

“AS LONG AS YOU MAKE MONEY” : AN INQUIRY  
INTO THE CRIMINOGENIC EFFECTS OF THE  
PROFIT MOTIVE

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This paper would not have been possible without the invaluable help and guidance of Professors Aneil Kovvali, Leandra Lederman, Todd Haugh, India Thusi, during my studies at the Indiana University – Bloomington, and Professors Enrico Basile, Tommaso Trinchera, Francesco Mucciarelli, Melissa Miedico, Giovanni Tuzet, Eleonora Montani, Matteo Erede, Fabio Quarato, during the time of study and current work at Bocconi University – Milan. I owe them my deepest gratitude. Any remaining mistakes are solely my own.

**ABSTRACT**

Corporations are born to make money. Although the corporate purpose is still a highly debated topic, shareholder value maximization is a dominant theory in modern corporate law. Managers – the agents – must steer the corporation to maximize shareholder value in the best interest of the principals – those whose money is at stake.

However, the relentless pursuit of profits can push agents to misbehave. Thrilled by juicy stock options, pressured by short-termism, and threatened by the risk of failure, some officials can reach the point where delinquency becomes a justified means for corporate success.

Yet, the relationship between the profit motive and misbehavior lacks a solid theoretical framework to make sense of their causal connection and provide actionable policy proposals. Corporate purpose is primarily examined in the context of corporate governance, whereas white-collar criminology is often less concerned with the technicalities of profit maximization in modern firms.

A timely analysis, this paper aims at filling a gap in the literature by offering a systematic approach to the complicated relationship between shareholder value maximization and misbehavior, offering incentive-based and cooperation-based countermeasures and proposals to minimize criminogenic risks in value maximizing companies.

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## INTRODUCTION

*“The moral of the story is: you can break the rules, you can cheat, you can lie, but as long as you make money, it’s all right.”*  
—Enron Official, VPs meeting<sup>1</sup>

It is a commonly accepted principle in Corporate Law that a corporation’s purpose is to make money.<sup>2</sup> Although now questioned by some,<sup>3</sup> the so-called profit motive and its supporting shareholder value maximization theory (S.V.M.) are the guiding lights of the modern corporation.<sup>4</sup> S.V.M. makes its way into the governance of corporations and

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<sup>1</sup> John Schwartz, *Enron’s Many Strands. Darth Vader. Machiavelli. Skilling Set Intense Pace.*, N.Y. TIMES (Feb. 7, 2002), <https://www.nytimes.com/2002/02/07/business/enron-s-many-strands-former-ceo-darth-vader-machiavelli-skilling-set-intense.html> (reporting what an Enron vice-president said at a meeting after former CEO Skilling had praised an employee’s malfeasance). The phrase is emblematic for the present article because it represents the underlying issue that an excessive pursuit of profits can bring about: the belief that the maximization of profits and returns can overshadow the infringement of the law committed to achieve that result, the fact that misbehavior can become a legitimate way to achieve the maximization of profits.

<sup>2</sup> Originally stated by Milton Friedman, the idea behind this principle is that “the social responsibility of business is to increase its profits”: see Milton Friedman, *A Friedman Doctrine-- The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> [hereinafter *A Friedman Doctrine*] (noting how shareholders are the *owners* and the *principals* of the corporation, and the directors’ job as *agents* is to maximize share value); see also WILLIAM MAGNUSON, *FOR PROFITS: A HISTORY OF CORPORATIONS* 217-52 (2022) (for a focus on how profit-driven corporations became the norm in modern corporate law).

<sup>3</sup> See LYNN A. STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012) [hereinafter Stout, *SHAREHOLDER VALUE MYTH*] (arguing that shareholder primacy is not required by law, is not economically efficient and is harmful for both shareholders and the public). See also E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?* 45 HARV. L. REV. 1145 (1932) (one of the first perspectives on the corporate purpose debate, arguing in favor of pursuing corporate constituencies *other than* the profit motive).

<sup>4</sup> See STEPHEN M. BAINBRIDGE, *THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION*, at 1-6 (2023) [hereinafter BAINBRIDGE, *THE PROFIT MOTIVE*] (defending shareholder primacy as the corporate purpose); see also STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS*, at 410-38 (Foundation Press 2002) [hereinafter BAINBRIDGE, *CORPORATION LAW AND ECONOMICS*]; see also Keith Davis, *The Case For and Against Business Assumption of Social Responsibilities*, 16 ACAD. MGMT. J. 312, 317-21 (1973) [hereinafter *Social Responsibilities*] (for a summary of the cons of the business assumption of social responsibilities).

The principle has been also upheld by Delaware courts in many landmark cases: see, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (1986) (applying the shareholder primacy theory to corporate takeovers); see also *Dodge v. Ford Motor Co.*,

influences its internal dynamics. Internal reward systems, stock options, high-return and high-risk short-term investing are some of the rules in its book.<sup>5</sup> They are accepted as methods to efficiently make profits.

In the United States, Delaware courts also generally uphold such principles and defer their application to the sound business judgment of directors, keeping board decisions mostly free from judicial scrutiny.<sup>6</sup> This has allowed S.V.M. to establish itself as the staple of modern corporate law. In and of itself this is nothing to be wary of.<sup>7</sup> Problems lie ahead if such theory is applied radically, paired with the obsession with short-term profits and the vertical climbing of stock price. The strong pressure to see those numbers go up, to get those bonuses, and to please investors and the market, creates the conditions for *certain types* of corporate officials to misbehave.

*But how and why does that really happen?* Not all corporate officials are the same. *White hats, black hats, and gray hats* are the three categories this paper uses to classify the members of a corporation depending on their tendency to misbehave.<sup>8</sup> Such a framework clarifies the types of incentives

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160 N.W. 668, 684 (Mich. 1919) (“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end . . .”); *see also* Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994) (arguing that in corporate takeovers directors are required to pursue the transaction that will produce the best value for stockholders).

<sup>5</sup> Linking the pay of directors to share value is the first way to incentivize its maximization and align the directors’ interests with those of shareholders: *see* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 4, at 418.

<sup>6</sup> *See* BAINBRIDGE, CORPORATION LAW AND ECONOMICS, *supra* note 4, at 242 and following (for a summary of Delaware’s position on the business judgment rule and a defense of judicial deference to the board in business matters).

<sup>7</sup> *See, e.g.*, BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 1-10.

<sup>8</sup> Such three-part division was inspired from H.L.A. HART, THE CONCEPT OF LAW 196 (2nd ed. 1994) [hereinafter CONCEPT OF LAW] (Hart referred to angels and devils arguing that a legal system would *not* be needed if men were *all angels* or *all devils*: it is precisely for those who sit in the middle that a legal system exists); the reference to three groups of individuals, characterized by different attitudes towards compliance to the law, was also used by Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1500 (“There may be three general types of taxpayers, those that are committed to compliance, those that are susceptible to influence, and a few that are committed to noncompliance”); *see also* Eric Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1796 (2000) [hereinafter *Tax Compliance*] (defining the three groups of compliance as “mainstream”, “marginal”, and “deviant”); the terms “white hats, gray hats and black hats” has reportedly been used by Larry Langdon, Commissioner of the Large and Mid-Sized Business Division of the IRS (LMSB), as cited in Posner, *Tax Compliance*, at 1795 (quoting David Cay Johnston, *Corporations’ Taxes Are Falling Even as Individuals’ Burden Rises*, N.Y. TIMES, Feb. 20, 2000, at A36); *see also* Jon S. Davis, Gary Hecht & Jon D. Perkins, *Social Behaviors, Enforcement, and Tax Compliance*

and influences that the profit motive creates and the effects they produce on individuals.<sup>9</sup>

*White hats* are immune from the temptation to misbehave. They are not touched by the pressure to maximize shareholder value above all else and would never commit crimes even if given the opportunity. They are deeply invested in the good management of the corporation and in justice, and they never see delinquency as justified. On the opposite side of the spectrum are black hats. They will *always* engage in misconduct, regardless of the tweaks and changes applied to the governance of the firm. They are the Bernie Madoffs – they would offend anyways. *Black hats* have no problems in bending the rules of the game for the sake of corporate success. They do not need significant pressures or incentives to misbehave – misbehavior is their *favorite course of action*. The middle chunk of the spectrum is occupied by *gray hats*. Subject to the high pressures of the business world, *gray hats* can *crack* and fall into the deep hole of crime. Gray hats, therefore, are more prone than others to be influenced by profit-driven incentives and pressures. To these individuals, S.V.M. and its push towards short-termism turns into an opportunity to engage in misdeeds. They would not *normally* misbehave but can easily change their course of action depending on the pressure they are subject to. The obsession with shareholder value creates such incentives and increases the risk of misbehavior.

The connections between the drive towards S.V.M. and the incentive to misbehave are thus complex and need a solid framework of analysis to be better understood. The path this work adopts is dissecting the effects that the profit motive can have in three main areas of influence (“concentric circles”):<sup>10</sup> the *individual*, the *organization*, and the *market*, going from the smaller to the wider sphere of influence. This will more clearly show what

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*Dynamics*, 78 ACCT. REV. 39 (2003) [hereinafter *Social Behaviors*] (for a similar model).

The terms *white*, *gray*, *black hat* are also commonly referred to in Cybersecurity literature: *see, e.g.*, Shubham Goel et al., *Ethical Hacking and Its Countermeasures*, 3 INT’L J. ADVANCE RES. & INNOVATION 623, 624 (2014) (classifying hackers into white, grey and black hat, and describing white hat hackers as “ethical hackers”); *see also* Mikhail A. Shlyakhtunov, *White-Grey-Black Hat Hackers Role in World and Russian Domestic and Foreign Cyber Strategies*, 12 INT’L J. ADVANCED COMPUT. SCI. & APPLICATIONS 429, 431-32 (discussing the features of white, grey and black hat hackers).

The use of such terms in the present work serves solely the purpose of categorizing corporate officials based on their propensity for misbehavior within a corporate setting. These terms have no connection to race, ethnicity, or any other personal characteristic, and their use is strictly for analytical purposes within the context of corporate governance and misbehavior.

<sup>9</sup> *See infra* Part II, B. THE ACTORS. SHADES OF BLACK, WHITE AND GRAY (for a detailed description).

<sup>10</sup> *See infra* Part III, A. CONCENTRIC CIRCLES, INFLUENCE, AND PROPOSALS.

role each motive plays, connecting corporate governance with white-collar crime and then offering solutions accordingly.

By so doing, this paper will fill a gap in the literature by providing a systematic analysis of the ways S.V.M. and misbehavior interact. Using the above-mentioned trichotomy of corporate officials, it will dissect the criminogenic risks that the most popular theory on the corporate purpose can have on the *individual*, the *organization*, and the *market*. Building on that analysis, it will provide countermeasures aimed at reducing the risk of misconduct and preventing corporate crime.

Attracting and retaining white hats, while positively influencing gray hats and excluding black hats from the corporate structure is key in reaching this aim. The proposals that this work presents are mostly based on correcting incentives, ensuring ethically sound corporate cultures and enhancing cooperation with the Department of Justice (“DOJ”). This is even more relevant considering the more recent changes in the approach that the DOJ adopts against white-collar crime and corporate misbehavior. Incentives and cooperation, rather than severe punishment and jail, are the key strategies of the DOJ’s approach.<sup>11</sup> The present work is thus timely – the framework it provides well fits within the new corporate criminal justice agenda and offers insightful reflections on the topic.

There is authoritative and widespread literature on corporate purpose and on the profit motive, which analyzes in detail exactly *what* corporations are for, together with the roles and responsibilities of its members.<sup>12</sup> There is also extensive literature on white-collar crime and on the potential criminal deviances corporations and officials can fall into.<sup>13</sup> The gap this paper aims

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<sup>11</sup> See U.S. Dep’t of Just., *Corporate Crime*, (focused on cooperation and self-reporting procedures), <https://www.justice.gov/corporate-crime>; see also United States Sentencing Commission, *Guidelines Manual*, §8 generally and §8B2.1 (focused on compliance and ethics programs in sentencing, establishing cooperation between law enforcement and corporations); see also *Justice Manual*, §9-28.010, -28.300, -28.700, -28.800 (2018) (for an application of the same principles at prosecutorial level); see also Memorandum from Deputy Attorney General Lisa O. Monaco, *Further Revision to Corporate Criminal Enforcement Policies Following Discussions with Corporate Crime Advisory Group*, (Dep’t of Justice Sept. 15, 2022) at 6-11, 15 (among other things, focusing on voluntary self-disclosure by corporations, cooperation, and the promotion of compliance) [hereinafter, *Revisited Monaco Memo*], which is a revision to the previous Memorandum from Deputy Attorney General Lisa O. Monaco, *Corporate Crime Advisory Group and Initial Revisions to Corporate Criminal Enforcement Policies*, (Dep’t of Justice Oct. 28, 2021).

<sup>12</sup> See *infra* Part II, C. THE MOTIVE (analyzing S.V.M. and the general debate on the corporate purpose and referring to the relevant literature).

<sup>13</sup> See *infra* Part II, A. INTRODUCTION. LAW, ECONOMICS AND CRIMINALS, and Part II, C. THE MOTIVE, *iii. What Has Crime Got to Do with It*, specifically notes 134 (for sources

at filling is the middle ground – it is less common for studies on corporate purpose to focus on the potential criminogenic risks of the profit motive, nor is it common for white-collar crime studies to dig into the technical analysis of corporate dynamics.<sup>14</sup>

To name a few, ‘The Profit Motive’ by Stephen M. Bainbridge masterfully tackles the complex topic of corporate purpose, offering a strong defense of shareholder value maximization – however, it is not concerned with the potential criminal deviances that such principle can trigger.<sup>15</sup> On the side of white-collar crime, Joel Bakan’s magistral works ‘The Corporation’ and subsequently ‘The New Corporation’ are fundamental contributions to the literature, but they are more specifically focused with analyzing the corporation as a separate “psychopathic” entity.<sup>16</sup> Vincenzo Ruggiero’s work on ‘Financial Delinquency’ is also a paramount contribution to the field and is significantly relied upon as basis for this analysis.<sup>17</sup> The difference from Ruggiero’s book lies with the analysis of the technicalities of the corporate purpose, questioned as the potential *roots* of individual misbehavior. Ruggiero adopts a more historical perspective, reaching similar conclusions through a different path. Similar reasons distance David O. Friedrichs’s masterful take on white-collar criminality ‘Trusted Criminals’ from this work.<sup>18</sup> Friedrichs is less concerned with a detailed analysis on the corporate purpose and its structural connections with individual misbehavior.

Therefore, considering both the current – extremely active – debate on the corporate purpose and the DOJ’s rethinking of its strategy to tackle white-collar crime, it is necessary to address this issue and strive to provide a helpful

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that are relevant for criminology in general) and 135 (for sources that are relevant for white-collar crime specifically).

<sup>14</sup> Exceptions can be found, for example, in William W. Bratton, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders? Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1275 (2002) [hereinafter Bratton, *Dark Side*]; also, in the literature on tax compliance: see, e.g., Graeme S. Cooper, *Analyzing Corporate Tax Evasion*, 50 TAX L. REV. 33, 75 (1994); see also Mihir A. Desai & Dhammika Dharmapala, *Earnings Management, Corporate Tax Shelters, and Book–Tax Alignment*, 62 NAT’L TAX J. 169, 171 (2009); see also Leandra Lederman, *The Fraud Triangle and Tax Evasion*, 106 IOWA L. REV. 1153, 1185-87 [hereinafter, *Tax Evasion*].

<sup>15</sup> See BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4; see also *infra* Part II, C. THE MOTIVE.

<sup>16</sup> See Bakan, THE CORPORATION, *infra* note 213; see also Bakan, THE NEW CORPORATION, *infra* note 232; see also *infra* Part II, A. INTRODUCTION. LAW, ECONOMICS AND CRIMINALS, and Part II, C. THE MOTIVE, §iii. (for a more detailed discussion).

<sup>17</sup> See FINANCIAL DELINQUENCY, *infra* note 247; see also *infra* Part II, A. INTRODUCTION. LAW, ECONOMICS AND CRIMINALS, and Part II, C. THE MOTIVE, §iii.

<sup>18</sup> See TRUSTED CRIMINALS, *infra* note 135; see also *infra* Part II, A. INTRODUCTION. LAW, ECONOMICS AND CRIMINALS, and Part II, C. THE MOTIVE, §iii.

outlook on *how and why individuals are brought to misbehave in pursuit of profits, and how to respond to it.*

In PART I, the case studies of Enron and Wells Fargo (hereinafter, W.F.) will serve as examples of the possible relationship between the profit motive and misbehavior. In both cases, either top executives or low-level employees were *pushed to the limit* by the pressure to meet financial goals and maximize share value. These two examples still appear the most fitting for the present work, as they clearly show how profit-driven governance produced criminogenic effects on the whole organization (Enron, the “superstar firm”), or mostly on individuals (W.F.).

In PART II, the paper will divide corporate officials into the three categories of *white hats*, *gray hats*, and *black hats*, depending on their tendency to misbehave. The profit motive will subsequently be analyzed, centering the discussion on how its effects unravel on the three *concentric circles* of the individual, the organization, and the market as a method to dissect *how S.V.M.* plays out and how it can be connected to misbehavior.

PART III proposes solutions and countermeasures to the phenomenon on the basis of the theoretical framework set forth.

## I. PAST MISTAKES

### A. Enron<sup>19</sup>

*“It is much safer to be feared than loved, when, of the two, either must be dispensed with.”*

—Niccolò Machiavelli<sup>20</sup>

#### i. What Happened?

“I would not have done anything different” – said former Enron CEO Jeff Skilling.<sup>21</sup> He is known for having been at the helm of the company that underwent one of the world’s most disastrous corporate scandals, biggest bankruptcy reorganization in U.S. history, and most remarkable audit failure.<sup>22</sup> During its peak performance, the company totaled \$63.4 billion in

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<sup>19</sup> Extensive and excellent literature has been written about the Enron scandal. I will refer to it in this paragraph and refrain from repeating what other authoritative voices have already said. This paragraph is not a detailed summary of the scandal, rather it highlights the aspects of the Enron’s case that are relevant for this paper.

<sup>20</sup> Niccolò Machiavelli, *Il Principe* (1532): the quote was referred to by one of Enron’s former employees to describe the environment that Jeff Skilling created in the company: see Schwartz, *supra* note 1, at C3.

<sup>21</sup> See Schwartz, *supra* note 1, at C4.

<sup>22</sup> See Bratton, *Dark Side*, *supra* note 14; see also Simon Constable, *How the Enron*

assets,<sup>23</sup> was America's seventh largest firm for market capitalization,<sup>24</sup> and was crowned the most innovative firm by Fortune for five years running.<sup>25</sup> Enron was admired in the business community as a ". . . center of innovation and entrepreneurship".<sup>26</sup> This all came to a halt when it was publicized that the company had engaged in the biggest financial fraud in history, *cooking the books* in a way that would show unrealistic profits through the fair value and mark-to-market techniques of aggressive accounting.<sup>27</sup> Enron tried to cover the fraud up, through ". . . a systematic and pervasive attempt . . . to misrepresent the company's financial condition".<sup>28</sup> It defrauded investors by manipulating publicly disclosed data.<sup>29</sup>

Enron went from being a leading company in the energy sector that occasionally made use of financial instruments to raise capital to being primarily a *financial* company, wholly vested in the maximization of share value and profits.<sup>30</sup> In pursuit of that goal, the company became laser-focused on earnings per share<sup>31</sup> and neglected to follow the law in doing so.

Enron became in desperate need of cash, realizing how its old-fashioned core business was not sufficiently profitable.<sup>32</sup> Accurately reporting its financial condition would have had a significant backlash on the market and the firm's finances, as investors would have realized the financial risks that Enron was facing.<sup>33</sup> *Misbehaving* and misreporting its financial condition would have avoided investor concerns and satisfied its management's quest for S.V.M.<sup>34</sup> Andy Fastow, Enron's former CFO, said it loud and clear: "While CFO, I and other members of Enron's senior management fraudulently manipulated Enron's publicly reported financial results. Our

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*Scandal Changed American Business Forever*, TIME (Dec. 2, 2021, 1:06 PM EST), <https://time.com/6125253/enron-scandal-changed-american-business-forever/>.

<sup>23</sup> See Constable, *supra* note 22, at 3.

<sup>24</sup> See Bratton, *Dark Side*, *supra* note 14, at 1276.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.* at 1278.

<sup>27</sup> *Id.* at 1303 (explaining how MTM and fair value accounting was abused by Enron).

<sup>28</sup> See John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor's Perspective*, 76 U. COLO. L. REV. 57, 70 (2005) (quoting the former Dean of the Texas Law School on joining Enron's board of directors in 2001) [hereinafter, *A Prosecutor's Perspective*].

<sup>29</sup> *Id.* at 71.

<sup>30</sup> See Bratton, *Dark Side*, *supra* note 14, at 1288 (highlighting how Enron set out to become a pure financial intermediary).

<sup>31</sup> *Id.* at 1284 (citing Enron's 2000 Annual Report (2001)).

<sup>32</sup> See, e.g., Kroger, *A Prosecutor's Perspective*, *supra* note 28, at 71-72 (explaining the ways Enron defrauded investors, regulators, and the public).

<sup>33</sup> *Id.* (explaining the ways Enron defrauded investors, regulators, and the public).

<sup>34</sup> *Id.* (explaining how Enron chose the *misbehaving* option and manipulated its financial statements).

purpose was to . . . inflate artificially the price of Enron's stock and maintain fraudulently Enron's credit rating”.<sup>35</sup>

Soon thereafter, \$4 billion in additional liabilities suddenly appeared in Enron’s fraudulently kept books, causing Standard & Poor’s to downgrade its obligations to a *junk* status and Dynegy – a company Enron was negotiating with – to call off the nearly closed deal amid negotiations.<sup>36</sup> In addition, \$30 million appeared to have been object of self-dealing by the CFO,<sup>37</sup> \$700 million of net earnings were burnt and \$1.2 billion of shareholders’ equity disappeared.<sup>38</sup> The company plummeted and had no choice but to file Chapter 11 bankruptcy. Criminal convictions of top executives followed, and the company ceased to exist.<sup>39</sup>

Exposure of the fraud came from within: as explained later,<sup>40</sup> it was an Enron employee – Sherron Watkins – who unveiled the company’s financial malfeasance and helped bring the fraud to a halt.

#### ii. How Did it Work?

The reasons why Enron collapsed are complex and varied. One reason was attributed to Enron’s corporate purpose and the fraudulent means adopted to pursue it. The company engaged in excessively risky activities, keeping low assets and divesting. It enacted an obsessive-compulsive version of the contractarian ideal of the firm all while following the NorthStar of high share prices.<sup>41</sup>

Pushed by the obsession to maximize shareholder value and helped by the market deregulation of the early two-thousands, Enron managers and employees were pushed over the limit of legality for the sake of profits. Misbehavior became the accepted way of doing business and influenced the company’s relationship with auditors as well. Complicity with regulators and auditors helped the company overcome the obstacles of public oversight and

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<sup>35</sup> Plea Agreement Exhibit I, Glisan Statement - Count Five, United States v. Glisan, Cr. No. H-02-0665, (S.D. Tex. Sept. 10, 2003), as cited in *id.* at 72 (acknowledging the statement made by Fastow in his guilty plea agreement).

<sup>36</sup> See Bratton, *Dark Side*, *supra* note 14, at 1323 (dissecting Enron’s crash).

<sup>37</sup> *Id.* at 1305 (noting Fastow’s major role as CFO in exploiting the loopholes that allowed Enron’s misdeeds to go undetected).

<sup>38</sup> *Id.* at 1282.

<sup>39</sup> For a summary, see *Timeline: A Chronology of Enron Corp.*, N.Y. TIMES (Jan. 18, 2006), <https://www.nytimes.com/2006/01/18/business/worldbusiness/timeline-a-chronology-of-enron-corp.html>.

<sup>40</sup> See *infra*, § iii.

<sup>41</sup> See Bratton, *Dark Side*, *supra* note 14, at 1287-92; see also Kroger, *A Prosecutor’s Perspective*, *supra* note 28, at 65-67 (delving into Enron’s aggressive diversification strategy and subsequent immediate need for capital).

allowed it to misbehave undisturbed. If on one side the obsession with profits incentivized misbehavior, on the other a regulatory blind eye allowed it to operate undetected. Enron openly and exclusively pursued S.V.M.<sup>42</sup> This obsession became the company's death sentence, as it caused its managers to embark in risky activities, manipulate earnings, and conceal critical information.<sup>43</sup>

Enron wanted to be the best on the market.<sup>44</sup> It did not only want to be better than its competitors – it wanted to be better than the market itself.<sup>45</sup> This mindset pervaded the whole firm and influenced the way it functioned.<sup>46</sup> High pressure to succeed, low to zero tolerance for failure, and hyper-competitiveness were some of the rules in the book, designed to make it the “superstar firm”.<sup>47</sup>

One example was the internal “rank or yank” rewards system, which worked as a brutal way for top-management to evaluate employees and for employees to evaluate each other.<sup>48</sup> The system worked as a tournament: each recruit picked ten other employees to rank, also through unsolicited evaluations.<sup>49</sup> At the end of the year, results were put on a curve: those at the bottom got terminated;<sup>50</sup> those at the top end got lavish bonuses, paid trips, and privileges.<sup>51</sup>

Former CEO Jeff Skilling made it clear: he wanted success, not failure; he wanted solutions, not problems – regardless of what this entailed.<sup>52</sup> Louise Kitchen, a former Enron employee, was praised by Skilling for violating his prohibitions regarding the opening of the company's internet-based trading

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<sup>42</sup> See Bratton, *Dark Side*, *supra* note 14, at 1283 (“Enron under Ken Lay and Jeff Skilling pursued *maximum shareholder value*.” (emphasis added)).

<sup>43</sup> *Id.*; see also *id.*, at 1283; see also Kroger, *A Prosecutor's Perspective*, *supra* note 28, at 67-83 (summarizing the company's fraudulent practices and accounting techniques).

<sup>44</sup> See Bratton, *Dark Side*, *supra* note 14, at 1330 (describing Enron's managers as having a “belief system biased toward winning”).

<sup>45</sup> See *id.* at 1285 (“[T]heir [the principals'] job was not just to make money, but to make the most money – to be the superstar firm[.]”); see also *id.* at 1289-90.

<sup>46</sup> *Id.* at 1291, 1328-29.

<sup>47</sup> *Id.* at 1287-98 (considering how Enron embodied an exaggerated version of the contractarian theory of the firm); see also Joseph Fuller & Michael C. Jensen, *Just Say No to Wall Street: Putting a Stop to the Earnings Game*, 22 J. APPL. CORP. FIN. 59, 61 (2010) (for a critic).

<sup>48</sup> See Bratton, *Dark Side*, *supra* note 14, at 1292-93 (describing Enron's rewards system); see also Alexei Barrionuevo, *Jobless in a Flash, Enron's Ex-Employees Are Stunned, Bitter, Ashamed*, WALL ST. J., Dec. 11, 2001, at B1.

<sup>49</sup> See Bratton, *Dark Side*, *supra* note 14, at 1293.

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 1291; see also Schwartz, *supra* note 1, at C3.

operation. The employee had started Enron Online regardless of Skilling’s repeated express prohibitions, using unauthorized funds which had been allocated for other purposes.<sup>53</sup> Basically, Ms. Kitchen had *misbehaved*. Instead of being reproached or sanctioned, she was rewarded and received praise from Skilling himself. The *violation* made money – share value was maximized. Skilling was happy, even if he had expressly vetoed the operation. The *end had justified the means*. A former VP who had attended the meeting where Skilling praised Kitchen summarized the episode as follows: “The moral of this story is, you can break the rules, you can cheat, you can lie, but as long as you make money, it’s all right”.<sup>54</sup>

Considering the outcome, it looks like an accurate description of the company’s culture: accepting misbehavior as long as it is profitable.

### iii. Did Everyone React the Same Way? (They Did Not)

Enron was an irresponsible firm.<sup>55</sup> The way Enron functioned influenced both top-executives – Skilling, above all – and employees – Louise Kitchen is an example. Both appeared to be blinded by their obsession to keep Enron’s market value up.<sup>56</sup> Once that was set to be the only endgame of the firm, engaging in malfeasance for the sake of reaching that goal was perceived as culturally accepted within the firm.<sup>57</sup>

If misbehavior is not reproached as long as it satisfies the *profit motive*, it becomes clear how this incentivizes turning a blind eye once *money is made misbehaving*.

As for top executives, the relentless pursuit of maximum profits fueled their overconfidence.<sup>58</sup> This incentivized high-risk, high-return, short-term

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<sup>53</sup> See Schwartz, *supra* note 1, at C3.

<sup>54</sup> *Id.*

<sup>55</sup> The term is borrowed from LUCIANO GALLINO, *L’IMPRESA IRRESPONSABILE 5* (Einaudi, 2005); see also LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA’S NEWEST EXPORT* (2001) (for a study on the irresponsibility of the US model of the share-value-maximizing firm) [hereinafter MITCHELL, *CORPORATE IRRESPONSIBILITY*]; but see Douglas M. Branson, *Review of Lawrence E. Mitchell, Corporate Irresponsibility – America’s Newest Export* (Yale University Press, New Haven, Connecticut, 2001), 15 BOND L. REV. 398 (describing Mitchell’s idea as “poppycock.” *Id.* at 399).

<sup>56</sup> See Bratton, *Dark Side*, *supra* note 14, at 1285 (“[T]he line under appropriate and inappropriate behavior has for many dissolved under the real-world pressure to produce shareholder value.”).

<sup>57</sup> See Stuart P. Green, *Moral Ambiguity in White-collar Criminal Law*, 18 NOTRE DAME J.L. ETHICS & PUB. POL’Y 501, 506-18 (2004) (for an argument on why it is difficult to define the morally wrong in white-collar crimes) [hereinafter *Moral Ambiguity*].

<sup>58</sup> See Troy A. Paredes, *Too Much Pay, Too Much Deference: Behavioral Corporate Finance, CEOs, and Corporate Governance*, 32 FLA. ST. U. L. REV. 673, 689 (2005) (for an account of how the behavioral issue of overconfidence plays out for top executives: “People

activities and influenced directors by producing the thrill that fuels overoptimism in the form of an underestimate of risks and overestimate of benefits.<sup>59</sup> Galvanized by the bonuses of the rewards system, Enron's top officials crossed the line of what can be justified in the corporate setting.<sup>60</sup> Excited and obsessed with *winning the tournament* they put themselves in, they overestimated their ability to avoid the chance of collapse.<sup>61</sup> "I am never unsuccessful in business or work, ever" Skilling famously said.<sup>62</sup>

As for lower-level employees, the rewards system combined the fear of draconian consequences of failure with the appeal of higher salaries and generous benefits. The mixture induced compliance to the *game* Enron was playing. Skilling did not want to hear bad news and was not concerned with issues of misconduct.<sup>63</sup>

Such a setting created the opportunities for employees to engage in misdeeds and, in some cases, rendered misdeeds the only option to avoid termination.<sup>64</sup> "I felt like I was being eaten alive," said a former Enron employee describing the relationship to Mr. Skilling inside the firm.<sup>65</sup>

Operating under the assumption that it would not be held accountable for the consequences of its actions, Enron exemplified the characteristics of an irresponsible firm. Its officials were not only influenced by the incentives of

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overestimate their abilities, believe that they know more than they in fact do, and suffer from an 'illusion of control', believing that they exert more control over results than they actually do". *Id.* at 689 [hereinafter *Too Much Pay*]; see also Dan Lovallo & Daniel Kahneman, *Delusions of Success: How Optimism Undermines Executives' Decisions*, HARV. BUS. REV., July 2003 at <https://hbr.org/2003/07/delusions-of-success-how-optimism-undermines-executives-decisions> (discussing how cognitive biases and organizational pressures lead managers to be overoptimistic in decision-making and to underestimate risks); see also Bratton, *Dark Side*, *supra* note 14, at 1283 ("[I]ts [Enron's] managers suffered the behavioral biases of successful entrepreneurs. They overemphasized the upside and lacked patience[.]").

<sup>59</sup> See Paredes, *Too Much Pay*, *supra* note 58; see also Lovallo & Kahneman, *supra* note 58.

<sup>60</sup> See Lovallo & Kahneman, *supra* note 58, at 3 (noting how in decision-making executives usually commit the "planning fallacy").

<sup>61</sup> See Bratton, *Dark Side*, *supra* note 14 (for the description of the internal functioning of Enron as a tournament).

<sup>62</sup> See Schwartz, *supra* note 1, at C3.

<sup>63</sup> See, e.g., Lovallo & Kahneman, *supra* note 58, at 7 (explaining the risks of suppressing criticism and being overoptimistic in a firm: "When pessimistic opinions are suppressed, while optimistic ones are rewarded, an organization's ability to think critically is undermined."); see also Bratton, *Dark Side*, *supra* note 14, at 1291.

<sup>64</sup> See Lovallo & Kahneman, *supra* note 58, at 7; see also Schwartz, *supra* note 1, at C3 (noting how the environment at the firm was one of fear: Skilling was described like an "angry dog" by an employee, unapproachable and silently fierce. *Id.*).

<sup>65</sup> Schwartz, *supra* note 1, at C3.

the rewards system – they also acted with a foundational belief that accountability could be avoided.<sup>66</sup>

There are three types of characters in the Enron story:

Jeff Skilling: He shaped how the company worked, breathed, and behaved. He was engaged in delinquency and was ultimately convicted on counts of fraud and conspiracy.<sup>67</sup> He created the environment that later turned out to be criminogenic. After all the dust had settled, he said he would not have done anything different.<sup>68</sup> Jeff Skilling could be depicted as a black hat, although he would probably not consider himself an evildoer: “I had no idea the company was in nothing but an excellent shape,” he famously said.<sup>69</sup>

Andy Fastow: He was the Chief Financial Officer of Enron. Not only is he a black hat – he acknowledges his role in the fraud. He admits causing “a great deal of harm, not just financial . . . but personal harm to people as well.”<sup>70</sup> And he admits that he “. . . should have been called the Chief Loophole Officer. That’s all I did every day, and we were the best at it.”<sup>71</sup> Considering the lack of remorse, it is reasonable to assume that such a character would not have shied away from misconduct even under different incentives.

Sherron Watkins:<sup>72</sup> She is one of the former vice presidents of Enron, known for blowing the whistle on the company’s malfeasance. She became aware of the accounting improprieties Enron used while working for Andy Fastow from June to August 2001.<sup>73</sup> Specifically, she believed that the company was using its own stock to generate gains and losses on its income statement.<sup>74</sup> Although she was troubled by this, she feared that revealing her concerns to Fastow and Skilling would result in her termination.<sup>75</sup>

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<sup>66</sup> See GALLINO, *supra* note 55, at 5.

<sup>67</sup> Press Release, U.S. Dep’t of Just., Former Enron CEO Jeffrey Skilling Resentenced to 168 Months for Fraud, Conspiracy Charges (June 21, 2013), <https://www.justice.gov/opa/pr/former-enron-ceo-jeffrey-skilling-resentenced-168-months-fraud-conspiracy-charges>.

<sup>68</sup> Schwartz, *supra* note 1, at C4.

<sup>69</sup> *Id.* at C1.

<sup>70</sup> *Enron Ep. 3: The Fixer and the Whistleblowers*, BAD BETS (WALL ST. J. podcast Oct. 30, 2022), <https://www.wsj.com/podcasts/bad-bets/enron-ep-3-the-fixer-and-the-whistleblowers/2b5105a1-b0d5-48c7-a3f6-9e73fd1854be> [hereinafter BAD BETS].

<sup>71</sup> *Id.*

<sup>72</sup> Her page can be found at <https://www.whistleblowers.org/whistleblowers/sherron-watkins/>.

<sup>73</sup> See Leonard M. Baynes, *Just Pucker and Blow?: An Analysis of Corporate Whistleblowers, the Duty of Care, the Duty of Loyalty, and the Sarbanes-Oxley Act*, 76 ST. JOHN’S L. REV. 875, 877 (2002) [hereinafter *Corporate Whistleblowers*].

<sup>74</sup> See *id.*

<sup>75</sup> See *id.*

Thus, she decided upon sending an anonymous letter to Kenneth Lay – Enron’s chairman at the time – in 2001, informing him of the company’s accounting misdeeds.<sup>76</sup>

She then met personally with Lay on August 22, 2001, requesting a transfer from working with Fastow, and was later moved to HR.<sup>77</sup> Lay had assured her that the irregularities would be taken care of. She did not report her concerns to the SEC or any other agency or government official.<sup>78</sup> Beginning in October 2001, Enron started reporting significant quarterly losses, until it conceded that it had overstated its earnings by \$586 million.<sup>79</sup> It filed for bankruptcy and the party was over.

Watkins played a major role in unveiling the fraud. Blowing the whistle regardless of personal consequences could render Ms. Watkins describable as a white hat. Her main goal was to bring an end to the misconduct.<sup>80</sup> “I am incredibly nervous that we will implode in a wave of accounting scandals,” she admits in her letter.<sup>81</sup>

She can be considered as the “. . . prototypical whistleblower, because she had knowledge of damaging information and she disclosed it to her supervisor’s supervisor.”<sup>82</sup> However, she was somewhat atypical. She shared her concerns with the head of the company, but she did not directly trigger the public investigations that are generally needed to detect and stop wrongdoing.<sup>83</sup> Also, she did not *directly* cause Enron’s collapse, and her actions did not directly compromise her employment.<sup>84</sup> Some even say that she could have engaged in insider trading herself.<sup>85</sup> This is all to concede that

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<sup>76</sup> See her testimony in the following conference: Sherron Watkins & Cindy Mohering, *Sherron Watkins: Inside the Mind of an Enron Whistleblower* (YouTube, Oct. 13, 2022), <https://www.youtube.com/watch?v=5PfGwNwYVhY> [hereinafter *Enron Whistleblower*]; see also *id.*, at 877-78 (2002); for the text of the letter, see *Text of Letter to Enron’s Chairman After Departure of Chief Executive*, N.Y. TIMES (Jan. 16, 2002), <https://www.nytimes.com/2002/01/16/business/text-of-letter-to-enron-s-chairman-after-departure-of-chief-executive.html> [hereinafter *Watkins Letter*].

<sup>77</sup> See *Corporate Whistleblowers*, *supra* note 73, at 878.

<sup>78</sup> See *id.*

<sup>79</sup> See *id.*

<sup>80</sup> See *Enron Whistleblower*, *supra* note 76.

<sup>81</sup> *Watkins Letter*, *supra* note 76.

<sup>82</sup> *Corporate Whistleblower*, *supra* note 73, at 880.

<sup>83</sup> See *id.*

<sup>84</sup> See *id.*, at 880-81.

<sup>85</sup> See *id.*, at 880 (citing her testimony before the House of Representatives: *The Financial Collapse of Enron: Hearing Before the House Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce*, 107<sup>th</sup> Cong. (2002); in her testimony, she acknowledged that she had traded \$47,000 in Enron stock when she was blowing the whistle but denied any wrongdoing).

classifications are not absolute – Ms. Watkins may indeed be qualified as a white hat, but such a definition may be flexible.

There are three takeaways from the Enron *debacle* that are relevant to this article.

(i) The company relentlessly pursued S.V.M. and looked at no other corporate goal in its governance.

(ii) As far as *company policy* goes, S.V.M. entailed an obsession with keeping stock prices up and the belief that anything was justified to satisfy that end. Also, the aggressive enactment of the contractarian techniques of keeping low assets and divesting was the main cause for the company’s desperate need for capital, which created opportunities for fraud. Ultimately, it also entailed the implementation of a *brutal* internal rewards system.

(iii) As far as the *effects* produced, S.V.M. played out both on the organization and the individual. As for the organization, it supported a hypercompetitive environment<sup>86</sup> which turned out to be criminogenic, suppressing dissent and rewarding delinquency.<sup>87</sup> As for individuals, every member of the company was subject to the influence and pressures of both the rewards system and of Skilling’s and Fastow’s fierce characters.<sup>88</sup>

The paragraph above used Enron as an example of profit-driven malfeasance, showing how S.V.M. can come to influence the organization as a whole. Wells Fargo, as the next example, will show how lower-level employees, likewise, can be involved in misconduct if pushed by the environment they work in.

## B. *Wells Fargo*

### i. What Happened?

Once a 19<sup>th</sup> century stagecoach carrying valuable goods to and from the gold mines in the West, Wells Fargo (W.F.) managed to grow quickly and steadily throughout the 20<sup>th</sup> century.<sup>89</sup> It built the solid reputation of being a Main Street community bank, close to its clients, loyal, and somehow safely

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<sup>86</sup> See Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 GEO. WASH. L. REV. 968 (2002) (for an analysis of Enron as a hyper-competitive firm) [hereinafter *Hyper-Competition*].

<sup>87</sup> Schwartz, *supra* note 1, at C3 (summarizing Ms. Kitchen’s case).

<sup>88</sup> See Bratton, *Dark Side*, *supra* note 14, at 1292 (lower-level employees), and 1326-27 (top executives).

<sup>89</sup> Timothy D. Naegele, *Wells Fargo: An American Banking Nightmare*, 136 BANKING L.J. 493, 504 (2019) [hereinafter Naegele, *Nightmare*].

foreign to the fierce and unapproachable sharks of Wall Street, whose “dumb mistakes” W.F. had historically always been able to avoid.<sup>90</sup>

The image of the trustworthy bank was strengthened during the 2008 financial crisis, where W.F. stood out as the least risk-prone of the protagonists of the crisis and was “not swimming naked” once the tide went out.<sup>91</sup> Coming out virtually unharmed by the financial crisis helped build the bank’s untouchable reputation. While most other *too-big-to-fail* banks were struggling to stay afloat,<sup>92</sup> in 2008 W.F. acquired Wachovia and became the third-largest bank in the country by assets.<sup>93</sup> The bank surfed a wave of corporate success roughly for the following eight years.<sup>94</sup> CEO John Stumpf was crowned *Banker of the Year* in 2013,<sup>95</sup> and two years later W.F. was named the 7<sup>th</sup> most respectable company on the *Barron’s* list.<sup>96</sup> Unlike many competitors, customers trusted it.

Its story from the outside is thus one of solid success. From the inside, the narrative changes dramatically. “Just thinking about it [the bank] gives me palpitations and a stomachache,” a former employee told the Los Angeles Times in the notorious article that first exposed the fraud.<sup>97</sup> And for good reasons.

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<sup>90</sup> *Id.*, at 505; see also Bethany Mclean, *How Wells Fargo’s Cutthroat Corporate Culture Allegedly Drove Bankers to Fraud*, VANITY FAIR (May 31, 2017), <https://www.vanityfair.com/news/2017/05/wells-fargo-corporate-culture-fraud> (noting that W.F. “positioned itself as the bank of the real economy”); see also Brian Tayan, *The Wells Fargo Cross Selling Scandal*, Stanford GSB Research Paper No. 17-1 (Jan. 8, 2019), at 1; see also Adam Lashinsky, *Riders on the Storm*, FORTUNE (May 4, 2009) (highlighting how Wells Fargo is known to avoid “the rest of the industry’s dumbest mistakes”).

<sup>91</sup> The analogy is borrowed from investor Warren Buffet, who uses the expression referring to how it is only during adverse conditions that one realizes the risks companies are taking; see also Tayan, *supra* note 90, at 1 (noting how the bank was uninjured by the crisis).

<sup>92</sup> The infamous Lehman Brothers collapse is dated 15 September 2008: see Andrew Rose Sorkin, *Lehman Files For Bankruptcy; Merrill is Sold*, N.Y. TIMES (Sept. 14, 2008), <https://www.nytimes.com/2008/09/15/business/15lehman.html>.

<sup>93</sup> See Tayan, *supra* note 90, at 1; see also Naegele, *Nightmare*, *supra* note 89, at 505. The company’s website gives further information on the acquisition at <https://www.wellsfargo.com/about/corporate/wachovia/>.

<sup>94</sup> See Tayan, *supra* note 90, at 1 (for a useful summary).

<sup>95</sup> Maria Aspan, *Wells Fargo’s John Stumpf, the 2013 Banker of the Year*, AMERICAN BANKER (Nov. 21, 2013), <https://www.americanbanker.com/news/wells-fargos-john-stumpf-the-2013-banker-of-the-year>.

<sup>96</sup> Vito J. Racanelli, *Apple Tops Barron’s List of Respected Companies*, BARRON’S (June 27, 2015), <https://www.barrons.com/articles/apple-tops-barrons-list-of-respected-companies-1435372737>.

<sup>97</sup> E. Scott Reckard, *Wells Fargo Pressure-Cooker Sales Culture Comes at a Cost*, L.A. TIMES (Dec. 21, 2013), <https://www.latimes.com/business/la-fi-wells-fargo-sale-pressure-20131222-story.html> (Rita Murillo’s testimony is part of the L.A. Times article which uncovered the fraud).

Former CEO Richard Kovacevich saw the bank as a store, clients as customers, and financial instruments as products to sell.<sup>98</sup> He strongly believed in the novel idea of banking as a sales business, rather than a financial one. The basic rules of sales, namely selling as many products as possible, made their way into W.F.’s banking rulebook and shaped the company’s culture.<sup>99</sup> When Stumpf replaced Kovacevich as CEO, the obsession with cross-selling financial products soared.<sup>100</sup> They both saw cross-selling as the most effective way to pursue revenue maximization, applying the infamous “Going for Gr-Eight” mantra.<sup>101</sup> That meant aiming for the unrealistic goal of selling at least eight financial products per household.

W.F. applied that mantra at all corporate levels, engineering a strict incentives system that rewarded bankers able to meet unreasonably steep sales goals and punished those who could not. The system was ruthless.

Basically, bankers who met the sales goals received a 15-20% increase in their salaries; bankers who did not would see the deficiencies added to the following day’s goal.<sup>102</sup> Failure to reach the targets was met with public humiliation, heavy criticism, and, in some cases, termination of employment. Bankers and tellers feared not being able to fulfill the sales system; if that happened, they would be “severely chastised and embarrassed” in front of colleagues and superiors.<sup>103</sup>

The whole system turned W.F. into a “pressure-cooker”.<sup>104</sup> Crushed by the necessity to sell multiple financial products to the same customers and pushed by the fear of being unsuccessful at doing so,<sup>105</sup> local bankers, managers, and employees were brought to misbehave. Cheating was the *only* way sales goals could be achieved. There was no legitimate, mathematically sound way of winning.<sup>106</sup>

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<sup>98</sup> See Mclean, *supra* note 90, at 3 (reporting how Kovacevich saw the bank’s financial instruments as products to sell).

<sup>99</sup> *Id.* (reporting what a Norwest executive said about this: “It was a religion. It very much was the culture.”).

<sup>100</sup> *Id.*

<sup>101</sup> See Reckard, *supra* note 97; see also Mclean, *supra* note 90 (underlining how it was Kovacevich who introduced the mantra).

<sup>102</sup> See Tayan, *supra* note 90, at 2.

<sup>103</sup> So confessed a Pacific Northwest branch manager: see Reckard, *supra* note 97 (“If you do not make your goal, you are severely chastised and embarrassed in front of 60-plus managers in your area by the community banking president”).

<sup>104</sup> See *id.* (for the use of the term “pressure-cooker”).

<sup>105</sup> See Mclean, *supra* note 90 (“the incentive to cheat is based on the fear of losing their job” – was written by an investigator in 2004).

<sup>106</sup> *Id.* (noting how an investigator who studied the company in 2004 wrote that “. . . team members feel like they cannot make sales goals without gaming the system;” an analysis done for a lawsuit confirmed that “without fraud, the math didn’t work.”).

The bank itself acknowledged the infeasibility of the system, famously referring to it as the 50/50 plan; only 50 percent of the branches were expected to succeed.<sup>107</sup> This translated to selling as many products as possible even without obtaining the clients' authorization. In some extreme cases, the manipulation entailed forged and falsified signatures, fake emails, fraudulent transactions, and more. In other words, it amounted to fraud.

W.F.'s decentralized corporate structure made it difficult for central management to oversee what was happening in local branches, so the fraud spread quickly and uncontrollably. The Consumer Financial Protection Bureau (C.F.P.B.) described it as "fraudulent conduct . . . on a massive scale."<sup>108</sup> The bank admitted to having opened 2 million accounts without authorization from clients and as many as 565,000 credit cards over a period of five years.<sup>109</sup> W.F. hence agreed to pay a \$185 million fine to the C.F.P.B. in September 2016.<sup>110</sup>

Many employees came forward publicly denouncing the bank and its "cutthroat" corporate culture. The company faced a backlash of lawsuits, executive compensation claw backs, and public hearings. Stumpf was questioned in a 4-hour-long Senate hearing in September 2016. Senator Elizabeth Warren harshly criticized the executive's and the company's behavior, stating how:

. . . you [Stumpf] squeezed your employees to the breaking point so they would cheat customers and you could drive up the value of your stock and put hundreds of millions of dollars in your own pocket. And when it all blew up, you kept your job, you kept your multimillion-dollar bonuses, and you went on television to blame thousands of \$12-an-hour employees who were just trying to meet cross-sell quotas that made you rich.<sup>111</sup>

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<sup>107</sup> See Tayan, *supra* note 90, at 4 ("In many instances, community bank leadership recognized that their plans were unattainable. They were commonly referred to as 50/50 plans, meaning that there was an expectation that only half the regions would be able to meet them.").

<sup>108</sup> See Mclean, *supra* note 90, at 5.

<sup>109</sup> See *id.*; see also Tayan, *supra* note 90, at 2.

<sup>110</sup> Some criticize the fine for being "a pittance" compared to the sheer size of the fraud, as it was less than their CEO's compensation and amounted to 3% of second-quarter profits: see Mclean, *supra* note 90, at 6.

<sup>111</sup> *An Examination of Wells Fargo's Unauthorized Accounts and the Regulatory Response: Hearing Before the S. Comm. on Banking, Hous., & Urb. Affs.*, 114th Cong. 510 (2016) (S. Hrg. 114-510) (statement of Elizabeth Warren, Member, S. Comm. on Banking, Hous., and Urb. Affs.).

What is relevant here is how sales incentives were geared in a way that resulted in delinquency, especially among the most local branches of the bank. The following paragraphs will focus on how and why that happened.

ii. How Did it Work?

The obsession with sales figures and the maximization of revenue were founding pillars of W.F.’s corporate culture.<sup>112</sup> As much as both Kovacevich and Stumpf liked to stress how keen the company was on its “vision and values,” the reality followed a different script.<sup>113</sup> “Our vision has nothing to do with transactions, pushing products, or getting bigger for the sake of bigness,” is what the bank told the public.<sup>114</sup> “A veritable litany of horrific experiences” is what employees recounted instead.<sup>115</sup> Selling more products and making more money was the true vision of the bank, which centered its governance on S.V.M. above all else. The sales system was just a way to maximize profits and shareholder returns.<sup>116</sup> In Kovacevich’s words, revenue growth is the metric for success.<sup>117</sup> If Enron publicly pursued the profit motive to an extreme extent, W.F. was more subtle, sweetening the reality of the bank’s purpose with a different narrative.<sup>118</sup> Still, its system incentivized delinquency.<sup>119</sup>

The company knew about the correlation between the brutal incentives system and malfeasance: in addition to the (ignored) complaints filed by employees regarding suspicious gaming practices to ensure high cross-selling figures,<sup>120</sup> a 2017 investigation report found that the head of strategic planning for W.F. knew that higher percentages of cheating were linked to

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<sup>112</sup> Kovacevich believed that revenue growth was a metric for success: see Mclean, *supra* note 90, at 12.

<sup>113</sup> See Tayan, *supra* note 90, at 13 (highlighting the conflict between the bank’s “Vision & Values” and its emphasis on sales goals).

<sup>114</sup> John G. Stumpf, *The Vision and Values of Wells Fargo* (2012), at 4, <https://www.slideshare.net/slideshow/wf-vision-and-values-2012-14755931/14755931> (leaflet distributed by Stumpf to all employees) [hereinafter *Vision and Values*].

<sup>115</sup> Mclean, *supra* note 90, at 11.

<sup>116</sup> As of March 2016, the bank had the highest shareholder returns in the banking sector over a period of 3, 5, and 10 years: see Tayan, *supra* note 90, at 9 Exhibit 1.

<sup>117</sup> Mclean, *supra* note 91, at 12.

<sup>118</sup> *Id.* (for the *real* focus on revenue growth); see also *Vision and Values*, *supra* note 114 (for the *sweetened* version).

<sup>119</sup> See, e.g., Andris A. Zoltners, Prabhakant Sinha & Sally E. Lorimer, *Wells Fargo and the Slippery Slope of Sales Incentives*, HARV. BUS. REV. (Sept. 20, 2016), at 1, <https://hbr.org/2016/09/wells-fargo-and-the-slippery-slope-of-sales-incentives> (linking the fraud to the bankers’ pressure to “. . . meet sales quotas and earn incentives”) [hereinafter *Slippery Slope*].

<sup>120</sup> One example is Yesenia Guitron, who was fired after signaling cheating concerns to the company well before the scandal broke out: see Mclean, *supra* note 91, at 7 and following.

high goals in the incentives system.<sup>121</sup> The commitment to revenue growth was so strong that the bank kept the system alive even after its criminogenic effects were unveiled.<sup>122</sup>

The impact of the sales system helped create a culture of acceptance towards cheating – either you bought into that game or you were out.<sup>123</sup> Receiving social acceptance for a certain behavior reinforces its legitimacy, regardless of how morally bankrupt it may be.<sup>124</sup> In W.F., such acceptance helped delinquency quickly spread among employees.<sup>125</sup>

The effect was not the same on *everyone*, however. Through the trichotomy of gray, white, and black hats, the next paragraph will analyze how the system produced different results depending on the type of corporate official.

### iii. Did Everyone React the Same Way? (They Did Not)

Three are the key features of W.F.'s incentives system that contributed to pushing employees to misbehavior: (i) high rewards from *winning*, (ii)

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<sup>121</sup> Excerpts of the report are cited in Tayan, *supra* note 90, at 4 (“low goals cause lower performance and high goals increase the percentage of cheating”); although the full report has been deleted from the bank’s website, further information can be found at Independent Director of the Board of Wells Fargo & Company: *Sales Practices Investigation Report*, (April 10, 2017), at <https://newsroom.wf.com/English/news-releases/news-release-details/2017/Wells-Fargo-Board-Releases-Findings-of-Independent-Investigation-of-Retail-Banking-Sales-Practices-and-Related-Matters/default.aspx> [hereinafter *Investigation Report*].

<sup>122</sup> In 2013, Gary Kishner, a Wells Fargo spokesman, said that “. . . our team members have goals. And sometimes they can be blinded by a goal” see E. Scott Reckard, *Wells Fargo Fires Workers Accused of Cheating on Sales Goals*, Los Angeles Times (Oct. 3, 2013), at 2, <https://www.latimes.com/business/la-xpm-2013-oct-03-la-fi-mo-wells-fargo-workers-fired-20131003-story.html>; see also *Investigation Report*, *supra* note 121, as cited in Tayan, *supra* note 90, at 16 (sales practices abuses were minimized even if labeled as “high-risk” because they were thought to have no “costumer harm”; the report also noted that management failed to see the link between sales goals and bad behavior even if it was shown by the data: “. . . as sales goals became more difficult to achieve, the rate of misconduct rose.” *Id.*, at 4).

<sup>123</sup> See, e.g., Mclean, *supra* note 91, at 11 (“An entire generation of managers thrived in the culture, got rewarded for it, and are now in positions of power”); see also *Hyper-Competition*, *supra* note 86, at 971 (the author links the implementation of an internal rewards system to the culture of the corporation: “. . . these cultures are often the reflection of the internal rewards system over time”); see also *infra*, §iii.

<sup>124</sup> See, e.g., John M. Darley, *How Organizations Socialize Individuals into Evildoing*, in *CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS* 13 (David M. Messick & Ann E. Tenbrunsel eds., 1996) (for an account of how evildoing in corporate settings is mainly influenced by a type of organizational pathology rather than individual psychology) [hereinafter *Evildoing*].

<sup>125</sup> See Naegele, *Nightmare*, *supra* note 89, at 13 (noting how W.F. had a culture of “greed, misconduct, and criminality”, that “. . . permeated Wells, infected its activities and global reputation”).

humiliation and punishment from *losing*, and (iii) the fact that the metric of the system was solely based on sales numbers and not on *how* the numbers were reached. The combination of these elements with the cultural acceptance and pressure to do whatever it takes to meet the goals produced the scandal.<sup>126</sup> Employees wanted to earn bonuses, feared termination and humiliation, and were evaluated only on results rather than behavior. Cheating was also not perceived as morally deplorable.<sup>127</sup>

Some of W.F.’s protagonists created the criminogenic system, and it is reasonable to say that they would have done the same in any scenario. They are the black hats.

It is debatable whether Kovacevich falls within this category – on one side, he was convinced of his idea of the bank as a sales firm and pushed strongly for the incentives system; on the other, it would be a stretch to define him as having a criminal mind. Overall, it is more reasonable to define the evolution of the company’s sales policy from Kovacevich to Stumpf as a mixture between a black hat and a gray hat.

Most employees and bankers at W.F. are not exactly criminal minds – still, they cannot be described as inherently good managers. They are individuals who would not have resorted to delinquency themselves but who were pushed towards it. They are the ones that “. . . thrived in the culture, got rewarded for it, and are now in positions of power.”<sup>128</sup> They did receive the external push to engage in malfeasance, but they also benefited from and thrived in it. Their choice of cheating because of the “pressure-cooker” still retained a degree of free will and was not coerced. This paper would define them as *dark-gray hats*.

The situation is different for those employees who did cheat but were virtually forced to do so. Fear of losing their home and situations of extreme economic disadvantage pushed them to buy into the game. Former employee Ken Mac puts it clearly: “I felt sick in my stomach . . . but it was a tough economy, and I was worried, if I lost this job, I would be in a tough financial situation.”<sup>129</sup> These officials are harder to reproach. They misbehaved out of necessity, regretted it, and did not benefit from it.

Other employees seemed somewhat intrinsically good. Former employee Yesenia Guitron is an example. Although she needed the job at W.F., she was shocked by the culture of greed and criminality that pervaded the firm.

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<sup>126</sup> See, e.g., *Slippery Slope*, *supra* note 119, at 2 (explaining how sales goals can push employees to do *whatever it takes* to meet them).

<sup>127</sup> See, e.g., Naegele, *Nightmare*, *supra* note 89, at 13 (reflecting on Wells Fargo’s culture of criminality).

<sup>128</sup> *Id.* at 11.

<sup>129</sup> *Id.* at 10.

Having seen the scale of the fraud, she tried to signal it to higher executives but was repeatedly ignored – first – and fired – later.<sup>130</sup> She stated how everyone in the firm knew of the fraud but was locked in because they needed the job, and so did she, but “. . . she knew right from wrong.”<sup>131</sup> Rejecting buying into the system at all costs, while trying to make things good by signaling misbehavior to top management, can put Guitron in the category of white hats.

### C. Conclusions

The previous section showed examples where the utmost pursuit of profits was linked to incentivized delinquency. It also showed how, in both cases, the response of individuals to the pressures of S.V.M. can change depending on what type of individual one is – from the sense of justice held by white hats to the criminal minds of black hats. Enron and W.F. are not the same, however. By oversimplifying two very complex corporate scandals, two main differences can be highlighted:

(i). Enron very publicly pursued S.V.M. and embodied the contractarian idea of the firm. Its competitive environment was specifically designed to have high-performing employees pursue maximum profits. The reward system was the chosen way to achieve that aim.

W.F., on the other hand, was more subtle. Keen on keeping the image of a reliable community bank, it did not push too hard on the *profit at all costs* narrative.<sup>132</sup> Care for employees, clients, and an ethical workplace were among its recurring themes.<sup>133</sup>

(ii). In terms of the criminogenic influence of S.V.M., it can be said that Enron is an example of how the entire *organization* can become a lawbreaking machine, with a hustling corporate culture and a collective obsession with doing whatever possible to increase share price. The whole company was vested in S.V.M. as an *entity*. Such a collective diffusion helped create organizational rationalizations for misbehavior and prevented employees from coming forward earlier.

W.F., on the other hand, is an example of how the *individual* can be pushed to misbehave under extreme pressure. The bank could not be said to be collectively vested in lawbreaking – for instance, it had what was considered an efficient compliance system and ethical-violations report

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<sup>130</sup> She was fired for failing to meet the sales goals after she had complained about the gaming system: Mclean, *supra* note 90, at 8.

<sup>131</sup> *Id.*

<sup>132</sup> See *Investigation Report*, *supra* note 121, as cited in Tayan, *supra* note 90, at 13 (“There was a growing conflict over time in the Community Bank between Wells Fargo’s Vision & Values and the Community Bank’s emphasis on sales goals”).

<sup>133</sup> See *Vision and Values*, *supra* note 114.

system. However, the way the incentives system was geared inevitably brought many to violate the law.

Having looked at two examples of profit-driven misconduct, the article now turns to a more detailed analysis of the trichotomy of white, gray, and black hats. As a way to categorize types of *misbehavior*, the analysis will be preceded by reflections on misconduct in general. The study of the role that the profit motive specifically plays in this framework will follow. References to the cases of Enron and W.F. will appear throughout the whole piece.

## II. AN ANATOMY OF MISBEHAVIOR IN CORPORATE ORGANIZATIONS

### A. Introduction. Law, Economics and Criminals

The issue criminologists and scholars have been dissecting for years is why, oh why, do people commit crimes?<sup>134</sup> The question to ask here is – more specifically – why they do so in a corporate setting. Some would define such deviance as white-collar crime.<sup>135</sup> Digging deeper into that question requires sharp tools. The one that best fits the current analysis is the law and economics of crime, as this section will explain.

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<sup>134</sup> Many are the theories that try to explain *why* people commit crimes; landmark works on criminology and the causes of crime include CESARE BECCARIA, ON CRIME AND PUNISHMENTS (1764) (dealing more closely with the issue of just punishment); CESARE LOMBROSO, THE CRIMINAL MAN (1876) (setting the basis for the Positivist School and arguing that criminals are psychobiologically different from non-criminals); FRANCESCO CARRARA, PROGRAMMA DEL CORSO DI DIRITTO CRIMINALE, PARTE GENERALE (1867); ENRICO FERRI, SOCIALISM AND POSITIVE SCIENCE (1894); *see also* the work of TRAVIS HIRSCHI, CAUSES OF DELINQUENCY (1969) (explaining his “control theory” of delinquency); for an extensive overview on different theories of crime, *see* RONALD L. AKERS & CHRISTINE S. SELLERS, CRIMINOLOGICAL THEORIES: INTRODUCTION, EVALUATION, AND APPLICATION (8<sup>th</sup> ed. 2020)

<sup>135</sup> Although it is still a contested definition: *see* Edwin Sutherland, *White Collar Criminality*, AM. SOCIOLOGICAL REV. 138-39 (1940) (describing the white-collar criminal as a respectable, upper class, well-educated individual); *see also* DAVID O. FRIEDRICH, TRUSTED CRIMINALS: WHITE COLLAR CRIME IN CONTEMPORARY SOCIETY 1-12 (2010) (explaining Sutherland’s definition of WC crime and analyzing the WC criminal) [hereinafter TRUSTED CRIMINALS]. *See also id.* at 13-16; *see also* Stuart Green, *The Concept of White-Collar Crime in Law and Legal Theory*, 8 BUFF. CRIM. L. R. 101, 102 (referring to the meaning of white-collar crime as being “deeply contested”) (2004); *see also* Michael L. Benson et al., *Core Themes in the Study of White Collar Crime*, in SHANNA R. VAN SLYKE (ED.), OXFORD HANDBOOK OF WHITE COLLAR CRIME, at 1-22 (OUP 2016) (summarizing different approaches to defining white-collar crime) [hereinafter *Core Themes*].

From the works of Beccaria<sup>136</sup> and Bentham,<sup>137</sup> followed by Becker<sup>138</sup> in more recent times, scholars have long proposed looking at criminal law and misbehavior through the lenses of costs and benefits.<sup>139</sup> Simply put, the assumption backing this approach – the rational-choice theory – is that the rational offender *ticks* when the expected costs of obeying the law are higher than its expected benefits. This means that the expected benefits of violating the law are higher than its expected costs. Deterrence, therefore, is obtained by increasing the cost of misbehavior – that is, by making misbehavior less desirable for the offender in economic terms. Or, at least, by making it less desirable *than obedience*. The idea of rational offenders being influenced by cost/benefit calculations is famously found in Oliver Wendell Holmes’s *The Path of the Law*.<sup>140</sup> Holmes argues how even a *bad man* is influenced by the expected punishment for his foul actions, albeit caring “nothing for an ethical rule”:<sup>141</sup>

[Y]ou can see very plainly that a bad man has as much reason as a good one for wishing to avoid an encounter with the public force . . . A man who cares nothing for an ethical rule which is believed and practiced by his neighbors is likely nevertheless to care a good deal to avoid being made to pay money, and will want to keep out of jail if he can.<sup>142</sup>

Holmes effectively summarizes the economic approach to criminal law. He acknowledges that some men are not easily persuaded by *moral* norms, but will consider the expected fines and punishments issued in case of

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<sup>136</sup> BECCARIA, ON CRIMES AND PUNISHMENTS, *supra* note 134.

<sup>137</sup> See JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION, in 1 Works of Jeremy Bentham 1, 86-91 (J. Bowring ed. 1843); JEREMY BENTHAM, PRINCIPLES OF PENAL LAW, in 1 Works of Jeremy Bentham, at 365.

<sup>138</sup> See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POLIT. ECON. 169 (1968) (for a landmark work on the law and economics of crime) [hereinafter *Crime and Punishment*].

<sup>139</sup> See RICHARD POSNER, THE ECONOMIC ANALYSIS OF LAW (4th ed. 1992) for a landmark work on the law and economics cost/benefit approach on the law [hereinafter ECONOMIC ANALYSIS]; see also Richard Posner, *An Economic Theory of the Criminal Law.*, 85 COLUM. L. REV. 1193 (1985) [hereinafter *An Economic Theory*]; see also Thomas S. Ulen, *Firmly Grounded: Economics in the Future of Law*, 1997 WIS. L. REV. 433, 434 (1997) (underlining the relevance of law & economics in the development of the law, but proposing amendments) [hereinafter *Firmly Grounded*].

<sup>140</sup> See Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897) [hereinafter, *The Path*].

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

lawbreaking.<sup>143</sup> That explains the relevance of designing an incentive-based response to misbehavior, tailored on the three types of individuals that populate corporations.

The idea of adopting a cost/benefit approach to crime spurred active scholarly debates.<sup>144</sup> Recalling the rational-choice theory, Professor Thomas S. Ulen qualifies criminals as utility-maximizing individuals capable of performing cost-benefit analyses of legal and illegal actions.<sup>145</sup> They compute expected benefits and expected costs.<sup>146</sup> If the result favors misbehavior, “the rationally self-interested criminal commits the crime . . . and refrains if the reverse is true”.<sup>147</sup> In the words of Professor Jerry L. Mashaw, the rational-choice theory thus assumes “. . . that people behave as if they were purely rational calculators of their own gains and losses from alternative courses of action”.<sup>148</sup>

Former Judge and law Professor Richard Posner is among the first and most active scholarly supporters of the rational-choice theory,<sup>149</sup> which he has reiterated in several cases. For instance, in *Luddington v. Indiana Bell Tel. Co.*, Posner focused on the severity of the sanction, holding that “The amount of care that individuals and firms take to avoid subjecting themselves to liability whether civil or criminal is a function of the severity of the sanction”.<sup>150</sup>

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<sup>143</sup> See *id.*; see also Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C.L.REV. 1265, 1323, n.223 (1998) (quoting Holmes) [hereinafter, *Corporate Compliance*].

<sup>144</sup> See, e.g., *An Economic Theory*, *supra* note 139 (author quests for establishing an economic analysis of the substantive doctrines of the criminal law); see also Keith N. Hylton, *Optimal Law Enforcement and Victim Precaution*, 27 RAND J. ECON. 197, 197–205 (1996) (adopting a law and economics approach to design an efficient punishment policy for deterrence purposes); see also A. Mitchell Polinsky & Steven Shavell, *The Optimal Tradeoff between the Probability and Magnitude of Fines*, 69 AM. ECON. REV. 880, 880–91 (1979) (studying the necessary balance between sanctions and their social costs to achieve deterrence).

<sup>145</sup> See *Firmly Grounded*, *supra* note 139, at 441 (the Author then calls for an emendation of the rational-choice theory).

<sup>146</sup> *Id.* at 442.

<sup>147</sup> *Id.*; see also *Crime and Punishment*, *supra* note 138.

<sup>148</sup> See JERRY L. MASHAW, *GREED, CHAOS AND GOVERNANCE*, 3 (1997), as cited in *Corporate Compliance*, *supra* note 143, at 1286, n. 73.

<sup>149</sup> See, e.g., *ECONOMIC ANALYSIS*, *supra* note 139; see also *An Economic Theory*, *supra* note 139.

<sup>150</sup> *Luddington v. Indiana Bell Tel. Co.*, 966 F.2d 225, 229 (7th Cir. 1992); see also *Economic Analysis*, *supra* note 139, at 5 (“An increase in either the severity of the punishment or the likelihood of its being imposed will raise the price of crime and therefore reduce its incidence.”).

One area of the law where the rational-choice theory is now commonly accepted and uncontroversial is contract law.<sup>151</sup> On the efficient breach of contract, in *Patton v. Mid-Continent Sys., Inc.*, Judge Posner argued that “Even if the breach is deliberate, it is not necessarily blameworthy. The promisor may simply have discovered that his performance is worth more to someone else. If so, efficiency is promoted by allowing him to break his promise, provided he makes good the promisee’s actual losses.”<sup>152</sup>

Thus, from contract law the idea developed that a violation (breach) is not bad in and of itself; it can be acceptable and warranted if it is efficient. Legal limits and prohibitions can thus be seen as something that can be overcome in the face of efficiency and, ultimately, profits.

Corporate lawbreaking then proves a good ground for the scholarly development of such an approach.<sup>153</sup> The corporate setting makes it easier to evaluate the profitability of one’s behavior: increased stock prices, increased sales, higher revenues, etc. – many are the ways corporate behaviors can be profitable. This also makes it easier for individuals to predict the expected benefits of their conduct. If tweaking financial statements causes stocks to go up, managers are paid more. If they are paid more, the benefits of misbehaving increase visibly. The representation of the expected costs and benefits of offending is evident.

Such a clear evaluation of profitability has brought scholars to push the boundaries of this theory even more. The pursuit of profits above all else – embodied in S.V.M. – brought some to argue that in some cases profits can even come to justify lawbreaking.<sup>154</sup> According to some scholars – namely,

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<sup>151</sup> See, e.g., *Corporate Compliance*, *supra* note 143, at 1267 n. 3.

<sup>152</sup> *Patton v. Mid-Continent Sys., Inc.*, 841 F.2d 742, 750 (7th Cir. 1988) (Posner, J.).

<sup>153</sup> See, e.g., Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, in RES. HANDBK. ECON. CRIM. L. 144 (Alon Harel & Keith N. Hylton eds., 2012) [hereinafter *Corporate Criminal Liability*] (for an application of the law and economics approach to the corporate setting); see also Dorothy S. Lund & Natasha Sarin, *Corporate Crime and Punishment: An Empirical Study*, 100 TEX. L. REV. 285, 286-9 (2021) (for an empirical study of corporate crime through law and economics lenses).

<sup>154</sup> See Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 MICH. L. REV. 1155, 1168 n.36 (1982) [hereinafter *Antitrust Suits*] (famously justifying profitable misbehavior); see also *id.*, at 1177 n.57; see also Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1271 (1982) [hereinafter *Corporate Governance Movement*] (when writing about the advantages of non-compliance, Fischel underlines that “Because the gains from the breach or violation presumably exceed the social costs . . . , compliance with the statute or contract is undesirable from a personal as well as social perspective”); see also FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW*, 38 (1991).

Frank H. Easterbrook & Daniel R. Fischel<sup>155</sup> – when *disobedience is profitable*, it should be justified. In a hypothetical hierarchy of values, this so-called *law-as-price theory* would put efficiency and profitability above obedience to the law.<sup>156</sup>

A W.F. employee breaking the law for the sake of a higher salary, or an Enron official cooking the books for a higher stock price, would thus become harder to condemn under the law-as-price theory. They did *disobey the law*, but they did so *profitably*.

It is clear then how profit-driven misbehavior has even come to receive scholarly support. What is missing from the puzzle is the distinction between how different corporate actors behave under the influences of the quest for profit-maximization: do they react to incentives in the same way? Would every corporate official rationally offend? As has become evident more than once, the answer is no.

This paper contends that corporate officials can be divided in the trichotomy of black hats, gray hats and white hats, depending on their tendency to offend.

One of the characterizing features of each category is what behavioral economists call “protected values” (hereinafter “PV” or “PVs”).<sup>157</sup> These are values that people uphold regardless of their economic costs or benefits – if someone holds truthfulness as a PV, they will tell the truth even if lying carries more benefits.<sup>158</sup> This is because the potential rewards of lying are less appealing if obtained through a violation of one’s PVs.<sup>159</sup> This means that people who hold honesty, justice, truthfulness as PVs, will be less likely to misbehave regardless of the potential benefits and incentives to do so. People who have low to zero PVs will not be inhibited from engaging in misconduct if economically beneficial.<sup>160</sup>

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<sup>155</sup> See *supra* note 155.

<sup>156</sup> *Corporate Compliance*, *supra* note 143, at 1285-95 (defining this approach as “law-as-price” theory).

<sup>157</sup> See Gibson et al., *Preferences for Truthfulness: Heterogeneity Among and Within Individuals*, 103 AM. ECON. REV. 532, 538 [hereinafter *Preferences for Truthfulness*] (considering protected values as a way to measure how people are committed to truthfulness, being honest, over lying, being dishonest).

<sup>158</sup> *Id.* (considering the PV of truthfulness as an intrinsic cost of lying – meaning that lying entails the violation of the agent’s PV and is thus more costly).

<sup>159</sup> *Id.*, at 545 (noting that “. . . protected values are non-consequentialist and induce a resistance to engaging in actions that would violate moral values, reducing the attractiveness of any financial gains obtained through such actions,” and that people with high PVs are trade-off resistant).

<sup>160</sup> Current auditing standards reflect and support such categorization: see CODIFICATION OF ACCT. STANDARDS & PROC., *Clarified Statements on Auditing Standards*, AU-C §240.A1

As every categorization, this trichotomy will generalize a terribly complex matter and oversimplify the understanding of human behavior. Finally, it will have blurry and flexible borders, rather than clear-cut lines – that is how human behavior is.<sup>161</sup>

It will, however, help build the tools necessary to study the effects of the profit motive on corporate misconduct. The three categories of officials will also make it easier to design the response to violations. The fierce criminal fraud scheme of a repeat white-collar criminal should trigger different consequences than the opening of a fake bank account by a pressured local banker in financial distress.

This three-part framework is even more relevant considering the DOJ's significant revisitation of its approach to white-collar crime.<sup>162</sup> The Department is in fact focusing greatly on compliance, prevention, and cooperation from the misbehaving firm.<sup>163</sup> Acknowledging the existence and studying the behavior of the different “hats” is, therefore, the first great step towards enacting a truly efficient incentive-based approach to white-collar crime.

### B. *The Actors. Shades of Black, White, and Gray*

*“ . . . But if men are not devils, neither are they angels; and the fact that they are a mean between these two extremes is something which makes a system of mutual forbearances both necessary and possible.”*  
- H.L.A. Hart<sup>164</sup>

What does it mean exactly to say that there are different kinds of offenders and different levels of misconduct?

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(AM. INST. OF CERTIFIED PUB. ACCTS. 2020); INT'L AUDITING & ASSURANCE STANDARDS BD., INTERNATIONAL STANDARD ON AUDITING 240: THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS ¶ A1 (2009), as cited in *Tax Evasion*, *supra* note 14, at 1174:

“[I]ndividuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character, or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.”

<sup>161</sup> See, e.g., Todd Haugh, *The Power Few of Corporate Compliance*, 53 GA. L. REV. 127, 157-63 (2018) [hereinafter *The Power Few*] (arguing how corporate misconduct can be unpredictable).

<sup>162</sup> See *supra* note 11.

<sup>163</sup> *Id.*; see also *supra* INTRODUCTION.

<sup>164</sup> CONCEPT OF LAW, *supra* note 8, at 196.

The underlying premise is that in most cases it is difficult to assess whether a corporate official has been *good or bad*, legally speaking.<sup>165</sup> Not all of them are inherently good or bad.<sup>166</sup> The categories of corporate actors used here are the *black hats*, the *white hats*, and the *gray hats*. The likelihood of wrongdoing from white hats towards black hats goes from virtually impossible to virtually certain.

The present analysis will go through them individually.<sup>167</sup> This will serve as a theoretical basis to dissect the effects of the profit motive on misconduct and to design the possible solutions that could prevent it.

As for the PV scale, the *hats* can be located from a lowest of 0 (no PVs) to a highest of 6 (highest PVs).<sup>168</sup> This means that black hats will misbehave with no concern for the violation of those values; white hats are trade-off resistant, meaning that they will not misbehave regardless of its benefits, if misbehavior entails violating their PVs. Gray hats occupy the biggest size of the spectrum, and their score sits in between that of white and black hats.

As the paper will demonstrate, the trichotomy is relevant in corporate governance and compliance design because it makes it a priority to design systems which have as objectives: (i) to keep black hats out of the corporation, and if they are in the corporation, to find them and exclude them;<sup>169</sup> (ii) to positively influence gray hats in such a way that draws them towards white hats and does not incentivize their malfeasance,<sup>170</sup> (iii) to retain white hats and attract them into the corporation, valuing positive behavior and ensuring a morally sound work environment.

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<sup>165</sup> A similar argument was made in *Moral Ambiguity*, *supra* note 57, at 502.

<sup>166</sup> See CONCEPT OF LAW, *supra* note 8 (arguing that a legal system would not be needed if men were *all angels* or *all devils*); see also Nina Mazar et al., *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MKT. RES. 633 (2008) (using six experiments to explain the theory of self-concept maintenance as a framework to inquire *why honest people can be dishonest*) [hereinafter *Dishonesty of Honest People*].

<sup>167</sup> See TRUSTED CRIMINALS, *supra* note 135, at 222-25 (for an overview of the psychological explanations of the causes of white-collar crime).

<sup>168</sup> The scale was developed by Carmen Tanner et al., *Geschützte Werte Skala: Konstruktion und erste Validierung eines Messinstrumentes (Protected Values Measure: Construction and First Validation of an Instrument to Assess Protected Values)*, 55 DIAGNOSTICA 174, 174–83. (2009) [hereinafter *Protected Value Measure*].

<sup>169</sup> For the effects that *unethical* individuals can have in a corporation, see, e.g., *The Power Few*, *supra* note 162, at 178-79 (analyzing how the effects of unethical “power few” in corporate settings can spread out within the company and increase the risk of compliance failures); for the effects that *unethical* organizations can have on individuals, see, e.g., *Evildoing*, *supra* note 124.

<sup>170</sup> An incentives system, such as the one W.F. had, is undesirable as it pushes gray hats to misbehave. See *supra* Part I, B. WELLS FARGO.

The methods implied to enforce such objectives will be explained in Part III and will tackle first the individual, then the organization and lastly the market.

It is to be specified that black and white hats represent some sort of ideal extremes, which have the function of clarifying the extent of the *misbehavior spectrum* for corporate officials. Like the *homo economicus* for economists, they represent more of an abstract idea rather than a common sight in corporate settings. The spectrum, however, does exist: if it may be hard to find a pure black hat (with a PV score of 0), or a pure white hat (PV score of 6), it will be much easier to find different shades of that. Some individuals will be more likely to lean towards a *dark-gray* shade, others will fall in the *light-gray* area of the scale. Understanding and locating the two extremes on the scale is paramount to study what would be seen in most corporations – the *gray middle ground*.<sup>171</sup>

To that regard, H.L.A. Hart would even argue that if people were all devils (or all angels) there would be no need for a legal system:

. . . [B]ut if men are not devils, neither are they angels; and the fact that they are a mean between these two extremes is something which makes a system of mutual forbearances both necessary and possible. With angels, never tempted to harm others, rules requiring forbearances would not be necessary. With devils prepared to destroy, reckless of the cost to them selves, they would be impossible. As things are, human altruism is limited in range and intermittent, and the tendencies to aggression are frequent enough to be fatal to social life if not controlled.<sup>172</sup>

Black hats: probably not as cursed as Cesare Lombroso's criminal men,<sup>173</sup> black hats can be described as those who, in a corporate setting, are

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<sup>171</sup> See *Preferences for Truthfulness*, *supra* note 157, at 546-47 (for an empirical study on people's preference to lie or to tell the truth, when lying is associated with monetary rewards and there is no incentive to tell the truth. It concludes that the preference to be truthful is distributed heterogeneously and is not divided only in *ethical* and *economic* types. The *gray middle ground* represents the heterogeneous spectrum of truthfulness); see also CONCEPT OF LAW, *supra* note 8, at 196.

<sup>172</sup> CONCEPT OF LAW, *supra* note 8, at 196.

<sup>173</sup> See Lombroso, *supra* note 134; see also Paolo Mazzarello, *Cesare Lombroso: An Anthropologist Between Evolution and Degeneration*, 26 FUNCT. NEUROL. 97, 97 (2011) (summarizing Lombroso's theory: offenders – "criminal men" – were considered *psychobiologically different* from non-offenders and affected by a condition referred to as

most likely to misbehave. Although they have nothing to do with Lombroso’s atavistic *degeneration*,<sup>174</sup> black hats see misconduct as the only way to reach their aims in corporate settings.<sup>175</sup> They are not necessarily prone to be influenced by external incentives, as they would offend anyways. If they do not have the opportunity to offend, they will *create it*. If there *is* the opportunity to offend, they will make the most of it. They probably do not need to rationalize their criminal conduct, as to them it appears rational enough already. Andy Fastow, Enron’s former CFO, said it openly: he was the Chief Loophole Officer, he took advantage of his privileged position within the firm and used it to offend.<sup>176</sup>

Ready to do whatever it takes to reach their objective and increase their personal gain, they are not particularly vested in the lawful management of the firm. In corporations, black hats are not sensitive to compliance programs, vision, values, and positive incentives. It all is trumped under a high tendency to cheat.

Ultimately, black hats would score a 0 in the scale of PVs.<sup>177</sup> Misbehavior does not carry the intrinsic costs of violating PVs, thus it is easily engaged in. Enron’s Andy Fastow did not find cheating particularly *costly* in terms of PVs: he did not appear to be in any way troubled by the misdeeds he was furthering.<sup>178</sup> Rather, he appeared proud of them.<sup>179</sup>

The likelihood of violations with individuals such as Bernie Madoff, Andy Fastow, and Jeff Skilling is already high – untouched by the efforts, time and money used to prevent them.<sup>180</sup>

The relevance of black hats for the sake of corporate compliance is designing a preventive solution that can identify and expel them from the corporate structure. Potentially, also of detecting them before they get hired.<sup>181</sup>

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“degeneration”); for a summary on the topic, see TRUSTED CRIMINALS, *supra* note 135, at 221-22 (dissecting the “biogenetic” causes of white-collar crime).

<sup>174</sup> See Mazzarello, *Cesare Lombroso*, *supra* note 173, at 97-99 (for the idea of “degeneration” in Lombroso’s criminology).

<sup>175</sup> The definition was also inspired by *Tax Compliance*, *supra* note 8, at 1795 (describing them as “deviant”).

<sup>176</sup> As he said in an interview. See BAD BETS, *supra* note 70.

<sup>177</sup> See *Protected Values Measure*, *supra* note 168, at 174-83.

<sup>178</sup> See BAD BETS, *supra* note 70.

<sup>179</sup> *Id.*

<sup>180</sup> Fastow and Skilling have been described *supra* Part I.A. ENRON. For Madoff, see DIANA B. HENRIQUES, *THE WIZARD OF LIES: BERNIE MADOFF AND THE DEATH OF TRUST* (2017) (providing an account of the scandal and of Madoff’s personality as *criminal*).

<sup>181</sup> See *The Power Few*, *supra* note 162, at 187-191 (proposing to focus compliance efforts also in identifying the “power few” during the hiring process).

White hats: at the opposite side of the spectrum sit the white hats. They have no interest in misbehavior, find no appeal in cheating, and see their objectives to be perfectly attainable through legal ways. They are what Professor Hart would define as “angels”. For a white hat, if the objective is unattainable with legal means, it is the objective that must change and not the means used to pursue it. The means and methods used by white hats are only legal – regardless of the pressure the corporate setting puts on them.

For white hats, the likelihood of violations is virtually zero. They score the highest on the PV scale.<sup>182</sup> For them, the violation of their PVs works as an insurmountable barrier to misbehavior – regardless of the potential benefits of committing violations, white hats will *always* be trade-off resistant and uphold their values instead.<sup>183</sup>

Yesenia Guitron knew what was going on at W.F.<sup>184</sup> She was in financial distress and she needed that job.<sup>185</sup> However, she also “. . . knew right from wrong”, and decided not to buy into the widespread cheating of the bank, signaling misconduct to top management and losing her job as a result.<sup>186</sup> She can be considered as a white hat, scoring high on the PV scale. Even with an opportunity to offend, white hats do not see wrongdoing as an acceptable conduct, ever.<sup>187</sup> Ms. Guitron would rather risk losing the job she desperately needed than resort to delinquency to meet sales goals and keep it – her PVs were thus *sacred* and insurmountable.<sup>188</sup>

Enron’s whistleblower Sherron Watkins can also be seen as an example of a white hat, or at least a light-gray one. She did witness suspicious accounting procedures, and she addressed them to top management.<sup>189</sup> She did fear retaliation from the firm, but proceeded anyway.<sup>190</sup>

As seen *supra*, even Watkins was somewhat an “atypical” white hat.<sup>191</sup> One should thus not make the mistake of believing that *pure* white and *pure*

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<sup>182</sup> *Protected Values Measure, supra* note 168, at 174-83.

<sup>183</sup> *See Preferences for Truthfulness, supra* note 157, at 545 (describing people with strong PVs as “trade-off resistant”: they will not trump over their values even if cost-efficient).

<sup>184</sup> Mclean, *supra* note 90, at 8.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> *Id.*

<sup>188</sup> *Id.*

<sup>189</sup> *See supra* Part I.A.; *see also Enron Whistleblower, supra* note 76; *Corporate Whistleblowers, supra* note 73, at 877 (showing that Watkins became aware of Enron’s accounting improprieties when she was working there from June to August 2001).

<sup>190</sup> *Id.*

<sup>191</sup> *See supra* Part I.A.

black hats are a common sight in modern corporations. They are the extremes of a spectrum that is blurred.

The relevance for the present paper of a white hat – and for a corporation in general – is to design and implement ways that *attract* them and *retain* them if they are already within the firm. The profit motive – and all that it entails – can put pressure on a white hat but cannot push them to commit violations.

Gray hats: most corporate officials would fall in the middle of the two extremes.<sup>192</sup>

Depending on the external inputs the individual is subject to, there will be different levels of delinquency or obedience to the law. In some cases, a situation of great financial hardship will push some gray hats to the realm of delinquency. This could happen, for example, if their conviction of being able to reach their objectives only by cheating is strong and if they are able to effectively rationalize their conduct (that is, convincing themselves that they are doing nothing *wrong*).<sup>193</sup> In these cases, cost-effective misbehavior is favored over the upholding of their PVs.<sup>194</sup>

Gray hats are located in the middle chunk of the PV spectrum<sup>195</sup> – depending on the individual and the circumstances, they can be more or less able to accept the violation of their PVs and misbehave to reach their goals, if choosing misbehavior over obedience is economically convenient.

An example could be a lower-level W.F. employee who resorted to delinquency to meet sales goals. As seen *supra*,<sup>196</sup> some of them opened fake bank accounts under the pressure of the sales incentives system, but also bought into the bank’s culture and thrived in it.<sup>197</sup> Others resorted to cheating

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<sup>192</sup> See TRUSTED CRIMINALS, *supra* note 135, at 223 (noting that most white-collar offenders appear to fall within the range of normal personality types); see also Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 959 (2003) (“Compared to other forms of criminal activity, white collar crime is famously written in shades of gray.”).

<sup>193</sup> Donald R. Cressey, *The Respectable Criminal. Why Some of Our Best Friends Are Crooks*, 3 CRIMINOLOGICA 13, 14 (1965). For the importance of protecting one’s self-image to commit misbehavior see also *Dishonesty of Honest People*, *supra* note 166, at 634 (people are dishonest when they can find a balance between the financial benefit that they would get from being dishonest and the maintenance of a positive self-concept).

<sup>194</sup> See *Preferences for Truthfulness*, *supra* note 157, at 545.

<sup>195</sup> See *Protected Values Measure*, *supra* note 168, at 174-83.

<sup>196</sup> See *supra* Part I.B.

<sup>197</sup> See *id.*; see also Mclean, *supra* note 90, at 11; TRUSTED CRIMINALS, *supra* note 135, at 223 (noting that some white-collar criminals show tendencies of risk-taking, recklessness, ambitiousness, egocentricity and hunger for power; but also, need for control, bullying, charisma, fear of failure, company ambition, lack of integrity, narcissism, lack of social

to meet sales goals, but did so feeling “sick in the stomach”.<sup>198</sup> Both can be regarded as gray hats, in that they are far from being good or bad in absolute terms.

Both did offend – however, they did so differently. Specifically, it can be argued that these two types of gray hats have two different *scores* on the PV scale. The first type (who could be defined *dark-gray hat*) rationalizes the violation to the point where they are not troubled by it – they thrive in that culture, furthering and imposing it on their subordinates. PVs are not an obstacle to an economically efficient violation.

The second type (*light-gray hat*) does not rationalize their misconduct – being *sickened* by it – but recognizes its necessity for survival.<sup>199</sup> This second type scores higher in the PV scale, meaning that it is more costly for them to misbehave as it entails a violation of their PVs. Both end up committing that violation, but at a much different cost.

A dark-gray hat will need *less of a push* to resort to misbehavior. These corporate officials have a higher likelihood of committing violations. A light-gray hat will be less prone to accept compromises and commit violations to reach their objectives. Only under extreme circumstances would misconduct prevail over their PVs. Former W.F. employee Ken Mac realized he had no option but to cheat.<sup>200</sup>

It is the interest of corporations to closely monitor who in the firm could fall in each category to better design the compliance incentives that would lure both *hats* towards the *white-hat-side* of the spectrum.<sup>201</sup> Great compliance advantage would be derived in a corporation that is able to empower its light-gray and white hats and use ethically designed incentive systems to prevent dark-gray hats to fall into the temptation to misbehave.<sup>202</sup>

The paper will now turn to the  *motive* that incentivizes misbehavior: *the profit motive*.

### C. The Motive

#### i. What Is the Profit Motive?

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conscience).

<sup>198</sup> See Mclean, *supra* note 90, at 10.

<sup>199</sup> Former Wells Fargo employee Ken Mac is an example. See *id.*

<sup>200</sup> See Mclean, *supra* note 90, at 10.

<sup>201</sup> For a focus on identifying and profiling new employees in order to favor ethical behaviors, see *The Power Few*, *supra* note 162, at 188-91.

<sup>202</sup> See *id.* at 191-93 (proposing ethical training and the selection of “behavioral compliance ambassadors” as solutions to unethical behavior).

“. . . in a free society, there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.”  
– Milton Friedman<sup>203</sup>

Milton Friedman said it loud and clear. The social responsibility of business is to increase its profits.<sup>204</sup> There is no point for the modern corporation to focus on constituencies *other* than profit maximization, entrusting managers with unlimited power to deplete shareholder money for reasons other than maximizing their investment.<sup>205</sup> That power would be exercised in violation of the basic agency relationship between the principals (shareholders) and the agents (managers), which requires the latter to act in the interest of the former.<sup>206</sup> Spending shareholder money for social aims would be – according to Friedman – like both imposing taxes and deciding how the tax proceeds should be spent.<sup>207</sup> Anyone who does not believe in shareholder profit maximization and argues for the business assumption of social responsibilities is an “. . . unwitting puppet(s) of the intellectual forces that have been undermining the basis of a free society these past decades”.<sup>208</sup>

Thus, the purpose of the corporation appears a relatively simple knot to untangle. The *Dodge v. Ford* court simplified it further: “A business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end . . .”.<sup>209</sup> Friedman is thus thought to be among the first scholars to

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<sup>203</sup> See *A Friedman Doctrine*, *supra* note 2, at 7.

<sup>204</sup> *Id.*

<sup>205</sup> *Id.* at 3 (underlining how managers are the shareholders’ agents and spend *their* [the principals’] money in managing the firm: “[T]he corporate executive would be spending someone else’s money for a general social interest.”).

<sup>206</sup> *Id.* at 4 (“[T]he executive is an agent serving the interest of his principal.”).

<sup>207</sup> *Id.* at 3.

<sup>208</sup> *Id.*

<sup>209</sup> See *Dodge v. Ford Motor Co.*, 160 N.W. 668, 684 (Mich. 1919). *But see* STOUT, SHAREHOLDER VALUE MYTH, *supra* note 3, at 22-25 (“*Dodge v. Ford*’s description of corporate purpose is a mere *dicta* in an antiquated case that did not involve a public corporation, and that has not been validated by today’s Delaware courts.” *Id.* at 24). *See also* Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163 (2008). *But see* ADAM WINKLER, WE THE CORPORATION: HOW AMERICAN CITIZENS WON THEIR CIVIL RIGHTS 248 (2018) (for a defense of *Dodge v. Ford* as the governing law on corporate purpose). *See also* BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 56-72 (“Lynn Stout wanted us to believe that *Dodge* tells a ‘charming and easily understood fable of shareholder value maximization.’. In fact, however, it is her interpretation of the law that

have clearly laid out what the S.V.M. entails, and one of its strongest supporters. For the sake of clarity, S.V.M. is defined by current corporate law scholars as the normative proposition that “. . . directors are obliged to make a decision based solely on the basis of long-term shareholder gain”.<sup>210</sup> This definition is an evolution of Friedman’s theoretical basis.

However, this is far from being the only take on corporate purpose. For each voice in loud support of S.V.M. as the main purpose of corporations, there is another which is diametrically opposite.<sup>211</sup> From scholars who passionately depict the maximization of profits as “the law” and a corporation’s DNA,<sup>212</sup> to those who find it the “dumbest idea in the world,”<sup>213</sup> the discovery of a corporation’s true purpose still troubles academics and professionals. The renowned Berle-Dodd debate on corporate purpose set the stage for the ongoing discussion on the reason a corporation exists.<sup>214</sup> Although this is not the proper venue for such a discussion, understanding its basics is a fundamental first step towards looking at the potential links between the profit motive and misconduct. Corporate purpose can be referred to as both the type of business the firm was built to carry out, or the reason for its existence.<sup>215</sup> The present paper uses the latter definition.

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is a fable.” *Id.* at 72.).

<sup>210</sup> BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 13.

<sup>211</sup> The tension between the two was effectively tackled by Davis. *Social Responsibilities*, *supra* note 4, at 312 (acknowledging how economists starkly differ in their views on the business assumption of social responsibilities and then analyzing the *pros and cons* of both theories); *see also* STOUT, SHAREHOLDER VALUE MYTH, *supra* note 3, at 17-21 (for a critical account of the S.V.M. debate).

<sup>212</sup> *See, e.g.*, BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 170.

<sup>213</sup> *See, e.g.*, STOUT, SHAREHOLDER VALUE MYTH, *supra* note 3, at 9 and following; the sentence was pronounced by Jack Welch, CEO of General Electric from 1981 to 2001 (“Shareholder value maximization is the dumbest idea in the world. Shareholder value is a result, not a strategy... your main constituencies are your employees, your customers and your products . . .”). *See* Steve Denning, *Making Sense of Shareholder Value: ‘The World’s Dumbest Idea’*, FORBES (Jul. 17, 2017), <https://www.forbes.com/sites/stevedenning/2017/07/17/making-sense-of-shareholder-value-the-worlds-dumbest-idea/>; *see also* JOEL BAKAN, THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFITS AND POWER (2005) [hereinafter THE CORPORATION] (describing the modern publicly traded corporation as a “psychopath”); MITCHELL, CORPORATE IRRESPONSIBILITY, *supra* note 55; GALLINO, *supra* note 55, at 5-22 (describing the sociological features of the “irresponsible firm”).

<sup>214</sup> *See* Adolf Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (in favor of constraining manager’s powers by imposing a fiduciary duty to run the firm in the best interest of stockholders); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) (debating that there is more than maximizing profits for shareholders to a corporation’s purpose); BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 38-40 (summarizing the Berle-Dodd debate).

<sup>215</sup> *See* BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 12.

As previously stated,<sup>216</sup> although the topic is still highly debated, over time Delaware courts have seemed to more often defer business decisions to the sound business judgment of directors if taken in pursuit of the S.V.M.<sup>217</sup> The expense of corporate resources for reasons *other* than profit maximization must generally be justified by a “rational connection” with shareholders’ benefits.<sup>218</sup> That is, the profit motive must guide business decisions even when other constituencies are taken into consideration.<sup>219</sup> Delaware Supreme Court Former Chief Justice Leo Strine reiterated the idea, stating that other goals can be taken into account in the governance of the firm only if they are “instrumental to profit generation.”<sup>220</sup>

The idea of governing a corporation in full maximization of shareholder returns is thus current and widespread among U.S. corporations and Delaware corporate law.<sup>221</sup> Some scholars even argue that enacting a different theory on corporate purpose – e.g., stakeholder capitalism – would require changing *most of corporate law*.<sup>222</sup> Business commitments to different corporate constituencies have been raised and praised<sup>223</sup> but have seldom been translated into actual governance reforms within corporations.<sup>224</sup>

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<sup>216</sup> See *supra* INTRODUCTION, at 2.

<sup>217</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (1986) (“A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders”).

<sup>218</sup> See *id.*

<sup>219</sup> *Id.* Delaware corporate law has upheld S.V.M. in other landmark cases related to corporate purpose and to the law of M&A: see *Paramount Commc’ns v. QVC Network*, 637 A.2d 34 (Del. 1994) (in corporate takeovers directors are required to pursue the transaction that will produce the best value for stockholders).

<sup>220</sup> See Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course? The Tension Between Conservative Corporate Law Theory and Citizens United*, 100 CORNELL L. REV. 335, 347 (2015).

<sup>221</sup> See, e.g., BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 73 (“Taken together, many provisions of corporate law require or incentivize corporate directors to put shareholder interests ahead of those of stakeholders. Making the law amendable to stakeholder capitalism would therefore require changing not just *Dodge* but a host of other rules”).

<sup>222</sup> *Id.*

<sup>223</sup> The reference is to the 2019 Business Roundtable. See Business Roundtable, *Our Commitment* (2019), <https://opportunity.businessroundtable.org/ourcommitment/> (the roundtable shifted its view in 2016 from a prevalently S.V.M.-oriented perspective to something that values other corporate constituencies too); see also David Gelles & David Yaffe-Bellany, *Shareholder Value is No Longer Everything, Top C.E.O.s Say*, N.Y. TIMES (Aug. 19, 2019), <https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html>.

<sup>224</sup> See, e.g., Robert G. Eccles, *Is Stakeholder Capitalism Real or Not? The Natural Experiment of COVID-19*, FORBES (Feb. 25, 2022), <https://www.forbes.com/sites/bobeccles/2022/02/25/is-stakeholder-capitalism-real-or-not-the-natural-experiment-of-covid-19/?sh=1d86bb799564> (noting how one year after the 2019

Some would even argue that new ESG trends – the latest advance in stakeholder capitalism – still inevitably refer to the maximization of shareholder value and ultimately the profit motive.<sup>225</sup> Without getting into the heated duel of stakeholderism v. S.V.M., one thing can be said for certain: S.V.M. is not going anywhere. That is why it is paramount to dissect the ways it permeates a firm’s behavior and influences its members.

The way a firm behaves depends largely on the purpose it sets out to achieve. This influences its internal mechanisms, rewards systems, goals, culture, and overall corporate governance. It also influences its members – after all, a corporation is nothing more than a legal entity made up of people.<sup>226</sup> The way these individuals are influenced and behave shapes the way the corporation as an organization behaves. So, if the organization is exclusively invested in profit maximization, every individual action within itself will be carried out with that final end game in mind.<sup>227</sup>

Thus, there is a very strong link between what a corporation believes its purpose is, and how its members behave.<sup>228</sup> In addition, the profit motive is so foundational to a corporation’s DNA that – some argue – it even influences firms which follow ESG-based or generally stakeholder governance strategies.<sup>229</sup> The consequence of this is that if a company is *for-profit* and not a *public benefit* one, it is likely that its management will pursue S.V.M. even if that contrasts with its socially responsible statements or commitments.<sup>230</sup> As Joel Bakan insightfully notes, “. . . maximizing

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BR not one signatory company had written a “Statement of Purpose” reflecting of the BR’s content), as cited in BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 123; *see also* Lucian A. Bebchuck & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 124-39 (2020) (dissecting the reasons why the BR ended up being “mostly for show rather than a commitment to an actual change in corporate strategy”. *Id.*, at 139) [hereinafter *Stakeholder Governance*].

<sup>225</sup> *See* BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 108-09 (referring to the results of the Test on Corporate Purpose, which studied the effects of COVID-19 on corporate governance, the Author notes that “. . . companies [signatories of the 2019 BR] remained focused on maintaining shareholder returns even as employees and other stockholders were losing jobs and dealing with a dangerous virus”). *But see* Anil Kovvali & Yair Listokin, *Valuing ESG*, 49 BYU L. REV. 705, 734-36 (2024) (proposing a way to effectively enact ESG principles and balance it with profit maximization).

<sup>226</sup> BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 10 (“. . . when we talk about a corporation we are talking about people”).

<sup>227</sup> *See Evildoing*, *supra* note 124, at 16-17 (“Organizations get committed to courses of action and the individuals who generated those courses of action are reluctant or unwilling to change them, even when others would see the need for change.”).

<sup>228</sup> *See, e.g., supra* Part I, A. ENRON, at 10 (reflecting on the influence of S.V.M.).

<sup>229</sup> *See, e.g., supra* BAINBRIDGE, THE PROFIT MOTIVE, *supra* note 4, at 123-24.

<sup>230</sup> *Id.* *See also Stakeholder Governance*, *supra* note 225, at 124-39, 147 (noting, analyzing directors’ incentives, that there are no mechanisms to “. . . incentivize directors to

shareholder value—by prioritizing profit, growth, and competitive advantage—will always be the corporation’s overarching mandate, at least in capitalist systems.”<sup>231</sup>

ii. What is the Shareholder Value Maximization Made Of?

One way corporations pursue profit maximization is to grant directors considerable discretion in management, assuming their decisions reflect sound business judgment and are guided by S.V.M.<sup>232</sup>

Due to imperfect alignment between directors’ and shareholders’ interests, the company’s management may sometimes not meet shareholders’ expectations. Unhappy shareholders can voice concerns, vote out directors, or pursue legal action if fiduciary duties are breached. Alternatively, they can disinvest. This agency problem, rooted in the separation of ownership and control, is addressed by corporate law.<sup>233</sup>

One key way it does so is through executive compensation and incentives.<sup>234</sup> The interests of the board are (more) aligned to those of shareholders when their pay is generally linked to performance – this can happen through stock-options, goals-related or stock-price-related bonuses, and internal rewards systems.<sup>235</sup> Performance is generally measured through share price, therefore *performing well* means keeping *share prices high*.<sup>236</sup> This dynamic encourages directors and executives to employ every available strategy to maximize shareholder value—a goal incentivized by the link between performance and financial rewards.<sup>237</sup> Thus, the incentive system primarily steers the board towards maximizing shareholder value.<sup>238</sup>

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benefit stakeholders beyond what would be desirable for shareholder value”. *Id.*); see also THE CORPORATION, *supra* note 213, at 28 (remarking how regardless of new trends in corporate social responsibility, the corporation remains a “. . . legally designated person designed to valorize self-interest and invalidate moral concern”).

<sup>231</sup> JOEL BAKAN, THE NEW CORPORATION: HOW GOOD CORPORATIONS ARE BAD FOR DEMOCRACY 33 (2020) [hereinafter THE NEW CORPORATION].

<sup>232</sup> See *id.* at 208-20 (arguing that boards prefer the protection of shareholder interests in corporate governance because they can hold them accountable).

<sup>233</sup> The intuition is from ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 6-7 (1932).

<sup>234</sup> See Guido Ferrarini & Maria Cristina Ungureanu, *Executive Compensation*, in THE OXFORD HANDBOOK ON CORPORATE LAW AND GOVERNANCE 335-36 (Jeffrey N. Gordon & Wolf-George Ring eds., Oxford Univ. Press 2015) [hereinafter *Executive Compensation*] (for a description of executive compensation as a way to address agency costs).

<sup>235</sup> *Id.* at 334.

<sup>236</sup> *Id.* at 340 (acknowledging that “share price is ordinarily the best available proxy for shareholder wealth and reflects overall corporate performance more effectively than business-line linked, target-specific bonuses”).

<sup>237</sup> *Id.* at 334 (using the term “compensation” loosely to refer to monetary increases tied to performance results).

<sup>238</sup> See *Stakeholder Governance*, *supra* note 225, at 155 (“CEOs are discouraged from

An additional incentive to perform well stems from the market for corporate control. This means that inefficient or disliked managers will attract insurgent groups willing to take over the board: this works as a market-based incentive for directors to perform well.<sup>239</sup>

Other than these corporate incentives and market-induced constraints, directors are generally granted significant discretion. Shareholders and the market can exercise some sort of oversight on their activity, but a firm's direction and the chosen route to get there is ultimately a decision of the board and its directors. Also, judicial intervention in business decisions is rarely warranted due to courts' limited business expertise.<sup>240</sup> This essentially means that the board finds itself in a highly privileged position with regards to the firm's governance.<sup>241</sup>

So, we have established that (i) the board of directors is granted discretion in the management of the firm, that (ii) courts rarely interfere with its business decisions, which are presumed to be the product of sound business judgment, that (iii) they are subject to the pressures, incentives, and oversight of shareholders and the market, who can ultimately hold them accountable for their activities, and eventually that (iv) all of this should happen in sight and pursuit of S.V.M.

This is the theoretical basis on top of which the following analysis relies. The next paragraph will test if this framework produces the unwarranted risk of misbehavior, analyzing the position of *individuals*, of the *organization*, and of the *market*.

### iii. What Has Crime Got to Do with It?

In theory, S.V.M. should be pursued within the "rules of the game,"<sup>242</sup> thus avoiding delinquency.<sup>243</sup> As we have seen, reality often follows a

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making any decisions that would benefit or protect stakeholders beyond what would be necessary for shareholder value maximization" – the Authors also note how the system of executive incentives is geared towards S.V.M. and not to protect other stakeholder interests: ". . . directors and executives have incentives not to provide stakeholder benefits that would come at the expense of shareholders." *Id.*)

<sup>239</sup> For an overview of the roles and responsibilities of the board of directors see Stephen M. Bainbridge, *The Board of Directors*, in *THE OXFORD HANDBOOK ON CORPORATE LAW AND GOVERNANCE* 335-36 (Jeffrey N. Gordon & Wolf-George Ring eds., Oxford Univ. Press 2015).

<sup>240</sup> See BAINBRIDGE, *CORPORATION LAW AND ECONOMICS*, *supra* note 4, at 242 and following for an account of Delaware court's position on the protection of the business judgment rule and of the deference to the board.

<sup>241</sup> *Id.*

<sup>242</sup> *A Friedman Doctrine*, *supra* note 2, at 7.

<sup>243</sup> See BAINBRIDGE, *THE PROFIT MOTIVE*, *supra* note 4, at 14.

different script.<sup>244</sup>

There are occasions where the aim of maximizing shareholder value is and seems perfectly attainable through legal ways – that is, *staying within the rules of the game*.<sup>245</sup> In these cases, gray hats can discharge their duties and perform well without recourse to misconduct – basically, behave as a white hat would. In other cases, these corporate officials see the maximization of shareholder value as unattainable in compliance with legal norms. That is, they picture it as something that can only be done *stretching* the rules of the game. The push towards misbehavior that this creates is enhanced by the need to avoid the negative consequences that would happen in case of failure – that is, poor performance. High performance, high stock prices, and S.V.M. thus become the only option.

A white hat would accept failure rather than offend. A black hat would offend even without risks of failure.

This paper uses three levels of analysis of the potential link between profits and crime: the individual, the organization, and the market.

The individual level is closely related to the incentives, compensation, and rewards a manager is subject to – what she is *personally enticed by or scared of* in the setting of the profit-maximizing corporation.

The organization amplifies the perverse effects that performance-based pay contracts can generate. The repetition of internal rewards systems overtime can influence a corporation’s culture and create a setting of collective acceptance towards misbehavior.

The same amplifying effect can be seen in the market. Ruled by aggressive deregulation and lack of effective oversight, the enthusiasm and financial growth of the shareholder-value-maximizing market has been linked to the association of success with criminal conduct.<sup>246</sup> Market-based pressures and incentives on managers are also a competing factor in the increment of corporate misconduct.

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<sup>244</sup> See *supra* Part I.A (Enron) and Part I.B (Wells Fargo); see also THE NEW CORPORATION, *supra* note 232, at 57 (highlighting the tension between profit maximization and the necessity to stay within the rules).

<sup>245</sup> A *Friedman Doctrine*, *supra* note 2, at 7.

<sup>246</sup> See VINCENZO RUGGIERO, DIRTY MONEY: ON FINANCIAL DELINQUENCY 156–57 (Oxford Univ. Press 2017) [hereinafter FINANCIAL DELINQUENCY] (arguing that this hypothesis is “based on the belief that the justification of greed and pressures towards financial growth acted, for the new ascending class, as a propulsive force, blurring the boundaries between speculation and crime.” *Id.* at 156); see also TRUSTED CRIMINALS, *supra* note 135, at 229 (reporting that for-profit corporations have been found to be more likely to engage in violations than nonprofit corporations).

These three concentric circles will now be analyzed in detail to dissect the potential criminogenic spillovers of S.V.M.

The individual: as seen *supra*,<sup>247</sup> incentives, equity-based compensation and rewards systems are bolted into S.V.M. More precisely, they are widely applied ways to tie a manager's performance to stock price,<sup>248</sup> aligning the interests of shareholders to those of managers.<sup>249</sup> This is thus how S.V.M. makes its way into the managers' behavior. Generally, these are systems that set a series of goals, which can be directly tied at stock price or at similar metrics. Success in meeting the goals triggers the reward.<sup>250</sup> Failure to meet the goals can have a series of sanctions. Internal sanctions can include measures such as termination, removal from office, or transfer to a lower position.<sup>251</sup> External, market-based sanctions can include reputational damage, difficulty or impossibility of future employment.<sup>252</sup> Managers are thus faced with two basic scenarios. High performance is met with rewards; poor performance is sanctioned.

In and of itself this is an accepted development in corporate governance and seen as an effective way to incentivize well-performing executives.<sup>253</sup> However, misbehavior soars when performance-based pay contracts become too extreme.<sup>254</sup>

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<sup>247</sup> See *supra* PART. II.C. THE MOTIVE, §i. and §ii.

<sup>248</sup> See, e.g., *Stakeholder Governance*, *supra* note 225, at 141 (noting that 99% of S&P 500 companies resort to equity-based compensation in the form of preferred or restricted stock, and that "equity pay represents more than half of director compensation in S&P 500 companies." *Id.*).

<sup>249</sup> *Id.* (noting that the reason is to align managers' interests with those of shareholders). But see *Executive Compensation*, *supra* note 235, at 335–36 (noting that executive compensation can become a device for self-dealing by conflicted managers).

<sup>250</sup> Referred to as rewards. See *Stakeholder Governance*, *supra* note 225, at 140–43.

<sup>251</sup> An example is Wells Fargo's rewards system: Yesena Guitron failed to meet her goals and was fired. See *supra* Part I.B (Wells Fargo); see also McLean, *supra* note 90, at 8; *Stakeholder Governance*, *supra* note 225, at 153 (noting that poorly performing CEOs are more likely to be removed).

<sup>252</sup> *Stakeholder Governance*, *supra* note 225, at 143–46 (analyzing labor and control market incentives for directors) and 153–54 (for CEOs).

<sup>253</sup> *Id.* at 141.

<sup>254</sup> For a summary of part of the literature see *Executive Compensation*, *supra* note 235, at 335–38. For a study on the link between excessive pay and high risk-taking in the 2008 crisis see Lucian Bebchuck, Alma Cohen, & Holger Spamann, *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000–2008*, 27 YALE J. REG. 257, 273–77 (2010) (finding a link between short-term incentives and excessive risk-taking). See also Edward Tomlinson & Amanda Pozzuto, *Criminal Decision Making in Organizational Context*, in THE OXFORD HANDBOOK OF WHITE-COLLAR CRIME 370–71, 375–76 (Shanna R. Van Slyke et al. eds., Oxford Univ. Press 2016) [hereinafter *Organizational Context*] (noting

Most criminal law scholars explain this criminogenic phenomenon as something that creates the “lure” which triggers misbehavior.<sup>255</sup> The lure represents the perceived benefits that the corporate official would gain by misbehaving, weighed against the perceived costs.<sup>256</sup> The perceived costs of misbehavior are generally described as credibility of oversight and likelihood of punishment in case of misbehavior.<sup>257</sup> This analysis posits that the corporate offender is a *rational* actor and that crime – in that context – is a choice.<sup>258</sup> The gray hat thus misbehaves when the perceived benefits of misbehaving are higher than the perceived costs, compared to obedience.<sup>259</sup>

As anticipated *supra*,<sup>260</sup> this neo-classic approach to crime has ancient roots.<sup>261</sup> Such perspective will be adopted here, under the shared belief that it can be a reliable guiding light in assessing how people behave in a corporate setting.<sup>262</sup>

The costs of obedience are equal to the benefits of misbehavior<sup>263</sup> and can be particularly high when, for example, the organization greatly sanctions the failure to meet goals.

The perception of such cost/benefit analysis and the ultimate choice to resort to misbehavior will depend on the individual. Light-gray hats who score high on the PV scale will more likely see misbehavior as inefficient and ultimately favor obedience.<sup>264</sup> This is because misbehaving entails a violation

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that there can be a criminogenic *dark side* to rewards system); see also FINANCIAL DELINQUENCY, *supra* note 247, at 162 (noting that the financial offences are also made possible by the decision to pay managers in stock instead of cash).

<sup>255</sup> See, e.g., *Organizational Context*, *supra* note 254, at 368–70; see also FINANCIAL DELINQUENCY, *supra* note 247, at 160–62 (describing financial crime as producing “thrill-seeking” and “seductive excitement.” *Id.* at 160).

<sup>256</sup> *Organizational Context*, *supra* note 254, at 368–70.

<sup>257</sup> *Id.* at 378 (“Individuals choose to engage in white-collar crime when the perceived benefits of doing so are believed to outweigh the perceived costs, relative to other potential courses of action.”).

<sup>258</sup> *Id.* at 368.

<sup>259</sup> *Id.*; see also FINANCIAL DELINQUENCY, *supra* note 247, at 156–57 (“Financial criminals, as goal-oriented individuals, decide to act assessing the circumstances that may favor their violations . . .”).

<sup>260</sup> See *supra* Part II.A. INTRODUCTION. LAW, ECONOMICS, AND CRIMINALS.

<sup>261</sup> See BECCARIA, *supra* note 134; see also AN INTRODUCTION, *supra* note 137; *Crime and Punishment*, *supra* note 138; *An Economic Theory*, *supra* note 139.

<sup>262</sup> See, e.g., *Corporate Criminal Liability*, *supra* note 153.

<sup>263</sup> Misbehavior avoids incurring in the costs of obedience (benefit = avoided cost).

<sup>264</sup> See *Preferences for Truthfulness*, *supra* note 157, at 545 (noting that the economic costs of truthfulness matter less to those who strongly hold truthfulness as a PV).

of their PVs, which both constitutes a cost and causes a decrease in the potential benefits that would be obtained through misconduct.<sup>265</sup>

Let's clarify with a set of examples. The examples are based on a gray hat who has a neutral score on the PV scale.

A manager has a set of goals that need to be met. In case of success, she gets rewards (more money, stock options, bonuses, etc.). In case of failure, she is sanctioned (reputational damage, termination, unemployment, etc.). She could *misbehave*, and be certain to reach those goals, but risk "legal" punishment (perceived cost).<sup>266</sup> She could be *obedient* and risk not meeting those goals, thus incurring in the sanctions of failure, but at the same time be sure to avoid legal punishment. There can be different scenarios.<sup>267</sup>

a) If – like in W.F. – goals are unattainable through legal means, obedience will necessarily equal failure. Misbehavior will necessarily be associated with success, hence rewards. The only counteracting factor against it will be the likelihood of legal punishment and the credibility of oversight.<sup>268</sup> Therefore, considering the low likelihood of legal punishment, the cost/benefit analysis will more likely favor misbehavior. That explains why unattainable goals in the rewards system are associated with incentivized malfeasance.<sup>269</sup>

The distribution of misbehavior in the hat spectrum will thus include a large portion of gray hats pushed to offend because of the unattainability of the goals.

Enron is also a great example. Pursuant to the S.V.M. theory, it matured an obsession with keeping extremely high stock prices, rewarding lavish bonuses to anyone who managed to achieve that – regardless of *how*.<sup>270</sup> It easily became impossible to achieve them without cooking the books. High bonuses functioned as great perceived benefits for the employees who were

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<sup>265</sup> *Id.* (the attractiveness of any financial gain obtained violating PVs is reduced).

<sup>266</sup> This is one of the perceived costs of misbehavior. *See Tomlinson & Pozzuto, Organizational Context, supra* note 254, at 371.

<sup>267</sup> Some scholars argue that egoism is the core inspiring principle of action in such situations, to "strive for the triumph of the prevalent economic thought". *See FINANCIAL DELINQUENCY, supra* note 247, at 161.

<sup>268</sup> *Organizational Context, supra* note 254, at 378.

<sup>269</sup> *Id.* at 375-76 ("Goals should be challenging but attainable . . . as unrealistically high goals might stimulate white-collar crime because that is the only method perceived to be viable", and "the pressure to achieve them 'at any cost' is more likely when illicit means are perceived to meet with greater likelihood of goal accomplishment (because the goal itself is otherwise deemed unobtainable) or have lower cost than more legitimate means". *Id.* at 376).

<sup>270</sup> *See Organizational Context, supra* note 254, at 370-71.

willing to bend accounting rules to make it seem like the company was a successful one.<sup>271</sup> Paired with low perceived costs, the cost/benefit analysis almost always favored misbehavior for the sake of profits.<sup>272</sup>

b) If the goals are attainable through legal means, obedience will not necessarily be associated with failure and misbehavior will not necessarily be associated with success and rewards. This is because obedience could still produce the result of success.

In these cases (e.g., the target share price can be reached legally), misbehavior is distributed more on the dark-gray spectrum of the *hats*, which means that it requires a higher rationalizing ability to occur. The offender would need to justify (i.e., rationalize) the recourse to misbehavior even if not necessary to reach the goals. A light-gray hat would refrain from misbehaving instead, taking the risk of not reaching the goals but sticking to obedience to the law.

It must be noted that the likelihood of legal punishment for white-collar criminality is generally low. Factors such as the prosecutorial discretion in bringing the case, the difficulty of detecting misbehavior within companies, the low resources generally allocated to white-collar crime investigations and prosecution, all play a role in lowering the likelihood of punishment.<sup>273</sup> This means that legal punishment is *highly uncertain*, while the internal rewards or sanctions have a higher degree of *certainty* (e.g., the automatic issuance of bonuses once sales goals are met). Still, there is no such thing as the beginning of an *automatic criminal punishment* in case of misbehavior. This means that the gray hat will generally rely more on the internal, *certain* cost/benefit analysis of the reward system rather than the external, *uncertain*, likelihood of criminal punishment.

So, internal rewards system that provide (i) high rewards in case of success, (ii) unattainable goals, (iii) high sanctions in case of failure, and are paired with a (iv) low likelihood of legal punishment and low credibility of oversight are more likely to incentivize misbehavior in gray hats. These

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<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

<sup>273</sup> For a detailed account of the issue see JESSE EISINGER, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* (2017); see also Jed Radkoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, 61 N.Y. REV. BOOKS (Jan. 9, 2014) (for a critic of the same issue); BRANDON L. GARRET, *TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS* 83 (2014) (noting how officers and employees are often not prosecuted when the company is); *Moral Ambiguity*, *supra* note 57 (noting how it is difficult to assess the level of “blamability” of white-collar criminality).

effects are amplified at the organizational levels. Through performance-based pay contracts, the organization's profits (benefits) are turned into personal profits (benefits).<sup>274</sup> Misbehaving to fictitiously increase the value of stock allows the manager to achieve a benefit for himself, the organization and shareholders.<sup>275</sup> If he or she perceives the outweighing costs as being low, misbehavior will be likely. The influence of the rewards system is also magnified in those individuals who present a pronounced "fear of failure" as a psychological trait.<sup>276</sup>

The organization: Organizations are social structures composed of individuals who come together to pursue a common goal.<sup>277</sup> As seen *supra*,<sup>278</sup> the corporate organization generally pursues the aim of S.V.M. and its structure can become a magnifier for criminogenic pursuits of profits.<sup>279</sup>

Some have even described the profit-maximizing corporation as an "irresponsible firm," defining it as ". . . a firm which assumes that it cannot be called to account by any public or private authority, or by public opinion, for the social, economic, and environmental consequences of its activity."<sup>280</sup> In that context, S.V.M. is associated with the prosperity of the irresponsible firm, which maximizes at any cost regardless of the consequences.<sup>281</sup> The change from the managerial to the irresponsible firm has been linked by sociologists to the pressure that shareholders put on managers to increase revenues between the 1960s and the 1980s.<sup>282</sup> Proprietors demanded the creation of stock value regardless of the protection of other corporate constituencies<sup>283</sup> – and managers, as agents, had to act in their interest.

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<sup>274</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 162.

<sup>275</sup> *Id.*

<sup>276</sup> See TRUSTED CRIMINALS, *supra* note 135, at 224 (noting that white-collar criminals often have a pronounced fear of falling or failing).

<sup>277</sup> The New Oxford American Dictionary defines the "organization" as an organized body of people with a particular purpose, especially a business, society, association, etc. *Organization*, NEW OXFORD AMERICAN DICTIONARY (3rd ed. 2010).

<sup>278</sup> See *supra* Part II, C. THE MOTIVE, §iii.

<sup>279</sup> See, e.g., THE CORPORATION, *supra* note 213 (describing the organization itself as showing *psychopathic* traits); see also MITCHELL, CORPORATE IRRESPONSIBILITY, *supra* note 55 (criticizing the perverse effects of S.V.M.); GALLINO, *supra* note 55, at 5 (describing the "irresponsible firm"). See, e.g., *Evildoing*, *supra* note 124, at 36 ("[I]ntentionally unethical companies do harm because the corporate controllers are willing to do so. Their corporate ideologies make it appropriate to harm others, and the structural conditions within the organization facilitate the doing of harm. Workers, fearful of losing their jobs, participate in the harm-doing, or taking a narrow definition of their responsibilities, do not seek to end it.").

<sup>280</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 166 (citing GALLINO, *supra* note 55).

<sup>281</sup> *Id.*

<sup>282</sup> *Id.*

<sup>283</sup> *Id.* (noting that the creation of stock value at all costs was pursued even if it damaged small investors).

But collective crime is not just a matter of *wanting to make more money*.

The organizational level of influence serves as a social and cultural *legitimizer* of misconduct. As it has been noted, “. . . corporate cultures and structures encouraging organizational crime . . . are seen as permanent features of the financial world.”<sup>284</sup> Highly pressurized corporate cultures are more likely to create a collective acceptance of misconduct as a legitimate way to maximize profits.<sup>285</sup> Members of an organization can then reach a “shared perception of legitimacy of the operations being conducted”<sup>286</sup> and a “. . . potent rationalization for the crimes being committed,”<sup>287</sup> for example, with regards to situations of complicity with auditors.<sup>288</sup>

This environment has been described as criminogenic by some,<sup>289</sup> and as downright “psychopathic” by others.<sup>290</sup> Psychopathic traits have been recognized in how individuals are affected within that organizational environment—they include dissociation from one’s own values, lack of empathy, and even schizophrenia.<sup>291</sup> The obsession with S.V.M. above all other constituencies thus renders the firm irresponsible,<sup>292</sup> manipulative, grandiose, unable to recognize the effects of its actions, and unable to feel remorse.<sup>293</sup>

It must be noted that this description may not apply to all corporations. Still, in those which reflect this psychopathic characterization, black hats will thrive, gray hats will be more highly distributed in the darker side of the spectrum, and white hats will remove themselves from that environment.<sup>294</sup>

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<sup>284</sup> *Id.* at 161.

<sup>285</sup> Both Enron and W.F. are examples. *See also Evildoing*, *supra* note 124, at 36-37 (for an outline of rationalization in organizations that do harm).

<sup>286</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 162.

<sup>287</sup> *Id.*

<sup>288</sup> *Id.*

<sup>289</sup> *Id.* at 158 (describing how some interpretations of financial delinquency uphold the belief that large organizations operate in “inherently criminogenic environments”).

<sup>290</sup> *See* THE CORPORATION, *supra* note 213, and THE NEW CORPORATION, *supra* note 232, at 57 (stressing how *new* corporations still present psychopathic traits even if they pledge to be socially responsible: they still are “. . . a psychopath—just a more charming one”).

<sup>291</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 159 (citing THE CORPORATION, *supra* note 213); *see also* THE NEW CORPORATION, *supra* note 232, at 57 (arguing that corporations are programmed to act out of self-interest, lacking the ability to care about others and causing harm).

<sup>292</sup> *Id.*; *see also* GALLINO, *supra* note 55, at 5 and following.

<sup>293</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 159.

<sup>294</sup> *Id.* (“Corporate psychopaths find ideal contexts in which individuals can lie, cheat, manipulate, thrive on thrill-seeking, and need constant stimulation”); *see also Evildoing*, *supra* note 124, at 13 (“[T]hrough participation in the organization, the individual has

The profit-maximizing organizational level of the corporation can thus *change* individuals, *re-socializing* and conforming them to its goals.<sup>295</sup>

Psychologists have also noted how *any* corporation could “drift into harm-doing” due to the corporate emphasis on profitability and their “complex interactional forces.”<sup>296</sup> This result can be reached even without full acknowledgment and intention of its members:<sup>297</sup> lower degrees of criminal intent are thus needed for someone to participate in corporate misbehavior.<sup>298</sup> This seems like the perfect recipe to *lure* gray hats into misbehavior, as they do not necessarily intend to do harm.

The criminogenic effects of social groupings on individuals have sturdy psychological bases<sup>299</sup>— some even suggest a higher concentration of psychopaths when the grouping is a corporate one.<sup>300</sup>

But there’s more. The perverse effects that the rewards system can have at the individual level have an organizational impact as well. This system *tells* the member of a company what the company values, what must be done to be rewarded and appreciated, and what the company does not tolerate.

Compensating people with money for “good” actions has a powerful, influential effect— it shapes and defines the actions that the organization not only accepts but deems worthy of a prize. The W.F. incentives system is an example of this. If the means generally used within the corporation to reach those goals are unlawful (misbehavior), and if this does not affect the issuance of rewards, the message that the organization’s members will receive is that *cheating* to reach goals is accepted and highly valued. This is reinforced if the company sanctions the failure to reach the same goals – not only is misbehaving to reach them equally rewarded, but the company does not tolerate failure to do so, to the point of punishment.

Repeating rewards over time reinforces common behaviors among organization members, shaping the company’s culture.<sup>301</sup> Through the normative socialization of individuals in organizations, behaviors are replicated, imitated, taught, and learned among colleagues, and ultimately

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undergone a conversion process and become an autonomous participant in harmful actions”).

<sup>295</sup> See TRUSTED CRIMINALS, *supra* note 135, at 227.

<sup>296</sup> See *Evildoing*, *supra* note 124, at 37.

<sup>297</sup> *Id.* at 14 (highlighting that “[O]rganizations can lurch toward evil in ways not intended by any of the participants in the organization”).

<sup>298</sup> *Id.* at 18 (explaining how the diffusion of responsibility within an organization can make it easier for individuals to take part into evildoing without intentionally wanting to).

<sup>299</sup> See, e.g., *id.*; see also TRUSTED CRIMINALS, *supra* note 135, at 226-28.

<sup>300</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 159.

<sup>301</sup> See, e.g., *Hyper-Competition*, *supra* note 86, at 971.

spread across the corporate structure.<sup>302</sup> Once a culture of acceptance towards misbehavior as a justified aim to maximize profits is built, it will be easier for gray hats to comply to it and difficult for them to change it. Within organizations, once a course of action is chosen and resources are spent to enact it, it is more difficult for its members to change it and easier to abide by it and replicate it.<sup>303</sup> A company culture of misbehavior therefore more easily pushes gray hats to the dark area of the spectrum.

Therefore, we have determined that the organizational influence of S.V.M. (i) is likely to produce an “irresponsible” corporate setting of moral detachment and pressurized competition, (ii) is likely to be accepting of the use of illicit means to reach goals and be rewarded, especially if the goals are *lawfully* unattainable, providing useful rationalizations and acceptance of misbehavior, (iii) is likely to be reproduced and spread within itself thanks to the normative socialization of its members, who are unwilling to change the common practices of the organization they work in.

The market: it is undisputed that the market values well-performing, profit-maximizing corporations. Stock value works as the basic metric to communicate corporate performance to the market. A poor-performing company will be reflected in the market by a lower stock price. If the market does not trust its management and sees it as unsuccessful, the price will drop even lower. The same works in reverse for high-performing companies, reflected by higher share prices. Generally, this means that the market trusts its management and trades its shares at the price it is believed to best reflect the value of the company.

Hence, the basic functioning of the free market is highly dependent on share price, and its maximization is rewarded with success. Corporate law scholars have classified four different ways in which market-based incentives influence a director towards S.V.M.:<sup>304</sup> (i) well-performing directors have higher chances of future directorships,<sup>305</sup> (ii) low shareholder value increases the chances of proxy fights, which can end in turnover,<sup>306</sup> (iii) low shareholder value and poor performance increase the chance of a takeover

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<sup>302</sup> Without revisiting the extensive literature on the organizational psychology of evildoing, *see, e.g., Evildoing, supra* note 124, at 37-39 (explaining the “reproduction of corruption” within organizations, and noting how individuals in organizations are “trained” and provide a “multiplicative effect on the pool of available evildoers.” *Id.* at 38); *see id.* at 38, for the use of the term “normative socialization.”

<sup>303</sup> *Id.* at 21-22 (explaining the phenomenon as that of “sunk costs”).

<sup>304</sup> *See, e.g., Stakeholder Governance, supra* note 225, at 144-46.

<sup>305</sup> *Id.* at 144.

<sup>306</sup> *Id.* at 145.

bid, threatening the director's position,<sup>307</sup> and (iv) low shareholder value increases the chance of intervention by hedge-fund activists and, if the company is targeted, that the hedge fund will obtain a settlement.<sup>308</sup>

Therefore, in addition to the *internal* pressures that individually *lure* managers into misbehavior, there are *external* pressures based on the shareholder-value-maximizing market, which the manager will dial into her cost/benefit analysis of misbehavior v. obedience. The decision-making process is analogous to the one at the *individual* level: if misbehavior has more benefits than costs in reaching the market-imposed goals with respect to obedience, a gray hat will misbehave to that end. The addition of market-imposed incentives to reach high performance goals sits on top of both the internal incentives of the rewards system and the organizational influences of the corporate setting. Two scenarios can be set forth.

A market that is highly reactive to share prices and does not tolerate poor-performing managers will have higher incentives for managers to misbehave in order to be valued as well-performing and avoid market-based sanctions. For example, an unregulated market that does not allow frequent resort to defense mechanisms against hostile take-overs will create a higher pressure on the manager to keep share prices up and avoid the take-over.

A market that is less reactive to share prices and is more highly regulated in market-imposed management turnovers will create lower pressures on managers. For example, a market that more strictly regulates mergers and acquisitions will be less reactive to a board that does not meet market expectations in terms of share value. Such regulations would make it more difficult for the interested company to take over the target. Reduced pressure on managers to maximize share value – in order to avoid being taken over – translates to a heightened attention towards obedience and not having to do *whatever it takes* to keep stock prices up.

The neoliberal, shareholder-value-focused marketplace better fits in the first description. The influences that can pressure the individual are not limited to future job placement or to the likelihood of takeovers – they are related to the gears that make the market work, to its basic functioning.

The higher pressure that unregulated, neoliberalist markets create, and their potential criminogenic effects, have been long studied by criminologists.<sup>309</sup> The thrill-seeking financial neoliberalism and severe

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<sup>307</sup> *Id.*

<sup>308</sup> *Id.*

<sup>309</sup> See, e.g., FINANCIAL DELINQUENCY, *supra* note 247, at 170-76; see also TRUSTED CRIMINALS, *supra* note 135, at 228-30 (referring to the “ecological” organizational dimension of white-collar criminality as the criminogenic market corporations work in), and at 240-41 (presenting the Marxist view which sees capitalism as a criminogenic system in

deregulation that have characterized the market at least until the 2008 crisis have led to the association of success with criminal conduct.<sup>310</sup> Market-driven enthusiasm for financial growth also encouraged financial offenses.<sup>311</sup> The criminogenic effects of the free market can be linked to a “justification of greed” and to pressures towards financial growth, usually accompanied by market optimism, deregulation, and significant emphasis on maximizing profits.<sup>312</sup> The higher the pressure, the higher the *lure* of misbehavior.<sup>313</sup> For those actors who more easily buy into the system – black and dark gray hats – crimes committed in the marketplace become an act of faith towards the system,<sup>314</sup> which enhances the social acceptance of misbehavior. This acceptance is directly related to the basic functioning of the market<sup>315</sup> and provides helpful rationalizations for misconduct. Such societal context thus contributes to the creation of a criminogenic environment through the implementation of non-intervention policies and severe self-regulation, ultimately incentivizing autocracy.<sup>316</sup>

Some argue that the criminogenic conditions of the free market are not rare occurrences, rather they are “inherent and cyclical features” of advanced economies.<sup>317</sup> The free market thus magnifies the effects of S.V.M. – if unregulated and pressurized towards profit pursuit, it can produce perverse effects on individuals and firms.

Market-based pressure for the gray hat can take the shape of the *need to meet market expectations*: a link has been found between “. . . levels of expectations for profitable financial statements and illegal or unethical

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and of itself); see also Robert Tillman, *Bad Banks, Recurrent Criminogenic Conditions in the US Commercial Banking Industry*, in ROUTLEDGE INTERNATIONAL HANDBOOK OF THE CRIMES OF THE POWERFUL 265-66 (Gregg Barak ed., Routledge 2015) [hereinafter *Bad Banks*].

<sup>310</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 156.

<sup>311</sup> *Id.* at 152 (pointing at “market worshipping, praise of greed, and laudatory sermons for privatization” as contributing causes to the wave of financial crimes of the new century).

<sup>312</sup> *Id.* at 156.

<sup>313</sup> See, e.g., *Organizational Context*, *supra* note 254, at 368-69 (for a criminological definition of *lure* and of its role, referring to it as the “benefits that can accrue from crime”. *Id.* at 369. Here, the benefits are the *avoided costs* of market-based sanctions).

<sup>314</sup> FINANCIAL DELINQUENCY, *supra* note 247, at 156.

<sup>315</sup> *Id.* (“The goals of that philosophy [of the market] and those of delinquency align to create a whole, systematic, behavioral guide adhering to the dynamics of the marketplace and to the prescriptions of the economy.” *Parenthesis added*).

<sup>316</sup> *Id.* at 162, 169 (noting that financial crime has been linked to the deregulation of transactions that were previously criminalized. *Id.* at 169).

<sup>317</sup> *Id.* at 172. See also *Bad Banks*, *supra* note 309, at 265 (underlining how criminogenic markets do not disappear and are connected to larger social institutions and ideologies). Some have argued that US society is criminogenic: see TRUSTED CRIMINALS, *supra* note 135, at 241.

accounting manipulations to meet those expectations”.<sup>318</sup> If one also considers the idea that profit-maximization and efficiency can come to *justify* lawbreaking under certain scholarly theses,<sup>319</sup> it becomes clearer how easy it is for managers to violate the law.

This paragraph has thus established that (i) there are corporate law, market-based influences that push managers towards S.V.M., (ii) these influences are amplified if the market is unregulated or self-regulated, (iii) the neoliberalist, profit-maximizing, free market has come to create a criminogenic environment in which corporations operate, pushing its members towards misbehavior.

Therefore, the profit-maximizing gray hat thrives within the profit-maximizing organization, which swims in the profit-maximizing, unregulated, neoliberalist, free market. If Friedman’s idea of the maximization of profits as something that ought to stay *within the rules of the game* is laudable, a more detailed criminological analysis reveals that there is a real tension between the utmost pursuit of profits and obedience to the law. The profit motive, to be more precisely defined as S.V.M., has thus been shown to have a potential *dark side*. It acts first on the individual layer of the manager, influencing his behavior through incentives, sanctions, and lack of punishment. It then amplifies such effects within the organized structure of the corporation, offering common acceptance and rationalization of violations and *training* new members to do the same. The firm and its members then receive a third layer of market-based pressures, expectations and rationalizations for misconduct, which enhance its likelihood of occurring.

The analysis will now turn to its *prescriptive* part. The next part will build on the previous analysis and propose solutions to the previous findings, pursuing the final aim of excluding black hats from the corporate structure, positively influencing gray hats, and attracting and retaining white hats.

### III. A POSSIBLE SOLUTION

#### A. Concentric Circles, Influences, and Proposals

The Enron and W.F. scandals show how there can be a tension between S.V.M. and obedience to the law. It has also shown how this tension does not

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<sup>318</sup> See TRUSTED CRIMINALS, *supra* note 135, at 230 (finding that corporations are more likely to engage in corporate crime when the “political or economic climate promotes aggressive pursuit of profits.” *Id.*).

<sup>319</sup> See *supra* Part II A, for a recollection on the “law-as-price” theory.

always favor obedience, and that this generally depends on how the different corporate actors behave. Analyzing this dynamic through the framework of the individual, the organization and the market provides a comprehensive perspective of how profit-driven misbehavior manifests in the corporate setting. In addition, the law-as-price theory works as a doctrinal link between profit-maximizing and disobedience, even suggesting that in some cases firms *should* commit profitable violations.

The issue of organizational misbehavior can be addressed in many ways. It is not the purpose of this paper to present a blueprint set of black-and-white rules to solve the issue of misconduct in corporate organizations, as that would be more fictional than practical. The purpose that this work strives to achieve is to provide a useful tool to better systematize the links between the exclusive focus on S.V.M. and misconduct, offering solutions that are consistent with the aim of favoring compliance. The proposed framework aims to be a clearer starting point for future research, rather than its finish line.

The trichotomy of black, white, and gray hats can serve to better define the **objective** of the solution. The three concentric circles of the individual, the organization, and the market, serve to better define the **methods** to be implied to enact the solution and its scope of application.

The **objective** of the proposal should be to

- (i) detect black hats within the corporation and remove them from the corporate structure;
- (ii) positively influence gray hats, trying to push them to obedience rather than misbehavior;
- (iii) attract white hats to the firm and retain them if they are already in it.

These are *ideal* objectives a system of compliance should seek to accomplish. Like every abstract *ideal*, it should be enacted with the awareness of its potential shortcomings, considering the virtual impossibility to remove *all black hats* from the corporate structure and— for example— *only hire white hats*. The underlying assumption is that this framework should allow the pursuit of S.V.M. to be carried out within the rules of the game. This framework should work as the ethical guardrails to guide the application of S.V.M.

The **methods** implied differ depending on the concentric circle they ought to be enacted in (individual, organization, market).

At the individual level, incentives systems should be tweaked to make it unfavorable for gray hats to misbehave. As previously stated, gray hats misbehave if their cost/benefit analysis favors misconduct over obedience. This can happen for different reasons: because the goals are unattainable through obedience to the law, because the rewards in case of success are particularly high, because the internal sanctions in case of failure are severe, because the likelihood of punishment (and credibility of oversight) in case of misbehavior is low. The more the *external* rewards system put in place by the firm is aligned with the individuals' *internal* rewards system, the less *moral dilemmas* it would create and the better it would work.<sup>320</sup>

These elements can be changed as follows.

The goals should be attainable, regardless of what they are tied to – stock price, sales numbers, and the like.<sup>321</sup> It should be clear to the manager that the objectives she should strive for are achievable through obedience to the law, and there should be no association of misbehavior with success.<sup>322</sup> In addition, being able to achieve the goals without violating one's PVs makes the financial goals more attractive and the individual more prone to reach them.<sup>323</sup> For instance, W.F.'s infamous "Going for Gr-Eight" goal was *designed to be unattainable* by at least 50% of the local branches.<sup>324</sup>

The metrics for the reward system should also consider the *methods* adopted to reach the goals and should not only be based on numbers. If they are only focused on numbers, they will further a perception of acceptance towards doing whatever it takes to reach them. The message should be that what the company values is being *responsibly successful*, and not *successful at any cost*.

Ethical and honest behaviors should be rewarded, in the same way that high-performing behaviors are generally rewarded. Receiving validation and rewards for honest actions aligns with one's internal rewards system, prevents violations of PVs, and increases the benefits of obedience.<sup>325</sup>

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<sup>320</sup> See *Dishonesty of Honest People*, *supra* note 166, at 633-34 (noting that people have an internal rewards system that triggers positive brain reactions in case of compliance and negative reactions in case of noncompliance, which hampers one's own self-concept).

<sup>321</sup> See *Organizational Context*, *supra* note 254, at 375-76 (concluding that rewards system should set challenging but attainable goals).

<sup>322</sup> See, e.g., FINANCIAL DELINQUENCY, *supra* note 247, at 156 (describing how the association of success with criminal conduct may be a feature of the generation of businesspeople that came after two decades of neoliberalism).

<sup>323</sup> See *Preferences for Truthfulness*, *supra* note 157, at 545.

<sup>324</sup> See *supra* Part I, B. WELLS FARGO.

<sup>325</sup> Obedience would be associated with rewards, upholding of one's own sacred values, and maintenance of one's own self-concept as a trusted and respectable individual, thus not requiring articulate rationalizations: see, e.g., *Dishonesty of Honest People*, *supra* note 166, at 634 (highlighting the importance of self-concept in understanding dishonesty); Cressey, *supra* note 194, at 13-15 (noting how important it is for the white-collar criminal to maintain

Failure should not be chastised nor excessively sanctioned within the firm. Executives already are predominantly fearful of failure,<sup>326</sup> and influencing their actions with threats and menaces of punishment if goals are not met only *increases the costs of obedience*, especially if obedience has a lower likelihood of helping reach the objectives. Associating failure with excessive sanctions pushes managers to consider every possible way to avoid it – the more one ties punishment to failure, the less failure is considered an option.

The likelihood of punishment and credibility of oversight should be strengthened.<sup>327</sup> There is not much a corporation can do with regards to regulating criminal punishment, but it should aim to make sure that within the firm misconduct is detected and sanctioned. This would increase the perceived costs of misbehavior and be weighed in favor of obedience. If misbehavior is not properly sanctioned and it is effective in reaching the goals set by the rewards system, it will be associated by managers with success and rewards and never with punishment. The message of collective acceptance of misbehavior will thus be reinforced by a corporate structure that is unable or unwilling to take a stance against delinquency. As Italian criminal law scholar Cesare Beccaria would warrant, punishment within the organization should be *certain* rather than *exemplary* – the *certainty* of receiving a reproach can have higher deterrence than the *uncertainty* of receiving an exemplary punishment.<sup>328</sup>

Enacting such measures would tweak the cost/benefit analysis of gray hats in such a way that pushes them towards obedience rather than misbehavior. Specifically, these measures would:

- (i) increase the costs of misbehavior, by increasing the likelihood of punishment and credibility of oversight;
- (ii) decrease the benefits of misbehavior, by setting attainable goals and reducing rewards in case of success;

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a self-perception of being a trusted individual).

<sup>326</sup> See, e.g., TRUSTED CRIMINALS, *supra* note 135, at 224 (on the fear of falling or failing of white-collar criminals).

<sup>327</sup> The likelihood of punishment dialed into the gray hat’s cost/benefit analysis also considers the likelihood of getting caught.

<sup>328</sup> That is also why in describing the cost/benefit analysis of white-collar criminals, scholars generally refer to the *likelihood* and not the *severity* of punishment: see, e.g., *Organizational Context*, *supra* note 254, at 368-69; see also BECCARIA, *supra* note 134; Daniel S. Nagin & Greg Pogarsky, *An Experimental Investigation of Deterrence: Cheating, Self-Serving Bias, and Impulsivity*, 41 CRIMINOLOGY 167 (2003) (for a study that confirms the hypothesis of how increasing the probability of punishment is more effective in deterrence than increasing its severity) [hereinafter *Deterrence*].

(iii) increase the benefits of obedience, in that obedience would keep the manager safe from the negative consequences of getting caught and align with their internal rewards system, avoiding violations of PVs;

(iv) decrease the costs of obedience, in that it would not be associated with failure and severe punishment but with success and rewards (the goals are attainable).

These measures have an impact at the organizational level as well, considering the impact that the repetition of a certain rewards system can have on corporate culture over time.<sup>329</sup> The organization must strive to ensure and promote a *morally sound* work environment, where white hats can be attracted to and where gray hats more easily slide towards the light-gray side of the spectrum. This proposition is supported by the business community. A 2016 study found that 85% of executives believe that a poorly implemented, ineffective corporate culture can lead to unethical or illegal behavior.<sup>330</sup>

One first way to make sure the company's culture is not overly competitive and accepting of misbehavior is – as just stated in the individual section – tweaking the rewards system and repeating it overtime, which should build the first bases for an ethically compliant environment.

Second, the company should foster a culture of compliance, adopting an ethics program and overseeing its application.<sup>331</sup> More than by sanctioning non-compliance, the program could be assisted by positive feedback and rewards in cases of compliance.<sup>332</sup>

In this way, obedience to the program will be associated with a favorable reaction and will be dialed into the perceived benefits of *not misbehaving*. It will also send a clear message of how the company values well-behaving managers in a way that is not necessarily tied to stock price, but to more *ethical* standards.<sup>333</sup> One way to enforce this *ethical* message is for top management to concretely show commitment to ethical behavior, which positively influences other members of the organization.<sup>334</sup>

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<sup>329</sup> See *Hyper-Competition*, *supra* note 86, at 971 (as discussed in *supra* Part II, C. THE MOTIVE, §iii).

<sup>330</sup> See John R. Graham et al., *Corporate Culture: Evidence from the Field*, 146 J. FIN. ECON. 552, 566 (2022) [hereinafter *Corporate Culture*].

<sup>331</sup> See *Organizational Context*, *supra* note 254, at 376-77 (highlighting how having an ethics program can lead to the perception that doing unethical things is not required to get ahead in the firm).

<sup>332</sup> *Id.* (noting that one way to shape an ethical culture in an organization is to dialing rewards for ethical behavior into the performance review process).

<sup>333</sup> *Id.*

<sup>334</sup> *Id.* (also noting that organizational deviance is lower when top management both provides and enacts ethical guidance); see also *The Power Few*, *supra* note 162, at 193

If managers engage in the idea that breaking the law is *good* if it is profitable, they will send the message to employees that rules are not there to be abided by. This would also give contradictory messages to employees: how are they supposed to be expected to blindly follow corporate rules, if their own employers *violate* public regulations for the sake of individual profits? Such a dilemma could push gray hats to the darker area of the spectrum and favor disobedience.

Favoring compliance instead could serve to both attract and retain white hats, who will feel more compatible with the ethical soundness of an *obedient company*, and to positively influence gray hats. The likelihood of a violation is lower for a gray hat who is rewarded for *good* (ethical) actions, who sees the *good* (ethical) example of top management, and who works in a culture that is not accepting of misbehavior.

The ethics program should *remind* individuals of their moral standards and PVs. It should therefore adopt communication strategies that convey such values and make sure that individuals are more attentive to their own moral standards. This *attention to moral standards* has been proven to be linked with higher levels of honesty.<sup>335</sup>

One other way that could help locate black hats – or misbehaving gray hats – and remove them from the corporate structure is the enhancement of detection procedures and whistleblowing. Ethics programs have been described as having a “smoke detector” function, as they give employees a tool to deter others from unethical behavior.<sup>336</sup> Without diving into the extensive literature on whistleblowing,<sup>337</sup> it suffices to say that an

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(proposing the introduction of an “ethical training” to foster compliance).

<sup>335</sup> See *Dishonesty of Honest People*, *supra* note 166, at 635-36 (in a behavioral study, participants who were made to recall and recite the Ten Commandments were found to be less likely to cheat and be dishonest) and at 637 (reaching similar conclusions in an experiment that involved signing an honor code, noting that it worked as a reminder of morality); *The Power Few*, *supra* note 162, at 192-93 (proposing to introduce “behavioral compliance ambassadors,” who – among other things – should “. . . talk about ethics and compliance with their co-workers.” *Id.* at 193).

<sup>336</sup> See *Organizational Context*, *supra* note 254, at 376.

<sup>337</sup> See, e.g., SEUMAS MILLER, *INSTITUTIONAL CORRUPTION: A STUDY IN APPLIED PHILOSOPHY* 206-25 (Cambridge Univ. Press 2017) (describing the phenomenon of whistleblowing in a corporate setting); see also MARCIA P. MICELI, JANET POLLEX NEAR, TERRY M. DWORKIN, *WHISTLE-BLOWING IN ORGANIZATIONS* (Routledge 2008) (research-based and empirical approach to whistleblowing); *Corporate Whistleblowers*, *supra* note 73 (analyzing whistleblowing in general and using Enron as an example); *TRUSTED CRIMINALS*, *supra* note 135, at 20-32 (describing whistleblowers as “. . . a related crucial source of information needed for the detection, and ultimately the prosecution, of many white-collar crimes, especially governmental and corporate varieties”. *Id.* at 22); Miriam H. Baer, *Reconceptualizing the Whistleblower’s Dilemma*, 50 UC DAVIS L. REV. 2215, 2241-49 (2017) [hereinafter *Dilemma*] (classifying potential corporate whistleblowers in the

environment where employees feel safe to report unethical practices – and where such reports are taken care of – is an environment where black hats can be more easily located and removed.

The employee should be certain that blowing the whistle will not have negative effects on their career, nor on their relationship with peers in the office. Things such as anonymity<sup>338</sup> and psychological support could help securing such a result. Whistleblowing and detection of misbehavior should always be voluntary and should not be perceived as a work-imposed obligation.

Also, there should be particular attention to who blows the whistle: in some cases, proximity to lawbreaking means complicity with it, therefore not *all* whistleblowers should be seen as white hats and should be glorified.<sup>339</sup> The use of tips to incentivize whistleblowing risk creating dangerous incentives within the firm and should be considered with caution.<sup>340</sup> Corporate officials should feel safe to blow the whistle when they feel it necessary – that is, when they are sure *something is wrong*. The decision to blow the whistle on someone or a company can trigger dangerous consequences, even coming to the extinction of the firm – it should be taken carefully and not only under the prospect of receiving money.

Overall, these measures could help build an ethically sound corporate culture. Fostering a culture of ethics and compliance can positively influence the members of the organization and consolidate obedience as the exclusive way of reaching corporate goals.<sup>341</sup> According to a recent study, a high percentage of executives believes that improving a company's culture can also help maximize value.<sup>342</sup> Thus, staying within the ethical guardrails of obedience by refining a company's culture can go hand in hand with value maximization.

It is necessary for the measures at the individual and organizational level to be adopted together – they work as a whole system of compliance and reciprocally assist one another. Disregarding this collective aspect could

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*complicits* and in the *innocents* and evaluating the effectiveness of the SEC's program on whistleblowing).

<sup>338</sup> The whistleblower should choose whether to maintain anonymity or not.

<sup>339</sup> See *Dilemma*, *supra* note 336.

<sup>340</sup> See *id.*, at 2223-33 (considering the SEC's "bounty program" that provides tips for blowing the whistle and assessing its effectiveness and potential shortcomings).

<sup>341</sup> This is more relevant considering how highly corporate culture is valued in the business community, as 91% of executives consider corporate culture to be "important" or "very important" at their firm. See *Corporate Culture*, *supra* note 329, at 554.

<sup>342</sup> *Id.* at 561-64 (noting that 92% of executives believe that improving their company's culture will increase the value of their company).

tamper their effectiveness. W.F., for example, had – what was considered – a sound and advanced compliance system.<sup>343</sup> However, it was not paired with an equally ethically sound incentives system, and ultimately failed.<sup>344</sup> The framework this paper fosters would impose equal focus on both the individual level (incentives system) and the organizational level (compliance system), thus avoiding risky asymmetries in the prevention of misconduct.

The market level is something which is more difficult for corporations to have a grip on. In preventing misconduct, it is more difficult for a corporation to apply measures to the market than to apply measures to itself or to its individuals. The basic premise is the same as before. Market-based consequences should make it more costly for managers to misbehave rather than behave. More precisely: the manager should perceive the costs of not reaching the market-imposed goals as more desirable than the costs of getting caught in case of misbehavior.<sup>345</sup> If the manager sees the prospect of failing in the eyes of the free market as worse than the *rare* chance of getting caught cheating, they will misbehave. How to influence that cost/benefit analysis?

*Increasing the costs of getting caught:* this could happen by enhancing cooperation between the corporation and the Department of Justice, without recurring to an increase in the length or severity of punishment<sup>346</sup> White-collar investigations are no revolutionary idea, but where there should be improvement is with the likelihood of the negative consequences that would arise in case misconduct is uncovered, not only against lower-level employees, but also with top management as well.

Another way is ensuring a higher public accountability of the misbehaving manager. There shouldn't be safety nets of high termination packages waiting for the CEO that gets laid off in case they misbehave, but a market ready not to tolerate unlawful conduct – at least, to tolerate it less than poor performance. This carries hard challenges, as the market generally reacts more quickly and easily to changes in stock price rather than levels of culpability of individual managers.<sup>347</sup> And even when it reacts to corporate

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<sup>343</sup> See *The Power Few*, *supra* note 162, at 172-74 (for an analysis of W.F.'s compliance system as “. . . a reputable one by all appreciable standards.” *Id.* at 172).

<sup>344</sup> See *id.* at 174 (according to the author, the system failed because it was “. . . incorrectly targeted based on a flawed assumption of how compliance lapses occur”).

<sup>345</sup> The costs of getting caught depend on the severity of misbehavior and can go from administrative sanctions (e.g., SEC-imposed fines) to criminal punishment.

<sup>346</sup> See *Deterrence*, *supra* note 327, at 183 (noting that “the prevalence of cheating significantly decreased with the certainty of the potential penalty but not with its severity.”).

<sup>347</sup> See, e.g., JOHN C. COFFEE, JR., *CORPORATE CRIME AND PUNISHMENT: THE CRISIS OF UNDERENFORCEMENT* 65 (BERRETT-KOEHLER PUBLISHERS, 2020) (finding that in some cases fining a corporation for wrongdoing has resulted in the increase of share price. Therefore, it would not seem that the market necessarily reacts negatively to wrongdoing).

wrongdoing, it may not necessarily react to it negatively.<sup>348</sup> A company should distance itself from the misbehaving manager and *remind* itself and the market of its values and ethical strength. If such a *sanction* becomes common custom in the market, as repeated by its corporate actors, the gray hat would dial these higher costs of misbehavior into her cost/benefit analysis and wrongdoing would be less likely.

*Decreasing the costs of poor performance:* with a system that ensures more public accountability and disclosure of corporate practices, potential instances of wrongdoing would get more easily exposed and become a part of the market's perception of a company's stock price. A high stock price would be seen not only as a successful number, but also as a representation of the *methods* implied to reach it. If the market was given this information, the *honest* poor-performing manager would be perceived as being no worse than the *dishonest* well-performing manager, whose performance is fictitiously inflated. With a market-based oversight of misbehavior it would also become more difficult for the manager to rationalize and justify their wrongdoing. The market could serve as a *moral reminder* of a company's PVs, thus contributing to decreasing the likelihood of dishonesty.<sup>349</sup> That would create a sort of a *public and collective* reminder of PVs.

### B. *Testing the Framework. An Example*

A fictional case study could help clarify. Imagine that Fish, Inc. is a leading company in the fishing industry, and its board is known to engage in ruthless shareholder-value-maximizing operations, to the point of violating the law.<sup>350</sup> Jerry F. Ruthlessborg, its CEO, has been caught on record saying the following to the CFO, Richard S. Fierceson: "I couldn't care less about the Ocean, Richie. We need those dividends, or our board is going up in flames. I don't care if we violate environmental regulations, throw that waste into the sea and make the dollars flow". An analysis of his statements would suggest the following:

(i) Jerry is keenly focused on S.V.M. He needs the dividends for shareholders, and he needs to "make the dollars flow": this is the corporation's main purpose.

(ii) His focus on profit-maximization can trump rules and justify violations: he applies the law-as-price theory, as he doesn't care if they violate environmental regulations. Clearly, profits are hierarchically superior to obedience.

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<sup>348</sup> *Id.*

<sup>349</sup> See *Dishonesty of Honest People*, *supra* note 166, at 635-36 (recalling one's moral standards decreases the likelihood of being dishonest).

<sup>350</sup> The case study is entirely fictional and not based on any real events or persons. Any resemblance to actual events or individuals is purely coincidental.

(iii) He is afraid of the negative consequences of failure. As much as he is obsessed with the maximization of profits, he is also afraid of his board "going up in flames". That would be the scenario if they abided by the environmental laws and failed to deliver dividends. Therefore, he has significant pressure from investors to maximize profits.

If the following measures were to be adopted, Jerry would be less inclined to misbehave:

(a) *At the individual level:* A compensation package and rewards system linked to lawful activity and not only to stock price: that is, salary and bonuses that are not only dependent on *numbers*, but also on the *methods* used to reach them. If Jerry were not to be paid if he violated environmental regulations, he would instead be keen to obey these regulations, as it would mean protecting his salary and maybe even enjoying additional rewards. A rightly tweaked rewards system can be an incredibly powerful tool of incentives.

(b) *At the organizational level:* A corporate culture which looks down on misbehavior and favors ethical compliance: this would reduce the organizational rationalizations that Jerry could use if the corporate culture embodied his law-as-price theory. If Fish, Inc. had an ethical corporate culture, Jerry would lose the faith and support of the corporate structure in cases of lawbreaking. It would be harder for Jerry to lead the company if he behaved in a way which would be prohibited by the company's ethics code and even *sanctioned* if it were committed by employees. Jerry would be seen as a dangerous outsider, rather than a cool leader. And, sooner or later, dangerous outsiders are ousted.

(c) *At the market level:* Jerry would also be less inclined to misbehave if competitors publicly condemned what he said and/or did. If the market and his competitors *reacted* by publicly distancing themselves from what Jerry said, he would be more inclined to do the same and retract his statements. That is, the pressure to avoid being publicly chastised in cases of misbehavior would be greater than the pressure to meet dividend goals and the fear of failing to do so. He ought to be convinced that it would be more likely for the board to "go up in flames" if he violated environmental regulations, than if he didn't reach quarterly financial goals.

The key for the corporation to influence the market is to communicate with it. The information that the firm feeds the market should be aimed not only at enhancing S.V.M., but also at rewarding the ethically compliant manager. This type of market-based reward would increase the benefits of obedience and be favorably considered by the managing gray hat.

The market level is the level the firm has the least power over. Issues such as neoliberalist deregulation, prosecutions by the DOJ, and reactions to stock price variations are all things the corporation can do little about. Still, the corporation's sphere of influence should not be overlooked, as proved here.

This paragraph has set forth some proposals to counteract individual misbehavior within organizations, building on the previously developed theoretical framework. The *objective* of the proposals is threefold: attract and retain white hats, positively influence gray hats, detect and keep black hats out of the corporation. As we have seen, the *methods* implied work at the individual, organizational, and market level.

More research is surely needed on the topic of white-collar crime and its prevention, especially regarding its link with S.V.M. As already stressed, this should be seen as the starting point for future analyses.

### CONCLUSION

The connections between the urge to maximize profits and the push to stretch the rules of the game in order to do so are many and complex to dissect. S.V.M. is generally studied from a corporate governance perspective and in comparison with stakeholderism – usually in the context of the debate for corporate purpose. White-collar crime and corporate misbehavior are more frequently studied from a criminological point of view. As we have seen, it is appropriate to analyze these topics in relation to the technicalities of corporate governance, specifically keeping in mind the theory that puts the maximization of shareholder value ahead of everything else. Adopting the cost/benefit lenses of the law and economics of crime as the theoretical basis for the discussion and enriching its perspective with the support of behavioral studies, this paper has provided a framework and a tool to better study the potential criminogenic risks of the maximization of shareholder value. In such context, the trichotomy of corporate officials works as a useful model to understand how individuals could react to the incentives of profit maximization. This happens at the individual, organizational, and market level. The application of this framework poses potential policy concerns for the prevention of misbehavior, which serve as the basis for the proposals this paper puts forward.

The present analysis thus offers a helpful tool. Corporate law and governance studies on corporate purpose can use the provided framework to analyze the effects of different policies on corporate individuals, leading to the adoption of measures which do not increase the chance of violations. Additionally, white-collar criminology can use the proposed framework to

retrace the potential causes of misbehavior to corporate policy decisions and better dissect them across the three concentric circles of the individual, the organization, and the market.

Ultimately, the insights that this tool offers can serve as the basis for advances in corporate compliance systems aimed at removing individuals who are more prone to misbehave (black hats), attracting individuals who are unlikely to cheat or be dishonest (white hats), and positively influencing the vast *middle ground* (gray hats) to behave rightly and obediently.