

An inside look at how GE has worked to build a culture that sustains both high performance and high integrity

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As the chief legal officer at GE for nearly 20 years, I was part of the senior management group that sought to fuse high performance with high integrity. No one was more demanding about hitting financial targets than Jack Welch or his successor, Jeff Immelt. But both knew that employees up and down the ranks face the temptation to make the numbers by fudging the accounts, cutting corners, or worse. Unconstrained, these internal pressures—made more intense by corruption in emerging markets, demanding customers, and unscrupulous competitors—can lead to corrupt capitalism.

The changes in laws, regulations, stakeholder expectations, and media scrutiny that have taken place over the past decade can now make a major lapse in integrity catastrophic. Fines, penalties, and settlements are counted in the hundreds of millions (or billions) of dollars, not the millions or tens of millions of a decade ago. And worse, in some cases (as Enron and Arthur Andersen demonstrated)—a company can actually implode.

Performance with integrity has been a central concern of governance reforms but, almost exclusively, the focus has been on the board's role. Certainly, when the rot is at the top, governance checks and balances must come from the board of directors. But, for GE, as for most companies, governance is not solely about the board's selection and compensation of the CEO or about its periodic oversight of major risks and opportunities. The more pervasive governance issue is the responsibility of the CEO on down: How does top management drive a demanding performance culture built on unyielding integrity throughout a complex enterprise? The integrity land mines that can blow up in the face of most companies are all across the globe, not just in the corner office.

It is now time to shift this debate about corporate integrity from board oversight of the CEO to how the CEO and top company leaders can most effectively fuse high performance with high integrity at all levels in a challenging, fast-changing, and at times hostile world. This is a grinding, complex, day-in, day-out task

that is difficult in the best of circumstances to do well. GE has certainly learned its own hard lessons along the way, sometimes dealing with integrity violations that went unnoticed and unreported for far too long.

This article highlights how GE has tried to build a culture that fuses high integrity and high performance using a series of core principles and key practices. In it, I outline how the company has attempted continually to improve its systems and processes and to build a culture where executives and employees are motivated to do the right thing, even in GE's famously high-pressure business environment.

Core Principles and Key Practices

Ultimately, it is a company's culture that sustains high performance with high integrity. Leaders and employees compete ferociously and meet tough economic goals lawfully and ethically not only because they are afraid of being caught and punished but because the company's norms and values are so widely shared and its reputation for integrity is so strong that most leaders and employees want to win the right way.

By forcefully communicating guiding principles, company leaders help create that culture. But it's also necessary to implement a set of practices that have real consequences and use significant resources to drive the message home. In our efforts, we recognized that we weren't about to repeal human nature, but by learning from our missteps we could continually try to reduce improprieties to a minimum. Based on my experience at GE and many discussions I've had with executives at other multinationals, I believe the following principles and practices—especially as they interrelate and reinforce one another—are essential to creating a high performance–high integrity culture.

Demonstrating consistent and committed leadership. In no area of corporate life is leadership commitment more important than in creating an integrity culture. And nothing is more effective in manifesting that commitment than a seamless consistency between leaders' personal attributes, their public and private statements, and their direct and indirect actions. Companies are preternaturally attuned to leadership hypocrisy. The stirring call for performance with integrity at the large company meeting can be eroded by the cyni-

cal comment an executive makes at a smaller meeting, by the winks and nods that implicitly sanction improprieties, by personal actions (dishonesty, lack of candor) that contradict company values. It is fundamental: A culture of high standards for employees requires high standards from the CEO and the senior operating and staff officers.

There is no more important task for the CEO than demonstrating that the top executives will be held just as accountable for lapses in integrity as they are for missing their numbers—and that the generals will be held to higher standards than the troops. Jeff Immelt began and ended each annual meeting of GE's 220 officers and of its 600 senior managers by restating the company's fundamental integrity principles: GE's business success is built on our reputation with all stakeholders for lawful and ethical behavior. Commercial considerations *never* justify cutting corners. Upholding this standard is the specific responsibility of the leaders in the room. For any serious lapse, the warning was clear: "One strike and you're out."

GE's senior managers and officers knew the CEO was serious because, as it turned out, every year or so, a senior manager who had knowingly or recklessly violated company rules for commercial or personal reasons was terminated. For example, in one emerging nation, an individual was let go for failing to conduct required diligence on shady third-party distributors that had a reputation for improper payments. People were dismissed even when the business consequences were painful—when, for example, the local national in question had extensive knowledge and experience in a tough market.

An even more thunderous message is sent when a senior leader is removed not for failing to follow key rules but for failing to create the right culture. During my time, there were two seminal examples. Both involved acts hidden for a number of years that were clearly understood by many in the respective business units to be suspicious or wrong but had been tolerated to keep difficult customers satisfied. The first involved fraud in a Middle East procurement contract financed by U.S. government funds in the late 1980s and early 1990s. The second, early in this decade, had to do with acquiescing to an Asian customer's request that GE falsify supplier documents included in regulatory submissions.

Ben W. Heineman, Jr., is a distinguished senior fellow at Harvard Law School's Program on the Legal Profession, in Cambridge, Massachusetts; a senior fellow at the Belfer Center for Science and International Affairs at Harvard's Kennedy School of Government; and a senior counsel to the law firm of WilmerHale. From 1987 to 2003, he served as GE's senior vice president and general counsel. From 2004 until his retirement at the end of 2005, he was GE's senior vice president for law and public affairs.

In both cases, when the lapses came to light, the first thing top GE leaders did was to determine the facts, resolve the matter with the governments, fix the broken systems (specifying how to deal with improper pressure, instituting better process checks), and discipline lower-level employees clearly engaged in wrongdoing. But the hardest issue to resolve—and one of the most important integrity questions we ever faced—was how to sanction the leaders of the respective business units. They had no personal knowledge of the acts, and they were widely seen as “good guys” by senior managers. But in the end it was decided that they had failed because improprieties within their organizations had gone unreported for too long (more than five years) and had involved too many people (20 to 30). At the core of these major compliance failures was a deep-

seated cultural failure. Accordingly, both executives were asked to leave the company. The message was clear: Top leaders indifferent to an integrity culture would be gone.

Going beyond formal financial and legal rules. Rigorous compliance with the financial and legal rules of specific nations is the foundation of integrity in a multinational company. But on some core matters, that isn’t good enough. Instead, for a number of reasons, the organization must adopt a global standard that is higher than the financial or legal rules in place in particular jurisdictions. A simpler, clearer standard for conflicts of interest, for example, is easier for employees around the world to understand and follow, despite the vagaries of their location. Global standards spelling out how to prevent money laundering increase employees’ effectiveness

The Business Case in Brief

Conventional arguments against extensive efforts to fuse high performance and high integrity are that they cost too much, require too much management time, or lose deals, contracts, and procurements. But I believe a strong business case can be made for the significant advantages the efforts hold for corporations.

The benefit of avoiding harm. The impact of recent scandals on corporations is eye-popping. Ask any business leader who has lived through the time, effort, expense, and distraction of a serious government investigation about the adverse effect on the company. Moreover, there is ample evidence to show that over the past decade, the ramifications of serious wrongdoing have increased dramatically. Integrity lapses can now have catastrophic financial consequences (liabilities in the hundreds of millions or several-billion-dollar range for Citigroup, JPMorgan Chase, Adelphia, and Computer Associates; bankruptcy proceedings for WorldCom and Parmalat; and the ultimate penalty—collapse—for Enron and Arthur Andersen). A company’s reputation and morale, which may have been built over decades, can be shattered in months. Corporate officers can be indicted and face jail time and severe personal financial penalties. Stakeholders—from shareholders to creditors to employees to pension-

ers to customers, suppliers, and communities—also suffer serious, if not grievous, harm, leading to calls for ever more regulation. (Whether particular rules are necessary or cost-effective is a matter for public policy debates, but adherence is obviously required until rules are changed.)

Affirmative benefits. Implementing uniform global standards can make it simpler for employees to understand their responsibilities and therefore make adherence more efficient. What’s more, compliance with both formal rules and self-imposed global standards can create a deservedly strong company reputation for integrity that will complement and enhance a brand. That strong reputation, in turn, can help recruit and retain high-performing employees. A meaningful performance-with-integrity culture can raise a company’s estimation in the eyes of investors, creditors, and rating agencies, which now, for purely economic reasons, have added integrity risk to their analyses of companies. For example, BP’s Texas plant explosion in 2005 and its Alaskan oil field problems in 2006 were not by themselves catastrophic for the company. But by raising serious doubts about BP’s overall safety and management systems, they drove down market cap by about 20% and have forced the early retirement of iconic CEO John Browne.

A reputation for integrity can also differentiate a firm from competitors and help sales to governments in emerging markets that want to deal with a “clean” company and avoid taint to themselves. An integrity culture can, in the end, be a significant morale builder and spur to productivity for those who wish to serve, to use Jeff Immelt’s phrase, in a great and good company.

The fundamental costs of systems, processes, and talented people focused on performance with integrity pale in comparison to the benefits, especially the benefit of avoiding catastrophic integrity minefields. Indeed, sound practices in areas like environment, health and safety, and consumer finance can simplify basic business processes and make them more effective and less costly. Similarly, the cost of rejecting corrupt payments, deals, or contracts, in my judgment and experience, is far outweighed by the benefit of avoiding the risks of external exposure—which are especially consequential for transnational enterprises—and by the benefit of preventing internal corrosion. Certain actions, like ethical sourcing, are taken by business leaders in the enlightened self-interest of the company to enhance reputation or culture. Even though the benefits cannot be precisely compared to the costs, common sense tells us that reputation, like brand, is a significant corporate asset.

in assessing customers. Ethical sourcing practices (checking suppliers' environmental record and working conditions in addition to their technical qualifications and financial health) address some objections to outsourcing like worker exploitation or environmental degradation. Establishing single, global standards that anticipate trends in law and government policy—for, say, consumer finance disclosure and collection practices—may be not only simpler but also wiser in order to reduce future risk.

Companies can best decide when and where to impose global standards by identifying which issues are most important for key stakeholders. For example, higher governance standards or rebalancing short- and long-term debt might be the most important issues for shareholders and creditors. New facilities around the world built to global—not just local—environmental standards might be critical to employees and communities where GE does business. Instituting the most rigorous of nondiscrimination rules across the globe might be an imperative for employees.

Deciding when to adopt global standards is not some abstract, philosophical exercise requiring the services of a senior vice president for political and moral philosophy. It is a basic risk-reward analysis rooted in the company's operations and culture. What is the cost (time, money, resources) compared to the benefit (simplicity, effectiveness, enhanced reputation with key stakeholders)? Immelt has formed a corporate risk committee of top officers, which meets quarterly. For each meeting, the CFO and general counsel develop an agenda that includes issues about global standards. The committee decides, among other things, whether a standard is needed and, if so, what that GE standard should be. Issues with significant operational or reputational implications, such as ethical standards for supplier qualifications, are vetted with the board. Elevating these issues to the highest levels is important: Such decisions are frequently based on judgment because the costs and benefits cannot always be compared quantitatively. They will often turn on an assessment of the company's enlightened self-interest. (See the sidebar, "The Business Case in Brief.")

Staying ahead of the sheriff. To update global standards and avoid ugly surprises, GE has sought systematically to gather information

on financial, legal, and ethical developments. This task occurs at all levels of the company—from P&L centers to large business units to the CEO's risk committee. The key is to present the findings on a regular basis, to make them part of a consistent business rhythm—which, in turn, ensures that the company makes timely decisions about whether to adopt new standards and practices.

At various levels of GE, experts regularly scour media stories, proposed laws and regulations, specialized reporting services, academic papers, filed cases, and reported legal decisions to track early-warning signs and global trends in finance and law. For example, in reviewing the Enron, WorldCom, and Parmalat scandals, GE's financial services arm recognized the emergence of an "aiding and abetting" theory, which was leading to huge liabilities (in the billions of dollars) in the financial services industry. Prosecutors and regulators were charging banks as "secondary wrongdoers," alleging that they knowingly provided material assistance to customers who were engaged in tax or accounting fraud ("the primary wrongdoers"). As a result, GE's financial services businesses have a significant effort under way to educate employees about the application of the aiding and abetting theory, to define red flags, and to institute new routines to prevent questionable actions.

GE has also systematically sought to identify ethical issues raised by the increasing chorus of voices in the stakeholder and NGO communities and to prioritize them according to either intrinsic merit or amount of public attention they might generate. Sometimes, these voices make a strong point that leads to change. For example, in recent years, shareholder groups presented proposals stipulating that GE's directors should be elected by a majority, rather than a plurality, of votes. The risk committee and then the board agreed. GE is careful, however, never to adopt sweeping codes of conduct often urged on companies by third parties (such as detailed lists of environmental precepts); it makes much more sense to consider specific changes one at a time in light of our history and our culture.

A separate process for highlighting ethical issues—the so-called commonsense review—was instituted as a result of insurance broker Marsh & McLennan's past difficulties in failing to disclose adequately that it was receiving

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ing contingent commissions when it was on both sides of some insurer/insured transactions (a problem affecting other major brokers, too). There were those who claimed MarshMac's incomplete disclosure of a potential conflict of interest was lawful. But in the light of day, there was little question that Marsh's long-standing incomplete disclosure was a bad business practice. In annual legal and financial compliance reviews, GE now looks at its own ingrained business practices relating to customers, competitors, and suppliers, and asks not just whether they are legal but whether they are still reasonable and ethical (for example, whether disclosure of interest rates on loans and credit card balances are hidden in credit-babble rather than expressed in plain English).

Building standards into business processes. Who should own the job of fusing performance with integrity? A common business response is to assume it is the sole province of the finance and legal staffs. "I'm too busy with customers and product development and manufacturing and productivity and..." is a typical businessperson's lament. GE addresses this problem, through the CEO's repeated oral and written communications, by explicitly and unmistakably giving business leaders in the field the lead responsibility in their divisions for performing with integrity. And GE reinforces that message by building global integrity standards into business processes wherever possible.

GE has sought, for example, to make plant managers and manufacturing leaders formally responsible for environmental, health, and safety issues in their divisions. For each facility in each business, quarterly reports track key parameters (spills, accident rates, notices of violation). These are rolled up into a master matrix that compares each plant with all the others, and the cross-business comparisons are sent to the CEO. Being in the bottom quartile is a great goad to improvement. Similarly, consumer finance leaders are charged with embedding legal and ethical requirements into the highly automated processes for selling (using scripts), making credit decisions (by instituting nondiscrimination protections), and collections (through random call monitoring). Sourcing leaders in individual businesses are responsible for finding, qualifying, and requalifying global suppliers not only under financial,

technical, and quality standards but also according to the company's detailed ethical-sourcing guidelines. They are held accountable both by the chief executive of their business unit and by the companywide sourcing leader, through corporate auditing.

No business process is more important than conducting thorough due diligence on potential mergers and acquisitions according to the acquirer's global integrity standards. GE has spent significant resources to make due diligence on integrity issues as robust and detailed as possible to minimize post-closing integrity surprises (like huge environmental costs or past criminal behavior by the target's employees) that could blow up the underlying deal economics. This is important because regulators may hold acquiring companies accountable for the target's criminal problems, and a best practice is for the target to resolve issues before the closing, if possible. Because such resolution may not occur, GE has also sought to make sure there is significant overlap between the diligence and acquisition-integration teams so that integrity issues flagged before the closing are dealt with promptly. Any delay would turn the target's problem into GE's problem.

Encouraging finance, legal, and HR to be both partner and guardian. The financial, legal, and human resource functions, at both the corporate and the business unit levels, have central responsibility for developing the tools, systems, and processes for preventing and remedying integrity violations. They also are a crucial part of the corporation's basic checks and balances. But these functions—and especially the corporation's chief financial officer, general counsel, and head of human resources—cannot be effective unless they are also deeply involved in helping to develop and execute commercial strategies. And there can be a fundamental tension between these dual roles of partner and guardian.

CEOs need to accept this tension and encourage the top staff leaders to assume this dual role. Day to day, this may be easier said than done, which is why it needs to be addressed explicitly as a key element of a performance-with-integrity culture. In most companies, the CEO will not explicitly sanction crossing the bright line that demarcates legal from illegal conduct. But most hard problems in fluid situations come clothed in

shades of gray, and the business leader often wants to act swiftly. In such cases, the CFO or general counsel may need time to get facts and assess any financial, legal, or reputation risks for the business leaders. The CFO or GC may need to lay out a number of options with varying degrees of risk and to justify a multifaceted recommendation.

In such ambiguous situations, which arise frequently, the CEO makes the ultimate decision (perhaps with board consultation). The CEO invariably tests presentations by pushing back strenuously, asking hard questions, and forcing people to defend their positions. For their part, the CFO and the GC must play the guardian role equally strenuously, being unafraid to answer candidly or to argue back, remaining undaunted by personal or group pressures. Their views must be on the table and discussed, not summarily dismissed in the heat of the moment.

In dysfunctional companies, when business leadership improperly decides to cross financial, legal, or ethical lines or to stifle debate, the CFO, GC, and HR leader have to stand up to the CEO, go to the board—or quit. But the larger problem in such companies is that these gatekeepers may be weak or even complicit (witness the CFOs guilty of crime in the accounting scandals or the CFOs and GCs implicated in the option-backdating proceedings).

Business leaders serve their companies well when they make clear to the organization that, while they retain ultimate decision-making authority, they *really* want candid, unvarnished discussion of financial, legal, ethical, and reputational precepts, even though exchanges on specific issues may be contentious. More important, they show their approval and encouragement of the partner-guardian role by hiring strong, independent people in these critical leadership positions.

Giving employees a voice. One of the trickiest—but most important—aspects of fusing high performance with high integrity is educating and training employees, especially in emerging markets and in acquired companies, so that they intuitively understand and follow global integrity standards when making everyday decisions. Such understanding also gives employees the capacity to articulate on-the-ground concerns about possible improprieties by peers or superiors. Giving voice to em-

ployees is key to ensuring a self-cleansing culture of openness and accountability.

GE employees have four major channels through which to report issues.

The ombuds system allows employees to lodge concerns, anonymously if they wish, without fear of retaliation. More than 500 people serve in a full- or part-time ombudsperson capacity around the globe. Receiving reports in 31 languages, the ombudspersons act as neutral intake points, referring concerns to financial, legal, and HR staffs for investigation. They also are responsible for following up on all of the issues brought to their attention to ensure prompt resolution and to keep the reporting employees apprised of the status of their concerns.

The key to the system is that all reports are examined without fear or favor and that retaliation is, itself, an explicit integrity violation that will lead to severe discipline. But employees also have a duty to report. A failure to report into the system or up the line, when red flags are snapping in hurricane force winds, can be—and has been—a firing offense. Approximately 1,500 concerns have been lodged annually in the last few years, with about 20% leading to serious discipline (and 50% just seeking information).

Each business unit's annual assessment of its compliance performance begins with a bottom-up review. Employees on the ground floor of the organization in every country are asked to identify issues or problems in systems, processes, or practices. Then employees higher in the organization are given the same opportunity. The review process builds up through localities, countries, and regions, culminating in a report on results for the global division as a whole. Concerns about particular individuals must go through the ombuds system, and employees may also use that system to report on a superior's failure to respond to a broader compliance concern. Employees and leaders are rewarded in any number of ways—financially, with promotion, or with recognition, for instance—for finding and resolving important issues.

The internal corporate audit staff is one of the most important assets of the company. Its 400-plus people spend about 80% of their time auditing for adherence to global financial, legal, and ethical standards and acting as a check on the business's own bottom-up and compliance

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reviews. About half of the audit staff is made up of non-U.S. citizens, reflecting GE's huge international operations. Many GE leaders learn the fundamentals of performance with integrity early in their careers because the audit staff service is an important gateway into GE's leadership ranks—about 20% of GE's 220 officers are audit staff alums.

Business units' financial, legal, and HR staff at GE have a strong dotted line to the company CFO, the GC, and the HR leader. There is a powerful expectation that they will consult with those corporate functional heads when they have questions about commercial, reputational, or compliance risks. Both the business unit CEO and the company CFO have to agree on the person hired to be business CFO, but either the business leader or the company CFO can fire that person. The same practice applies for business unit general counsels and HR leaders. Failure of a business finance manager, general counsel, or HR leader to alert corporate headquarters of high-risk issues is cause for serious sanctions, including termination. For their part, the company CFO and GC have to earn trust by not running to the CEO every time their counterparts in the field raise issues.

All four channels are part of an attempt to create an open and candid company. In doing so, business leaders from the CEO on down send a potent message about the importance of a self-cleansing culture that demands immediate discussions about what the right thing is to do—and requires immediate notification when the wrong thing is being done. This stands in sharp contrast to the “culture of silence” cited by Boeing's general counsel in a blistering January 2006 speech to company leaders, given at the request of CEO Jim McNerney, about the root causes of document theft and conflict-of-interest scandals.

This collective voice of the company does not just detect, it deters. Even an unethical business leader facing a tough quarter has to think twice about asking his or her staff if the books can be cooked, for fear of becoming the subject of an ombuds report. I have investigated many concerns and read many investigative reports, and in my experience these channels were rarely misused over the years and did not create a climate of fear and backbiting because we tried to ensure employees' concerns would be handled independently, reviewed professionally, and decided fairly, based on

facts, not internal politics. Cheap shots simply wouldn't work.

Holding business leaders accountable with integrity metrics. Compensation and promotion are, of course, the common methods for ensuring accountability. And it is a corporate cliché that, in making these decisions, companies evaluate performance in the context of integrity issues. GE has tried to move beyond the cliché by applying real metrics and tools to evaluate integrity performance—not just for the 220 officers but also for the top 4,000 executives who are either P&L leaders or key contributors on business teams.

The primary method is to evaluate how leaders carry out their own integrity responsibilities. Have they set appropriate goals and built the right systems? Have they instituted effective controls and thorough auditing practices? Have they built high ethical standards into all of their business processes? How do they handle integrity crisis management? How do they conduct country-, regional-, and global-compliance reviews? How do they make integrity resource decisions in tough markets? Do they place “A” players in the jobs in which it is critical to fuse high performance with high integrity?

These evaluations, often focusing on year-over-year trends, are conducted in a variety of ways, including corporate audits; on-site compliance reviews by corporate leaders; statistics from the ombuds system; personnel reviews; and formal, annual reviews of the businesses by the corporate compliance board (the CFO, the senior vice president for HR, the head of the corporate audit staff, and the general counsel).

A second, potent method is to compare the performance of one business unit with other GE businesses and, where information is available, with peer companies. These comparisons can arise during audit staff reviews of the whole company (which might uncover, say, which business has the most open-audit issues or which has the most problems with control-ership in emerging markets). Comparisons may be made through external metrics (like customer complaints or private lawsuits stemming from integrity issues or formal proceedings brought by governments). In addition, evaluations of GE businesses by former regulators are compared against regulatory standards and peer performance.

Another key comparative tool for assessing leadership is the employee survey. In 2006, fully 95% of the more than 127,000 professional employees throughout the company responded when they were asked, in an anonymous survey, if they had a favorable or unfavorable view of the statement: "There are no compromises around here when it comes to conducting business in an ethical way." For GE as a whole, 85% agreed with the statement, 10% had no opinion, and only 5% disagreed, but the numbers across business units and within smaller P&Ls varied, raising important questions about the intensity and effectiveness of leadership down the line.

Governance on the Front Lines

The principles and practices top management follows to drive a performance-with-integrity culture deep into a company is a vital third dimension of governance. But the other two dimensions—the relationship between shareholders and the company and the relationship between the board and the CEO—have received far more attention in the governance debates of the past decade. Especially on the issue of performance with integrity, many directors and observers are now realizing that we cannot pile more and more responsibility on a board that has a vital but limited role in choosing the CEO, setting compensation, and overseeing the strategy for addressing key risks and opportunities. The importance of

and different approaches to this vital third dimension of governance from the CEO on down are not yet receiving appropriate discussion and debate within the senior ranks of the business community and within the burgeoning governance community of investors, analysts, academics, advocates, and interest groups. It is telling that Institutional Shareholder Services—the best-known governance rating agency—has more than 60 rating categories, and not one relates to the CEO's governance of the company.

Many business leaders, like those at GE, are seeking the best ways to achieve performance with integrity at an operational level deep inside the company. Beneath the headlines and the current governance debates about directors' roles and shareholders' prerogatives, there is in leading corporations an intense engagement with this bedrock management issue. I have offered here my personal perspective on key principles and practices to fuse high performance with high integrity. But my larger point is that there should now be a dramatic shift in governance analysis and debate away from board responsibilities to the least-discussed and, arguably, most important dimension: governance on the front lines.

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