

Dysfunctional Management and Corruption: Recent ICAC Enquiries

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1. In 1973 the *Journal of Philosophy and Public Affairs* published an article by Michael Walzer called “Political Action: The Problem of Dirty Hands”. The term “dirty hands” is attributed to Jean-Paul Sartre, who in the late 1940s wrote a play with that title (*Les Main Sales*). According to Walzer, in the play, the characters deal with the necessity of employing unjust means (i.e. getting one’s hand dirty) to achieve just ends. “*No one succeeds in politics without getting his hands dirty*” is the proposition that Walzer debates.
2. Although Walzer’s paper was concerned with the wider issue of what it means to be a moral public servant or politician, one key aspect related to the usefulness of the feelings or scruples that are aroused when a public official gets his or her hands dirty. He refers to a hypothetical politician who suffers from feelings of guilt and anxiety when confronted by a morally ambiguous deal. Walzer says,

Because he has scruples¹ of this sort, we know him to be a good man [. . .] It is important to stress that we don’t want just anyone to make the deal; we want him to make it, precisely because he has scruples about it [. . .] That is what it means to have dirty hands [. . .]

Here is the moral politician: it is by his dirty hands that we know him. If he were a moral man and nothing else, his hands would not be dirty; if he were a politician and nothing else, he would pretend that they were clean.

Emphasis in original.

3. This idea of wrestling with moral ambiguity fits well within the virtue ethics stream of analysing decisions. Simply put, in the absence of a rules-based or otherwise reliable approach to resolving the tension between means and ends, we can legitimately expect our senior public servants to at least notice when their hands are dirtied and to conscientiously grapple with that realisation.
4. In corruption prevention circles, we sometimes use the term “dirty hands” when we see public sector managers confronted by evidence or proof of misconduct or its obvious precursors (a.k.a. “red flags”). Regrettably, in some cases the affected managers are

¹ Interestingly, the word “scruple” derives from the Latin for “rough pebble”. The philosopher Cicero is thought to have adopted the word to describe feelings of uneasiness because it resembled the sensation of having a pebble in one’s shoe; a very similar metaphor to “dirty hands”.

apparently quite blind to the evidence before them and as a result unwittingly dirty their hands by their negligence. Alternately, there are cases where despite clearly recognising the dirt, managers further compromise themselves by allowing extant misconduct to persist (that is, by falsely pretending that their hands were clean).

5. The remainder of this paper is devoted to three investigations finalised by the NSW Independent Commission Against Corruption (the Commission) in 2008. These are: *Report on an investigation into corruption allegations affecting Wollongong City Council*; *Investigation into tendering and payments in relation to NSW Fire Brigades capital works projects*; and *Investigation into bribery and fraud at RailCorp*. Respectively, these will be referred to as the Wollongong Council investigation, the NSWFB investigation and the RailCorp investigation. The full details can be viewed from the Commission's website, www.icac.nsw.gov.au.
6. In all three cases, the seriousness of the corrupt conduct was exacerbated by acts of commission and/or omission by public sector managers who were in important gatekeeper roles. As a result, these managers allowed themselves to be compromised or inculcated. In the Wollongong Council investigation, three senior managers miscondacted themselves so comprehensively that the Commission made separate corrupt conduct findings against them. If these managers ever felt any scruples about the conduct that was occurring on their watch, they certainly failed to resolve those feelings in the virtuous manner envisaged by Walzer.

The Wollongong Council investigation

7. There is insufficient space here to spell out the complete nature and extent of the corrupt conduct in this case. However, in a nutshell, the case centred around a senior town planner, Ms Beth Morgan, who formed close personal relationships with three local developers (Mr Frank Vellar, Mr Glen Tabak and Mr Michael Kollaras), which she failed to disclose, and then conferred numerous undeserved benefits and favours upon them in the exercise of her duties. In respect of her relationships with Vellar and Tabak, Ms Morgan was rewarded or induced by corrupt commissions in the form of gifts and cash.² Mr Tabak also offered her an apartment at less than market value in a 10 storey development that she corruptly approved.
8. However, what made this case particularly unusual, was that four additional tiers of the Wollongong Council hierarchy were also found to have engaged in corrupt conduct viz. the Manager of Development Assessment and Compliance, Mr John Gilbert; the Acting Group Manager, Sustainability, Mr Joe Scimone; the General Manager, Mr Rod Oxley; and four of

² It should be noted that although Ms Morgan had an undisclosed close personal relationship with Mr Kollaras and she engaged in partial conduct to his benefit, Mr Kollaras himself was not found to have engaged in corrupt conduct. Relevantly, Mr Kollaras did not provide Ms Morgan with any corrupt rewards or inducements.

the elected councillors, Messrs Val Zanotto, Kiril Jonovski, Frank Gigliotti and Zeki Esen. For the purposes of this brief paper, the Commission found that Messrs Gilbert and Scimone were aware of the Morgan/Vellar relationship and the favours that Ms Morgan was providing to Mr Vellar, but took no action to arrest the situation. Mr Oxley, while not directly aware of the relationships, corruptly allowed one of Mr Vellar's major development proposals to be approved contrary to Council policy and his own delegations.

9. Mr Oxley also engaged in "conduct liable to allow, encourage or cause the occurrence of corrupt conduct" including:
 - Fraternising with Mr Vellar in breach of Council's code of conduct;
 - Intervening in the assessment of development applications in a manner sympathetic to the interests of developers;
 - Failing to act on information clearly indicating that Morgan and Vellar were in an undisclosed relationship;
 - Failing to implement Council resolutions and breaching various planning policies; and
 - Ignoring or failing to consider expert planning advice.

10. Cr Zanotto allowed himself to be compromised by entering into an undisclosed business relationship with Mr Vellar (which was to include property development), which effectively prevented him from properly discharging his official duties. The Commission found that Crs Jonovski, Gigliotti and Esen jointly solicited a \$20,000 payment from Mr Vellar in return for their support for one of his development proposals. The payment was not made but according to an intercepted telephone conversation, it was possibly going to be made into the councillors' *"political slush fund [. . .] through the backdoor"*.

11. Because these four councillors formed a majority of the dominant political caucus, they exercised a considerable degree of control over the decisions of the Council. The result was that four layers of management above Ms Morgan were effectively compromised in their ability to regulate her conduct.

12. Ms Morgan and Mr Vellar were quite skilful when it came to grooming Council's senior managers; taking advantage of Mr Oxley's well-known pro-development philosophy and exploiting loopholes in Council's development assessment processes. Their grooming activities included forming friendships and business relationships, giving gifts and hospitality, asking for small favours, asking for and receiving advice, flattery, taking others into their confidence and sharing secrets and gossip. The upshot of this was that when evidence of Ms Morgan's misconduct and the Vellar/Morgan relationship was brought to the attention of certain managers, they failed to act and therefore effectively aided and abetted Morgan and Vellar. Among other things, Mr Gilbert ended up allowing Ms Morgan to approve Mr Vellar's

controversial \$100 million development using his electronic signature and without even requiring her to prepare an assessment report.

13. From a management point of view, it is Mr Gilbert's role that is most interesting. He was a very experienced and well-regarded planning manager and would have fully appreciated the relative merits of the developments in question. However, because of factors including (a) the manipulative behaviour of Morgan and Vellar (b) the pro-development philosophy of the General Manager, and (c) the hands-off attitude of some of the councillors, Mr Gilbert's ability to act on his scruples was substantially compromised.

The NSWFB investigation

14. Our investigation into the NSW Fire Brigades centred on two contracted project managers, Mr Christian Sanhueza and Mr Clive Taylor, whose job it was to manage capital works projects, primarily the construction of new fire stations. Shortly after their appointment in mid-2005, Sanhueza and Taylor determined that the NSWFB was already paying too much for its capital works. To take advantage of this, eight "\$2 companies" were registered which submitted a number of fake tenders. Thirty nine contracts, to the value of \$6.1 million, were then corruptly awarded to companies controlled by Mr Sanhueza. The work was then subcontracted and Sanhueza and Taylor retained the gross profits amounting to \$2.4 million.
15. This amounted to a 40% gross profit margin for Sanhueza and Taylor. Because the subcontractors that actually did the work were paid an amount that included their own profit, NSWFB was paying \$6.1 million for work that could have been done for \$3.7 million.
16. Unlike the situation at Wollongong Council, the relevant public sector managers at NSWFB were not directly privy to the actual corrupt conduct being carried out by Sanhueza and Taylor. However, their direct supervisor was criticised in our report for being "*unable to think of anything he did to supervise Mr Sanhueza and Mr Taylor that didn't rely on their word or trust*". That is to say, these corrupt individuals were fortunate enough to have an extremely inattentive manager who was blind to the excessive fat in the NSWFB capital works program. Sanhueza and Taylor made profitable use of the fact that NSWFB management concentrated primarily on whether budget was being met, with little regard to how.
17. It was also the case that NSWFB failed to check the bona fides of Sanhueza and Taylor and failed to use the required Department of Commerce panel of recruitment contractors. Sanhueza and Taylor were not asked to attend a formal job interview or induction, their referees were not contacted and they had no contract, position description or system of performance management. Arguably, this generally lax approach to their engagement played a direct role in emboldening Sanhueza and Taylor.

18. When a supervisor did happen across some non-compliance issues with one of the tenders which suggested the possibility of corrupt conduct, he did raise the alarm with his own superiors – for which he must be given credit. However, it is quite likely that his own managerial shortcomings (i.e. the dirt on his hands) crossed his mind as he reacted to what he had found. The broad thrust of the corruption prevention recommendations made in our report was to better equip NSWFB managers to spot red flags as they arise, thereby avoiding the awkward reality of having to confront corrupt conduct in hindsight.
19. Aggravating the problem at NSWFB was the fact that the hierarchy of project sign-offs and approvals created a completely false sense of propriety. On paper, there was a segregation of duties between the acts of setting a budget, recommending contractors and awarding contracts; but because there was complete reliance on the advice of Sanhueza and Taylor, the subsequent approvals were rather artificial. Ironically, as more senior managers endorsed the corrupt advice being provided by Sanhueza and Taylor, the easier it became for them to maintain the outward appearance of propriety and rationalise their own behaviour.

The RailCorp investigation

20. The Commission's investigation into RailCorp made corrupt conduct findings against 31 individuals including 14 RailCorp employees. At the heart of the investigation was \$19 million in contracts awarded as the result of \$2.5 million in corrupt payments. The details differ from case to case but in essence the investigation showed that a number of RailCorp officers with procurement delegations awarded lucrative contracts to friends, associates, business partners and/or their own businesses.
21. Some of the obvious red flags that our investigation reported included:
- Scores of work orders were approved retrospectively with no apparent objection from management (one witness estimated that 25% of plant hire was approved retrospectively). In other cases, work dockets or invoices were submitted several days or weeks after the relevant shift, making certification difficult.
 - Without consequence, staff were able to avoid existing supplier panels and engage their preferred contractors instead.
 - Staff could avoid obtaining the required approval by simply varying an existing order rather than creating a new one.
 - Some officers could unilaterally increase the budget for a project while also approving the work that was to be paid from that budget.
 - For a period in 2005, corrupt RailCorp officer Ms Renea Hughes was billing for working an average of 32 hours per day. No-one noticed.



- In 2001 Ms Hughes was actually caught modifying work orders without approval. Disciplinary action was recommended but not taken and Hughes was promoted in 2003. She went on to dishonestly obtain about \$600,000 from RailCorp.
- RailCorp employee Mr Michael Blackstock's disciplinary history included at least 43 breaches of the code of conduct. Admittedly, Mr Blackstock was dismissed after being convicted of assaulting a 14 year old passenger but was reinstated by a relevant appeals board. But that notwithstanding, the primary management response to Mr Blackstock's conduct was to transfer him to another unit within RailCorp. He received \$1.35 million in corrupt payments.
- RailCorp work done by the company in which Mr Blackstock had a hidden interest was at a profit margin of 58%. Another company was found to have a margin of 118% on a smaller one-off project. So, while management might not be expected to know about concealed conflicts of interest or corrupt payments, they could be fairly criticised for being unaware of the financial waste that was occurring on their watch (as was the case at the NSWFB).
- Notably, Mr Blackstock was one of 100 staff under the supervision of one manager, who had no formal management qualifications. This manager was regularly deceived by Mr Blackstock and others.
- Relevant Internal Audit recommendations were not implemented in a timely way, which led to the Commission criticising the RailCorp Board and its Audit and Risk Committee.

22. The problems at RailCorp were not confined to failures in individual internal controls. At least within parts of the Asset Management Group, there appeared to be a general tolerance for misconduct. For instance, RailCorp employee Christian Hansen set up a trucking company called "Hansen Transport" and was given \$377,000 of RailCorp work. His evidence was that the reason he did not get even more work was because he was in competition with another corrupt RailCorp employee, Louie Petrovski, who also had a trucking business but was advantaged by his friendship with corrupt team leader George Laidlaw.

Bizarrely, as part of his explanation for why his trucking company had allegedly lodged work dockets with forged signatures, Mr Petrovski argued that he could not possibly be responsible for the forgery because it was normal to approve work without actually being on site.

23. The Commission found that some managers and administrative staff had a "tick and flick" attitude toward authorising expenditure. Documents approved by some RailCorp managers contained obvious flaws or emblems of suspicion that were not picked up such as an insufficient number of quotations, purchasing from defunct panels, breaches of established budgets and obvious order splitting.

24. Another aspect of the dysfunction was the fact that because of ongoing restructures of RailCorp and its antecedent authorities, staff were confronted with multiple out-of date polices and “*confusion . . . about which managers should be supervising which staff*”. Other managerial responsibilities were divided between onsite field supervisors and head office line managers. That is to say, there were certain functions where officers effectively had no responsible manager.
25. The major recommendation arising from the investigation was that RailCorp ought to consider bringing certain outsourced functions back in-house (i.e. maintenance functions). In cases where the quality and quantity of work is difficult to monitor and where there is no genuine competitive market, there are strong incentives for under-delivery or over-billing. Part of the logic behind this recommendation is that managers cannot easily be held accountable for the performance of outsourced activities.
26. Sometimes the problem is not so much the inability to monitor delivery but rather the lack of will. This is the basis for the widespread corrupt practice of “Job and Knock” – whereby RailCorp contractors were able to bill the taxpayer for doing nothing. Essentially, timesheet fraud. In one widely-reported instance, a contracted RailCorp site supervisor, Mr Brett Schliebs, billed for an entire day of work that he spent, in part, at a lingerie restaurant in Woolloomooloo. Some witnesses told us that J&K had been going on for decades. One witness told the Commission that had he resisted J&K he would have been labelled a “troublemaker” and also harmed his career prospects.

We were able to estimate that one employee, Mr Shane Ward, was overpaid by \$35,000 over an 18 month period. However, anecdotally, we were advised that J&K was widespread and ongoing.

As a back-of-the-envelope calculation, in the Asset Management Group there are 4,300 staff (30% of all RailCorp employees). If a quarter of them did J&K only half as often as Ward, that would cost RailCorp over \$12 million per year in fraudulent timesheet claims – assuming they received the same pay as Ward (and he was very junior).

Conclusion

27. In the Commission’s experience, serious corrupt conduct is often allowed, encouraged or caused by dysfunctional management. In the three investigations briefly sketched out above, had a number of public sector managers taken some basic steps to address red flags and prevent themselves from being compromised, much of the corrupt conduct exposed by the Commission would have been prevented. When forced to appear at one of the Commission’s public inquiries, these managers sincerely regret not having taken stronger, earlier action in respect of the behaviour of officers such as Morgan, Sanhueza, Taylor, Hughes and Blackstock. That is to say, the dirty hands problem did not register until it was too late.
28. When we analyse corrupt conduct and formulate corruption prevention measures, we typically focus as much on the role played by public sector managers as we do on the



conduct of their corrupt subordinates. In no small part, our work is aimed at (a) encouraging public sector managers to notice, sooner rather than later, when they might have dirt on their hands, and (b) helping managers to respond to that realisation.

29. Developing a manager's 'scruples' and supporting a constructive response to them, is as important as any of the hard organisational controls designed to detect and deter the individual perpetrators of corrupt behaviour. At a minimum, senior managers in public sector agencies can ensure that their staff are not affected by perverse incentives that cause dirty hands-type feelings to be rationalised or for serious means-and-ends debates to be avoided altogether. Much of the corrupt conduct uncovered by the Commission is caused or exacerbated by a "just get it done", "this is how it's always been done" or "tick and flick" attitude to achieving results.

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