Lessons We Share With British Petroleum and Wall Street.

I see our risk management issues all over the reports of the Wall Street and Gulf of Mexico disasters. There's hardly anything I know less about than the financial markets, unless it's drilling for oil; but here are some thoughts about issues we share. Perhaps you are seeing some of the same similarities, and are searching, as I am, for how these disasters might inform our own risk management thinking.

As you know, my expertise is in managing the risks of legal liability – not operations. There are overlaps, however, so I hope I'll be excused for jumping into this learning opportunity.

The Wall Street implosion and The Gulf leak both involved miscalculations of the probability and severity of an event which, if it was anticipated at all, was considered too far off the probability axis to deserve serious attention. As someone observed early on, however, unprecedented does not mean impossible. It may not even mean unlikely. It means only that the bad event hasn't occurred -- yet. Dick Cheney, whom I don't often quote, supported what he called "The One Percent Doctrine" – if there's a one percent chance of a bad thing happening, tend to it!

A British Petroleum executive reportedly told a congressional committee that the explosion and leak were "an aberration" and "a rare event that the company is not likely to repeat." Where does that fall on a scale of probability? Would you send a client into a situation that you felt was "not likely" to kill her or him? Was the leak foreseeable (which the law interprets as "reasonably anticipated)? Thirty six thousand off shore wells have been drilled in the Gulf of Mexico since 1950. Only one spill, or leak, (off the coast of Mexico, in 1979) came close to causing the damage of this one. How does the probability of this oil leak compare to the Black Swans in your program?

The financial and oil leak disasters both reflect confusion, or indifference, regarding accountability. Goldman Sachs and BP, for example, arguably were serving the interests of their shareholders and creditors. That's what good corporations do,of course. Each of you have constituencies whose interests you must balance – a Board of Directors, alums and current clients, creditors, donors, partners and other owners, and peers in the industry. Their interests are not always the same, and may conflict with the interests of third persons who can be hurt by the actions of the organization. The collateral damage caused by this “trying to please others” has been terrible.

And, as so often occurs in our business, an unanticipated converging of small events created a problem far out of proportion to any of those events standing alone. Malcolm Gladwell wrote of this “cascade of events” phenomenon almost twenty years ago in his New Yorker article about the 1985 Challenger disaster – “Blow Up”. Small failings led to a big disaster.

Also present in both calamities were mistakes of judgment, made strategically, in the interest of profit and, in BP’s case, to make up for very expensive lost time. At the time of the explosion, BP’s well was over forty days behind schedule (at a cost of $500,000 per day for the rig alone!). According to the congressional committee’s letter to BP in advance of its appearance, BP chose not to do certain tests and not to install certain protective devices because to do so would cause further delays. You and I know that a significant contributor to accidents is the desire to keep a schedule.

David Brooks of The New York Times wrote that among BP’s biggest errors was too much faith in the back up system – the Blowout Preventer. Such misplaced faith can reduce attention to the front line defenses. I recall, still with some shock, Betty van der Smissen telling me she believed that programs relaxed their attention to operations because of their faith in their Releases. I disagreed with her. Something I did with fear and trembling.

In the financial meltdown and in the Gulf leak, regulations and certain industry standards were ignored; and those charged with oversight, within the organizations and out, were lax in performing their duties. The emergency action plan submitted by BP to the government agency in charge reportedly was a re-write of one used in another location for another well – citing dangers to walruses, for example. (No walruses have been reported in the Gulf of Mexico.)

In both cases command and control were so diffused as to be of little value. Consider the many players (and supervisors) in the marketing and distribution of the financial derivatives. And, of the 160 people reportedly on the rig before the explosion only 6 were BP employees). The disbursement of responsibility created an illusion of low risk and it confused accountability. No one had the big picture – no one could contemplate the totality of the risk. The same condition existed at the government level, in both disasters – too many committees, too many agencies and not enough coordination. “Teamwork” complicated assessment and action.

Most recent news reports point to negligence, and more, in the acts and omissions leading up to the respective disasters. Negligence is simply carelessness, and does not require an evil state of mind. But there appears to have been more going on than simple carelessness. More of a “can we get away with it”, than a “whoops”.

The unhappy truth (this thought is not original with me) is that we humans simply have not yet learned to cope well with the complexities and interconnectedness of modern systems. Immanuel Kant describes us (humans) as “fallible”. The more moving parts there are in a system, the greater the risk. Humans as moving parts enlarge the risk. In rulings involving inherent risks, Courts have held that “machines naturally fail”. That is not to say that machines always fail, but it is in their nature to do so. What about human beings? We are not as rational as we think we are. We are not as quick to recognize risk as we think we are. We ignore the reality that risk confronts us with the bad thing that hasn’t yet happened. We have lost our innocence in the way we view medicine, mineral production, health care, finance, sports, the established church – even law. None are as predictable or understood, or as well managed, as we once thought.

As Peter Bernstein said (roughly) in “Against The Gods”: the problem with this life is not that it is safe or not safe. It’s that it is not as safe as it appears to be. Whoever, or whatever, designed this program (life) left out certainty.

Can regulation – including, for us, more standards, accreditations and certifications – solve the problem? To some extent, but we’re still dealing with human nature. Effective regulation, internal to an organization or external , requires sharp, independent, agencies and actors and a structure that focuses accountability and oversight at a single point.

Ultimately, I offer with some discomfort, it comes down to us - the actors in the field, and the consumers of the services we provide. I want my oysters and shrimp and I don’t want to pay $10 per gallon for gas to go to Joyce’s Seafood Restaurant to enjoy them. So we have fishermen in the Gulf of Mexico drifting under rigs whose operators and owners and regulators are cutting corners to assure I can get to Joyce’s cheaply. It’s beginning to occur to me that I can’t have it all.

If some of my facts are a bit off (I don’t think they are), treat this as merely a good story which might reinforce some of the lessons we have learned in our businesses. BP has said it will do all possible to keep this from happening again. We haven’t heard the same assurances from Wall Street. The question is what did they – and what will we - do to keep it from happening the first time?

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