelor of science degree, *magna cum laude*, in Civil Engineering from Tufts University in 1976 and a juris doctor degree from Boston University School of Law in 1979.

**Todd L. Rowland**  
**Vice President—Contractor Insurance Programs**  
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Mr. Rowland is copresenting Workshop C, "Ethics in Construction: Challenges and Dilemmas," on Tuesday. As senior vice president—Construction Specialty Products and Services, he is responsible for directing underwriting and services for Construction Specialty Products, including Subguard, Project Risk, Homebuilder's Protective, Professional Liability and Alternative Risk Transfer, for the Zurich North America's Construction Business Unit. During his 30-year career, Mr. Rowland has had diverse experience in the engineering, construction, and insurance industries in the roles of profit center management, risk management, construction management, labor relations and safety, and insurance underwriting management.

He came to Zurich from Ulico Insurance Group's construction operation where he was senior vice president. Prior to joining Ulico, Mr. Rowland spent 4 years with the Brand Companies, a specialty contracting subsidiary of Waste Management International, where he served in several capacities including Business Unit president. He spent 16 years prior to that with the Bechtel Companies assigned to various domestic job sites and regional offices, where he performed increasingly responsible duties, culminating with an assignment as a business unit operations vice president.

Mr. Rowland attended California State University and Butte College where he studied Public Administration and Fire Engineering Technology. He was a member of a U.S. Department of Energy Benchmarking Task Force, a national management trustee for the Laborers and Employers Cooperation and Education Trust, a founding board member of the Environmental Management Employers' Association, and a former vice chairman of the Texas Safety Association. He is a current member of the Construction Financial Management Association.

# **ETHICS IN CONSTRUCTION: A TRAP FOR THE UNWARY?**

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**Michael C. Loulakis  
Wickwire Gavin, P.C.**



**Workshop C**

## **“Ethics” Defined**

**“Conforming to accepted professional standards of conduct.”**

Webster’s Dictionary

## **“Ethics” Defined**

**“A system of moral principles governing the appropriate conduct for an individual or group.”**

Encarta’s Encyclopedia

## **“Ethics” Defined**

**“You know it when you see it.”**

**\* \* \***

**“You’ve either got them or you don’t”**

Mike Loulakis

## **2003 National Business Ethics Survey**

- Comparison to 2000
- Top management kept promises (82% vs. 77%)
- Observed misconduct (22% to 31%)
- Most common misconduct
  - abusive behavior
  - misreporting hours
  - withholding needed information
- 44% of non-management employees do not report misconduct

## **Ethics in The Construction Industry?**

- Codes of Ethics
- Contractual obligations
- Reality of industry
  - image of construction
  - low price mentality
  - competition
  - razor-thin margins
  - nature of our employees

## **Thoughts on Ethics**

**When all things appear equal, I believe our profitability may depend on our good name. An excellent reputation is a differentiating competitive advantage.**

**Ben Maibach  
President of Barton Malow**

## **Thoughts on Ethics**

**People tend to rationalize unethical behavior by saying, "That's business." I do not believe being unethical is a way to run business. Throughout our business career and long after, our reputation will be known and remembered.**

**Ben Maibach  
President of Barton Malow**

## Where Can Ethical Lapses Really Hurt?

- **Corporate responsibility and governance**
- **Public sector environment**
  - Foreign Corrupt Practices Act
  - False Claims Act
  - Truth in Negotiations Act
- **Relationships with other team members**

### Question 1:

Your general superintendent tells you that the last batch of concrete he placed didn't technically meet the strict requirements of the specifications. You know that what's out there will be fine. What do you do?

### Question 2:

You are working for an owner that consistently cuts 10-15% of every proposed change order. Your project manager decides to pad each change order for negotiation purposes. What do you do?

### **Question 3:**

**You front end load your schedule of values despite having a clear contract provision prohibiting this.  
Is this ethical?**

## **Corporate Responsibility and Governance**

- **Officers and Boards of Directors**
- **Duties**
  - selecting and overseeing ethical management
  - putting company's interests first
  - producing clear and accurate financial statements
  - no self-dealing
- **Ultimate line of corporate accountability**

## **Sarbanes-Oxley Act of 2002**

- **Enacted on July 30, 2003**
- **Purpose: toughen oversight of the accounting industry**
- **Substantial budget (\$750m)**

## **Sarbanes-Oxley Act of 2002: Key Points**

- **Creation of Accounting Oversight Board**
- **Direct responsibility for officers and directors re: financial disclosures**
- **Disclosure of off-balance sheet conflicts and actions**
- **Impact on ability of accounting firms to do non-accounting services**
- **Whistleblower protection**
- **Mandate re: counsel reporting problems**
- **Major penalties**

## **Sarbanes-Oxley Act of 2002: Impact on Privately-Held Companies**

- **Acquisitions and going public**
- **Raising capital**
- **Standard of care for corporate governance**
- **Finding directors and getting D&O coverage**
- **Banking relationships**
- **Audits and document retention policies**
- **Future state law impact**

## **Sarbanes-Oxley: Construction Industry View**

- **Boardrooms Under Glass (ENR 7/21/03)**
  - corporate governance now a big deal
  - most companies scrambling
- **Actions**
  - adding outside directors
  - outside board getting slight voting majorities
  - new ethics hotlines
  - lender suspicions over financials

## **Sarbanes-Oxley Act of 2002: Steps to Protect Yourself**

- **Certification of internal controls and financials**
  - adequacy
  - trends
- **Getting the right advice (audit and legal) to assist in:**
  - understanding implications of Act
  - loans and transactions with officers and directors

### **Sarbanes-Oxley Act of 2002: Steps to Protect Yourself (cont'd)**

- Independent directors (audit and compensation committees)
- Establishing compatible documentation and IT policies
- Procedure to allow whistle blowers to function
- Codes of conduct for senior financial management
- Training

### **The Booking of Claims: The Brown & Root Experience**

- Altering accounting treatment of claims
- 19 class action lawsuits
  - sued Dick Cheney and other D&O
  - Judicial Watch also a plaintiff
- Question: when/how does a contractor recognize claims?
- What is the effect on D&O for failing to comply?

### **Where Can Ethical Lapses Really Hurt?**

- Corporate responsibility and governance
- Public sector environment
  - Foreign Corrupt Practices Act
  - False Claims Act
  - Truth in Negotiations Act
- Relationships with other team members

## **False Claims Act**

**Liability to any person who “knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government.”**

## **False Claims Act: A Brief History**

- **Passed in 1863 by President Lincoln**
  - protect Union Army from fraudulent suppliers
  - whistleblowers collected 50% of the damages
- **1943 Amendments**
  - restricted when action could be brought
  - reduced to recovery to 10% to 25%

## **False Claims Act: A Brief History (cont'd)**

- **1986 Amendments**
  - made it easier and more attractive for whistleblowers
  - changed level of “intent to defraud”
    - deliberate ignorance
    - reckless disregard
  - treble damages
  - whistleblower benefits and protections
    - share increased
    - attorney’s fees
    - protection from retaliation

## **False Claims Act: Post-1986 Amendments**

- **Statistics:**
  - \$10 billion recovered since 1986
  - \$1.1 billion recovered in FY 2002
  - 4,000 lawsuits filed since 1986
  - 300 *qui tam* actions filed in 2001
- **Across industries**
  - healthcare
  - defense
  - construction
- **State acts**

## **Tutor-Saliba Corp.**

- **Metro Rail subway for LAMTA**
- **Tutor-Saliba paid \$945 million on projects**
- **Sued LAMTA in 1995 for \$16 million in claims**
- **Counterclaim for false claims/fraud**
- **\$29.5 million judgment against Tutor-Saliba**

## **Tutor-Saliba Corp.**

**Tutor-Saliba and its attorneys “intentionally concealed, withheld and destroyed records and documents relevant and crucial to the trial.”**

## **Morse Diesel International (AMEC Construction Management)**

- **St. Louis Courthouse and San Francisco Customs House**
- **Allegations:**
  - provided GSA with an invoice for a bond premium market “paid”
  - fraudulent installation of defective door frames and late sub payments
- **Consequences: one year debarment as of 2/20/02**

## **False Claim Cases**

- **Foreman delivering defective products in invoice**
- **Mischarging labor hours**
- **Total cost claim approach**
- **Subcontractor submission of false resumes**
- **Excessive unit prices**
- **Labor classifications and prevailing wages**
- **Truth in Negotiations Act violations**

## **False Claim Potential Trouble Areas for A/Es and CMs**

- **Aggressive billing practices**
  - charging for hours not worked
  - invoicing for documents not produced
  - misrepresenting the need for additional services
- **Certifying payments for contractors who have submitted inflated bills**
- **Approving work that is not completed**

## **Consequences of a False Claim**

- **Fines**
- **Suspension and debarment**
- **Impact to subsidiaries**
- **Political challenges**
- **Impact on other claims**

## **Where Can Ethical Lapses Really Hurt?**

- **Corporate responsibility and governance**
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## **Relationships with Team Members: General**

- **Contract standards**
- **Implied warranties of good faith and fair dealing**
- **General “moral” standards**
- **The tendency to blame big-time when somebody feels “ethically wronged”**

## **Relationships with Team Members: Owners**

- **What we sell and how we market**
  - **preconstruction services**
  - **design-build “wraps”**
- **Information we provide to owners**
  - **problems with subcontractors**
  - **project schedules**
  - **change order pricing**

## **Relationships with Team Members: Design-Build Relationships**

- **Fragile environment**
- **Built on trust, partnering and ethics**
- **Major opportunity to take advantage of team members**
- **The “Ma-and-Pa Kettle” project**

## Deceptive Trade Practices Acts

- Actions for “false, misleading or deceptive” acts
- Texas statute:
  - representing goods are new or particular standard
  - misrepresenting scope of a guarantee
  - failing to disclose information concerning goods/services

## Final Thoughts

- Be corporately smart
  - ethics training
  - ethics compliance in standard operating procedures
- Understand the “lay of land” in public sector
- Think about what you are conveying to your employees
- Don’t assume that only the “big boys on Wall Street” get caught

# ***Notes***

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# ***ETHICS IN CONSTRUCTION: A RISK MANAGEMENT ISSUE***

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*Todd L. Rowland  
Zurich North America Construction*

## **Discussion Topics**

- Traditional Views of Risk In Construction
- Behavioral Risk
- Models for Managing the Business Risk of Ethical Lapses
- Resources for Help

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## **Traditional Views of Risk in Construction**

- Two broad categories
  - Fortuitous Risk
    - Events outside our control
    - Accidents, Injuries, Fires
  - Commercial/Business Risk
    - Marketplace Risk
    - Execution Risk

## **Managing Fortuitous Risk**

- **Technical Controls**
- **Policies & Procedures**
- **Risk Transfer**
  - **Contracts**
  - **Insurance**

## **Managing Business Risk**

- **Knowledge & Experience**
- **Policies & Procedures**
- **Controls Systems**
- **Contracts**
- **Price**

## **Behavioral Risk & Ethics**

- **Overlays the two other categories**
- **Can be organizational or individual**
- **Managed by motivating, controlling or modifying**
- **Ethical lapses result from failing to manage behavioral risk**
- **Individual ethical lapses may result in vicarious liability for an organization**

## Results of Ethical Lapses

- Civil or criminal penalties
- Debarment
- Reputational Loss
- Business Failure

## Question

What can an organization do to manage the risk associated with ethical lapses?

## Risk Management Models

- **United States Sentencing Commission-Federal Sentencing Guidelines for Organizations**
  - Responsible for establishing sentencing guidelines for violation of Federal laws
  - Promulgated Organizational Guidelines in 1991
  - Designed to give organizations an *incentive* to have an effective compliance program

## **USSC Model (cont)**

- **Minimum Standard for program**
  1. Established standards and procedures
  2. High level oversight
  3. Discretionary authority must be prudently delegated
  4. Effective communication of program
  5. Monitoring & auditing with safeguards
  6. Consistent enforcement – discipline
  7. Appropriate response mechanisms

## **USSC Model**

- **Look familiar?**
- **Originally established to mitigate fines**
- **Currently used to:**
  - Decide whether to prosecute
  - Help determine sentences
  - When sentence includes a a federal monitor

## **Risk Management Models**

- **Ethics Officers Association**
  - Non-profit professional association exclusively for managers of ethics, compliance and business conduct programs
  - Established in 1992
  - 975 members from a broad spectrum of industry

## **EOA Model**

- **Developing an ANSI standard for business conduct using ISO guidelines**
  - Sets guidelines for demonstrating conformity
  - Broadens USSC minimums
  - Provides guidance on establishing detailed policies

## Typical Policies (partial list)

- Accuracy of business records
- Alcohol/substance abuse
- Antitrust & competition
- Competitive information
- Legal compliance
- Conflicts of interest
- Customer relations
- Privacy
- Environmental compliance
- Equal opportunity
- Government contracting
- Health & Safety
- Gifts & favors
- Harassment
- Insider info and securities
- Marketing, selling advertising
- Outside business activities
- Political activities
- Product quality & safety
- Confidential Information
- Intellectual property
- Purchasing
- Records management
- Reporting violations
- Retaliation
- Supplier relations
- IS
- Use of corporate assets

## Resources

- US Sentencing Commission  
– [www.ussc.gov](http://www.ussc.gov)
- Ethics Officers Association  
– [www.eoa.org](http://www.eoa.org)
- Ethics Resource Center  
– [www.ethics.org](http://www.ethics.org)

## **Conclusion**

- **There are many more “grays” than “blacks or whites” to consider when managing the risk around ethical issues**
- **A disciplined and formal approach to risk management is required**
- **There are places to go for help**