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Discussing Corporate Misbehavior

THE CONFLICTING NORMS OF MARKET, AGENCY, PROFIT AND LOYALTY[*]

Daniel J. H. Greenwood[†]

I. INTRODUCTION

Corporate law remains thin, but corporate law scholarship is thickening. This Symposium is both a symbol of and a major contribution to that process. We are stepping beyond the narrow models of rationally maximizing fictional shareholders and purely self-interested managers competing in an evolutionarily determined and purely individualistic market inevitably maximizing social wealth through the pursuit of private profit. Instead, new scholarship is taking a richer perspective infused with the insights of group and individual psychology, recognitions of institutional realities, and broader conceptions of the social good.

American corporate law restricts itself to a limited view of the public corporation. In state corporate law, a corporation consists of little more than directors and shares,[1] with the

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[1] I use the term "share" rather than the more common "shareholder" because corporate law and scholarship alike normally ignore the portfolios and people who own the shares (i.e., the shareholders), instead focusing on a purely imaginary creature with no views, interests or desires other than maximizing the value of the particular corporate stock at issue. In corporate law, then, the term "shareholder" while misleadingly invoking images of a human being, actually refers only to a role. *See generally* Daniel J. H. Greenwood, *Fictional Shareholders: "For Whom is the*

occasional cameo appearance of creditors of a firm near bankruptcy, or managers as the secret doppelgangers of the inside directors. The issues of central concern to the law are similarly restricted: the formal voting rights of shares, the ultimate power of the directors to manage the corporation and the limited exception granted to shares to sue derivatively, the directors' limited fiduciary duties to the corporation and its shares, and some cameo appearances of other legal values when shares and directors are at odds over takeovers. Even in these areas, corporate law is famously "enabling," "towering skyscrapers of rusted girders, internally welded together and containing nothing but wind."[2]

When corporate law has entered the normative thicket, it has usually been to enforce the thin view of its purposes: to define shareholder interests as the interests of the role, rather than the human beings who inhabit it, and to force managers to restrict their view of the corporation's interests to those of these legally constructed fictional shareholders.[3] ERISA and the fiduciary and agency rules regulating the decision-makers for most institutional shareholders (that is, the holders of most shares), often require them to act as if their only concern were maximizing returns to undiversified shareholding in the particular corporation. Moreover, corporate law gives directors and shares the right to sell corporate control without consent of other corporate constituencies. Combined with the anonymous market for publicly traded stock, this creates vast market pressure to run the firm in the manner most likely to be rewarded by the stock market. And (at least since the demise of the conglomerate fad of the 1960s) the stock market has generally bid up the stock prices of corporations that

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Corporation Managed," Revisited, 69 S. CAL. L. REV. 1021 (1996). Moreover, voting in a corporation is on the basis of one share one vote, rather than one shareholder one vote; here too the term "shareholder" tends to mislead, giving the appearance of democracy where there is at best plutocracy.

[2] Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 245 n.37 (1962).

[3] *See* Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919) (declaring that the purpose of the corporation is to earn returns for its shares, regardless of the expressed views of the majority shareholder); State ex rel. Pillsbury v. Honeywell, Inc. 191 N.W. 2d 406 (Minn. 1971) (declaring illegitimate attempt of shareholder to cause corporation to consider values other than profit-maximization); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985) (requiring managers, under limited circumstances, to pretend that shareholders have no interests other than the value of their shares, and to run the corporation in those legally defined interests). More often, however, corporate law's business judgment rule removes the issue of corporate purpose from judicial purview.

demonstrate a decent respect for the opinions of institutional shareholders and show a keen focus on identifying corporate interests with stock market interests.

Other areas of the law regulate other aspects of the public corporation, but generally without consideration of the specific characteristics of corporations as such. Thus, securities law, in general, protects securities holders as outsiders, consumers of a product produced by the corporation, creating rights to information in the manner of a truth-in-packaging law.[4] Environmental law, constitutional law, criminal law, labor law and so on, generally regulate the corporation as a "person," ignoring its collective and corporate character and subjecting it to norms created for citizens without much consideration of special issues of organizational behavior.[5]

But public corporations are not individuals. They are large bureaucratic organizations, no more likely to respect individual rights or needs than the large bureaucratic organizations of the state, and generally a good deal less responsive to the views of the majority or those they affect. General American law starts from a basic distinction between state and citizen, public and private—but we have placed our large public business corporations on the private, citizen side of the divide, as if we needed rights for them rather than rights against them, or as if we existed for their sake rather than they for ours. Since the fundamental foundation of the individualist liberal political theory on which our polity is based is the recognition that groups and organizations often do not act as the individuals in them would like them to, this conflation of corporations with people is strange, to say the least.

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[4] Even the Williams Act, which edges into regulation of the firm's internal decision-making processes while retaining the form of consumer protection by disclosure regulation, strikingly avoids substantive discussion of how, by and for whom corporations are run.

[5] The corporate income tax scheme also treats the corporation as a person or entity, taxing the corporation's income just as it taxes any other person's income. The current attack on so-called "double taxation" however, seems to be premised on the claim that the corporation can be reduced completely to its shareholders, so that its income is theirs even though they have no right to receive or control it. This revisionist view rejects both the person/entity view most commonly seen in regulatory statutes in favor of corporate law's currently dominant view of the firm as a "moment in the market" with no institutional existence. As should be apparent, neither of these views are compatible with a perspective that takes the institutional reality of the firm seriously. A serious discussion of taxation of public corporations would have to begin by discarding rhetorical claims that the corporation is a person like any other or doesn't exist and instead to confront the near impossibility of determining the actual impact of corporate income tax on corporate participants in increased prices or reduced payments (salary, dividend, interest or prices).

Corporate law scholarship in the last quarter of the millennium both celebrated the limited protection the law offers and narrowed the scope of its own concerns even further.

Its psychological theory began, and usually ended, with a model of rational profit maximizers borrowed from neo-classical economics. Shareholders were modeled as one-sided fictions with no interests or values other than increasing the value of the stock they hold in a single corporation—as if they were undiversified aliens or colonial occupiers with no interest in the society they sought to exploit. Directors and managers were reduced to self-interested cynics who must be coerced or paid obscene amounts to do their jobs or observe minimal professional norms. Other employees simply disappeared from view altogether, except perhaps as tools to be maximally exploited.

Its normative concerns sometimes seemed restricted to no more than a debate between advocates of idolatry—viewing every idiosyncrasy of legally regulated markets as sacred—and plutocracy—seeking to ensure, market or no, that an ever increasing slice of the corporate pie was served to the capital markets.

Sociologically, in the leading models, the firm itself seemed at times to lose its corporeality, as "nexus of contracts" models made the institution invisible, no more than a collection of individuals meeting in a collection of moments to exchange and then depart again into the "woods of America . . . perfectly in a state of nature."[6]

In the last decade, however, we have moved into a new era. Corporate law scholars have begun to recognize that we must take into account the learning of real psychology, that we must understand group interactions outside the narrow bounds of neo-classical individualism, that the organization has

[6] JOHN LOCKE, TWO TREATISES OF GOVERNMENT 295 (Peter Laslett ed., Cambridge Univ. Press, 1988) (1690). Locke here follows Thomas Hobbes' description of the state of mutual disinterestedness—war—between individuals in America and anywhere else "where there were no common Power to feare." THOMAS HOBBES, LEVIATHAN 65 (Prometheus 1988) (1651) . Hobbes' portrait of man in the state of nature is closely related to the usual models of motivation used in classic late twentieth century corporate law. As he describes it, in the absence of relationship or government:

> To this warre of every man against every man, this also is consequent; that nothing can be Unjust. The notions of Right and Wrong, Justice and Injustice have there no place. Where there is no common Power, there is no Law: where no Law, no Injustice. Force, and Fraud, are in warre the two Cardinall vertues.

Id. at 66

behaviors and meanings that can no more be reduced to the individuals in it than government can be reduced to the governed, that ethical issues may be more complex than simply not stealing from shareholders (and stealing as much as possible for them).

The essay proceeds as follows. Part II uses Professor Linda Treviño's contribution to this Symposium, which details the important ways in which a corporate CEO influences the rule-abidingness of his subordinates, as a reminder that corporate law must consider the sociological institution of the firm, not merely the limited roles which we usually emphasize. Part III explores Professor John Darley's contention that people in firms seem unduly "recruitable into corrupt practices" and discusses how people in corporate roles often seem to conclude that the right thing is the wrong thing to do. Part IV takes the idea of role based norms one step further: The corporation, I contend, functions at the intersection of radically different market and fiduciary norms and is inherently a locus of normative conflict. Thus, corporate wrongdoing is as likely to result from the wrong norm in the wrong place (including but not limited to the team spirit, internal culture and loyalty that Professors Treviño and Darley discuss) as from selfishness, corruption or other forms of explicitly bad behavior. Part V discusses the ways in which corporations can mediate these normatively conflicts, successfully or not. Part VI concludes with some preliminary suggestions for further research and law reform.

II. THE ROLE OF THE CEO

Professor Treviño and others have demonstrated that CEO behavior critically affects firm ethics. When the CEO acts ethically and creates institutional structures that make clear to other employees that the firm values ethical behavior, the firm acts more ethically.

Over the course of the last three decades, CEO pay has risen astronomically in the United States, from perhaps 24 times the average employee's pay in 1965 to 300 times by the turn of the century.[7] With our CEOs now paid so much more

[7] LAWRENCE MISHEL ET AL., STATE OF WORKING AMERICA 2004/2005, at 212-216 & figure 2Y. *See also* Susan J. Stabile, *One for A, Two for B, and Four Hundred for C: The Widening Gap in Pay Between Executives and Rank and File Workers*, 36 U. MICH. J.L. REFORM 115, 116 n.4 (2002) (stating that in 2000, average

than the rest of us (and even than comparable CEOs in other countries[8]), a cottage industry has sprung up defending the high compensation. Institutional shareholders were persuaded by agency theory arguments that high, stock-based pay for CEOs would cause higher CEO productivity: By tying CEO incentives to share price performance, high pay would lessen CEO shirking, thereby increasing returns for shares.[9] After the pay increases, the standard neo-classical model of wage setting for employees provided an equal and opposite justification: A profit-maximizing company would hire someone only if their pay is lower than their contribution to the firm's profit. On the "best of all possible worlds" view of this perfect market theory, it seems to follow that high CEO pay must result from high CEO productivity. Combined, the theories contend that American CEOs are paid more than their foreign counterparts and their predecessors because they are doing a better job.[10]

But with high compensation should come high responsibility. All that pay must be for something. It has been

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CEO compensation was 531 times the pay of the average blue collar worker). Another way to see the same phenomenon is that average hourly wages were up 10% in real terms between 1989 and 2000, while average CEO compensation increased 342% in that period. MISHEL, *supra*, at 113 tbl. 2.1, 213 tbl. 2.46.

American CEO pay is almost as unequal as American income generally. Accordingly, average CEO compensation is vastly higher than median CEO compensation (in 2000, $11.194 million vs. $3.101 million). MISHEL, *supra*, at 213. Median CEO compensation of $3.6 million in 2003 was 336 times the $10,712 a full time worker would earn at minimum wage ($5.15/hr, 8 hours/day, 260 days/year) and 101 times average 2002 wages of $35,424. MISHEL, *supra*, at 113.

[8] Stabile, *supra* note 7, at 121 n.22; MISHEL, *supra* note 7, at 214, 215 tbl. 2.47 (stating that US CEOs are paid roughly three times as much as their counterparts in other developed countries).

[9] *See, e.g.*, Michael C. Jensen & Kevin J. Murphy, *CEO Incentives— It's Not How Much You Pay, But How*, 68 HARV. BUS. REV. 138 (1990). Agency theory suggested that tying CEO pay to stock performance would make CEOs more entrepreneurial. In my view, the changes in CEO pay probably did increase shareholder gains, but the incentive theory seems unduly mechanical. Instead, high pay alone, as well as vastly increased stock holdings, has changed CEO views of the team for which they play. The modern CEO is far less likely to identify with the bureaucracy he heads and far more likely to identify with his peers heading other corporations. Moreover, as CEOs become increasingly wealthy and increasingly large stockholders (both in their own company and the market generally), they are less likely to think of themselves as professionals and more likely to think as investors or owners. These reorientations make it less likely for CEOs to identify the interest of the firm with the interest of its employees. They, however, also make it more likely for CEOs to view their role inside the firm cynically and, in some instances, to abandon team playing altogether. For further discussion, see Daniel J.H. Greenwood, *Enronitis*, 2004 COLUM. BUS. L. REV. 773, 802 (2004).

[10] *See, e.g.*, Randall S. Thomas, *Explaining the International CEO Pay Gap*, 57 VAND. L. REV. 1171, 1172 (2004) (noting that US executives are paid more than their foreign counterparts and explaining it as reflecting greater productivity).

startling, then, to see the alacrity with which the CEOs on the "perp walk" (as Professor Treviño terms it) have adopted a defense based on ignorance. Apparently, we are supposed to believe that CEOs earn their enormous compensation through their ability to make the organization more productive, while simultaneously accepting that they really have no idea what is going on in their organization, even at the basic level of whether the organization is actually producing or just faking it. On this view, ignorance is a defense, even for those whose business is knowledge. As in My Lai or Abu Ghraib, the upper echelons deny any connection to crimes committed by their underlings: Those designing institutions insist that they should be entitled to assume that those below them will act appropriately in all circumstances regardless of institutional pressures, temptations or norms.[11]

Professor Treviño shows that, at least in the corporate world, we should just say no. Whether CEOs like it or not (and whether or not it fits into the thin theories of corporate behavior based on rational maximization), institutional ethics are largely under CEO control. CEO behavior matters. CEO talk matters. CEO silence matters. Organizational structures implemented by CEOs matter.

Professor Treviño maintains that most corporate actors are not fully autonomous rule-following ethicists unaffected by the norms and expectations of those around them. Instead, like most adults, they tend to conform their behavior to the norms they believe are expected of them. Since CEOs are instrumental in creating those expectations and the institutions that back them up, they are instrumental in determining how employees will behave.

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[11] For a recent corporate law discussion of this issue, see In re *Caremark International, Inc. Derivative Litigation*, 698 A.2d 959, 970-71 (Del. Ch. 1996). Caremark limited the old Delaware rule, set out in *Graham v. Allis-Chalmers Mfg. Co*, 188 A.2d 125, 130 (Del. 1963), that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists," *Graham,* 188 A.2d at 130, holding that directors have a "duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists" In re *Caremark*, 698 A.2d at 970, and that liability may be found if directors "utter[ly] fail[] to attempt to assure" such a system exists. *Id.* at 971 By focusing on "information and reporting," *id.*, *Caremark* continues to operate on a background assumption that wrongdoing occurs independent of corporate structure or internal corporate norms. Note however that *Caremark* involves board liability. Boards might reasonably be expected to have less responsibility for the firm's behavior than CEOs, who unlike directors are full-time employees of the firm with primary responsibility for creating and operating its structures.

Corporate law generally treats corporate ethics as outside of its scope, as if the structures created and regulated by corporate law had no significant influence on ethical behavior or as if those structures were outside the realm of corporate law. Companies and their employees may follow the rules or they may not. For corporate law (like criminal law), the firm is black box. These areas of the law look just to the results—if things do not work out, the firm will not be competitive or the regulators will stop it. But Professor Treviño's work, like the other work presented at this Symposium, suggests that we needn't be so agnostic. We know how to influence the degree of corporate ethical behavior, and we could mandate better processes than the ones we allow.

III. CORPORATIONS COMPOSED OF SHARES VS. CORPORATIONS COMPOSED OF PEOPLE

Corporate law, in my view, generally regards the corporation as a commonwealth of dollars. Shares, each representing an equal equity investment in the firm, are the citizens of this polity; it is they and they alone who are granted the political right to vote, entitled to demand equality, or barred from immigration and emigration without consent of the whole. Shares and shares alone are given the right to invoke the assistance of the law to insist that the firm consider their interests; in extreme versions of corporate law ideology (and in *Revlon* mode[12] as a matter of corporate law) only the interests of shares ought to be considered.

In this picture, even the shareholders, in their full humanity as pensioners, employees, CEOs or progeny of the robber baron elite, citizens or aliens, parents and children, and holders of various religious, ethical or aesthetic values, ultimately disappear. The people who are the corporation in the ordinary course—employees—never appear in the first place. They are the concern of some other area of law.

When corporations go bad, however, the firm itself comes back into focus, not as a evanescent nexus of contracts or as a commonwealth of shares, but as a sociological entity—a group of people—with actions and values that cannot be reduced to those of its component parts.

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[12] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1985) (creating duty to maximize share value in narrow circumstances, when the company's sale has become inevitable).

This is where Professor Darley starts: From the firm as a group of people working together, not a pot of money managed on behalf of its "owners." His puzzle is that people in firms seem "more recruitable into corrupt practices" than one would anticipate. His explanation is a combination of normative drift, group loyalty and social roles that value "playing rough."

The normative drift argument is a variant on the famous claim that a frog won't jump out of a pot if you heat it gently enough. Because it can only identify incremental change rather than absolute states, it feels perfectly comfortable until it cooks. Here, the argument is that many scandals begin with a small deviation and proceed in small increments, so that at each point the participants can see the next step as merely an insignificant addition to a commitment already made. They start out with the typical lawyer's rationalization—if "x" is permissible, then "almost x" must also be, since the two are so close as to be indistinguishable. By the point this rationalization no longer works, participants shift to the criminal's commitment: I'm in so deep already that a little more won't hurt.

This story is important, especially for law students, since it is often the lawyer's role to turn the heat up gently by pressing the interpretative limits of regulatory norms—but also to remember that when you press far enough, even in increments that are each justifiable, you generally end up cooked. Too many clever arguments without enough grounding in extra-professional norms ultimately lead to scandal, corporate collapse or even jail.

But it is on the latter explanations that I want to focus here. Here, Professor Darley is telling us not about people who have lost their normative way but about specific choices that seem correct to them, but wrong to more detached observers. Sometimes, as he points out, they are even consciously understood as moral dilemmas, not invisible at all, but great and traumatic, in which the employee must choose between loyalties. Then, corporate criminality partakes of classic tragedy. Pity the person who must choose between friend and country; only doom can result.

IV. THE CORPORATION'S CONFLICTING NORMS

As a lawyer rather than a social psychologist or student of management, my own concerns are centrally normative.

Corporations exist on the border between two conflicting sets of norms, and the issues raised by this Symposium can be seen as resulting from the conflicts between those norms. The problem, or at least part of it, is not violation of norms so much as their inappropriate application, following the right norm at the wrong time or in the wrong place. The normative conflict is irresolvable, but by highlighting it we can work towards a better mediation of our contradictory normative intuitions. Conventional corporate law scholarship, however, has largely concealed the conflict.

On the one hand, we have the market, governed by contract law. The basic norms are of John Locke's state of nature and Adam Smith's market: disinterested strangers treating each other as means to their own ends, not as Kantian ends in themselves.[13] The principles of loving your neighbor—or even your child—as yourself are out of place here; a marketplace can't function if the bargaining parties view their opposites as parts of themselves. This is the world of every man for himself, not one for all and all for one.

To be sure, trade and the division of labor ultimately result in more stuff for everyone, and cooperation is usually the only way to achieve private aims. However, any given bargain is inherently competitive: The more you get, even of the gains from cooperation, the less I do. An invisible hand may assure that my selfishness works to the common good (at least under the right conditions), but in the norms of this role, the common good, or indeed your personal happiness, is important to me only to the extent that it makes me more likely to get what I want.

Even norms as seemingly fundamental to the market as honesty are justified only in the self-centered utilitarian

[13] Hobbes, of course, is the locus classicus of the fully self-centered psychology. I choose Smith and Locke precisely because these authors have a clearer sense of the common good and allow for human sympathy, and yet still model a state of nature characterized largely by mutually disinterested (if not necessarily hostile) people. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (Univ. of Chicago Press 1976) (1776); LOCKE, *supra* note 6. Rawls, for all his emphasis on the Kantian view, describes parties behind the veil of ignorance in a similar fashion, as disinterested rather than mutually concerned. Respect for others is a constraint, not a consequence of love or community. This disinterestedness, which to me seems implicit in and necessary to the contract view that individuals join society to gain benefits for themselves, is central to Rawls's description of the original position and, therefore, undermines any commitment to treating others as ultimate ends. Were the bargaining parties allowed true mutual concern (or even envy, a closely related emotion), it seems likely that they would reject the difference principle as insufficiently egalitarian. *See* JOHN RAWLS, A THEORY OF JUSTICE (1999).

calculus of personal interest. Good bargainers never tell the whole truth about their intentions or concern themselves with the needs or expectations of the other side, except as tools to their own ends. The person who spots a value that others have missed and takes advantage of it—buying low, selling high—is an entrepreneurial hero, not a deceitful cheat.

The market is a world of symmetrical autonomy. In the market, we, or at least our dollars, are all the same in relevant part, all equal and all presumed to be able to take care of ourselves. Markets presume that their participants are self-sufficient adults, aware of what they want, able to balance their needs, desires and capacities, negotiating in their own interest from a position of reasonable independence. Equally important, markets price products, not status or person. Equal products ought to command equal prices; price discrimination is presumptively improper. Money is green regardless of pedigree; opportunities should be taken regardless of tradition; cooperation is bought and sold. The anonymous stock market—where buyers and sellers never even learn the other's identity—is the paradigm; the ideal of blind meritocracy its extension.[14] The market normative system is radically disrespectful of persons, status and relationship.

In the market, obligation stems mainly from contractual promise, and extends only so far as the promise did. This is not a world of solidarity or natural obligations. Your humanity or fellow citizenship has only a limited negative claim on me, that I not violate your individuality by violence or fraud, narrowly understood. Market participants are free, of course, to care for others, but to do so in public is nepotism or favoritism—a violation of market norms even when not illegal. In the public sphere, if you take the needs of your bargaining counterpart as values in themselves rather than tools to be used to overcome him, you are either discriminating or just a mark, a fool or a sucker. The goal of arms-length bargaining is to get as much as you can while giving as little as you can, limited only by the rules of the game.

But if firms hire, fire, buy and sell in the world of the market, they produce in a different arena altogether. As Coase

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[14] For further discussion, see, Daniel J. H. Greenwood, *Beyond the Counter-Majoritarian Difficulty: Judicial Decision-Making in a Polynomic World*, 53 RUTGERS L. REV. 781, 813-15 (2001) (discussing the difference between market and majoritarian decision-making in a democracy).

pointed out, were firms just markets, they would not exist.[15] Markets are better at being markets. Firms exist because they can do things that markets cannot do well. In particular, they replace disinterested contracting with cooperative planning.

Inside the firm, market norms disappear. Instead, the fundamental legal norm governing employees is agency, with its strongly asymmetrical fiduciary obligations.

An agent is required to work for her principal. Instead of maximizing what she can get from a stranger (and relying on an invisible hand to turn this seemingly selfish behavior into something socially useful), she must take the principal's ends as her own. Much as a mother is better off when her child is better off (without a contractual expectation of payback) or a patriot wins when the nation wins (even if he is killed in the process), the norms of agency demand that the employee see the employer's good as her own. She must put aside her self-interest (in the market, contractual sense) and concern herself only with the interests of the other.

Agency is profoundly opposed to the symmetrical anonymity and mutual indifference of market's strangers. The *market-contract* ideal is of blindness to personal characteristics and relationships—a common carrier open to all comers, an anonymous stock market, a medieval fair in which ancestral enemies meet momentarily to trade, charging the same price to lords and peasants alike, or a Weberian bureaucracy promoting and deciding on merit alone. In contrast, *agents* must always remember who is who. To her principal, the agent owes a fiduciary duty; that duty requires her to work for the principal and against (in the market sense) all others. Employees work for employers, not the other way around: The principal gives orders and the agent takes them; the employee must set aside her own interests but the employer need not. Inside the organization, you obey or you cooperate; with outsiders you compete. Relationships and status are essential. Until you know who is agent and who principal, who boss and who subordinate, who insider and who outsider, you know nothing at all. The market ideals of anonymity, autonomy and equality have no place in an agency relationship.

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[15] Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA (1937), *reprinted in* RONALD H. COASE, THE FIRM, THE MARKET AND THE LAW (1988) 33-57, *and in* THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT (Oliver E. Williamson & Sidney G. Winter eds. 1991).

This world of agency is defined by group loyalty and team spirit. The firm should be a team, with each agent working for the good of the whole (otherwise, it is hard to see how it could out-compete a market). Instead of the morality of independence, equality and autonomy, here we have the morality of self-abnegation, sacrifice, caring and unity. We work together, to promote our collective good (against the others). This is a world not of strangers but of family-like groups, in which each person's actions (and, as Professor Darley points out, self-understanding) is interrelated with others'.

We cannot privilege one value system over the other. Nor can we live by either alone. Market disinterestedness underpins bureaucratic regularity and offers liberation from feudal oppression, but threatens to descend into the Hobbesian war of all against all exemplified by the free market of post-communist Moscow or civil war Beirut. Agency status and mutual concern is the foundation of patriotism and social justice—as well as nationalist riots, mob violence, prejudice and group-think. Capitalist affluence and democratic liberal freedom alike depend on both existing and each restrained.

Professor Darley points out the "alternate identities on offer" in our business corporations, using the example of Michael Lewis's experiences as a bond trader. Lewis was shocked to discover that in his employer's view, his client was the bond desk, not the customer. To modify Professor Darley's terminology slightly, Lewis was confronted with a choice of roles and the morals associated with them. According to the bond desk culture he confronted, he was a member of a team. The team was the company, and the team contended that team loyalties trumped legal responsibilities (or alternative views of who he should have viewed as his team).

Note, though, that the issue here is not selfishness or greed (at least not Lewis's). Lewis was being asked to be loyal and self-sacrificing–but to the company, not his client. The ethical breach was not normlessness, but the wrong norm; not selfishness, but the wrong team. The alternative identities available include not just the Commedia del'Arte trickster that Professor Darley discusses, but the market hard bargainer, the capitalist entrepreneur, the team player and the loyal professional.

As Lewis's story demonstrates, when values slip out of their proper spheres or when the spheres overlap, scandal can result. In Lewis's case, the issue was how to define his

fiduciary duties: Was he meant to be working for his employer or his client, should his loyalty to his (local) teammates trump loyalty to his client or the more abstract requirements of law?

Often, however, the problem is not defining the team or limiting its demands. Many corporate problems stem simply from the conflict between the fiduciary norms of agency within the firm, which demand self-sacrifice in support of the team, and the market norms outside it, which demand self-interestedness. The celebration of unrestrained market in American political ideology of the last couple of decades has accentuated the conflict. Thus, a CEO who bargains for as many stock option grants as he can get or who sells his stock when the market is up is acting according to market norms. When he announces that the company is doing well when in fact it is not, he is bluffing in the way that contractual bargainers regularly do. When he fires employees for no reason other than maximizing corporate profit, or treats their pensions not as a social good but as a cost to be cut in any way legally permissible, or encourages his traders to use the rules of a semi-deregulated market to generate private profits at the expense of the California public, he is acting quite properly if the proper norms to follow are those of the disinterested market. In a market, strangers may be exploited to the maximum extent permitted by law. Indeed, if he cooks the company's books to make it appear to be worth more than it is, he may be acting as a faithful agent, putting aside his own interests (and integrity) in order to aid the firm and its shareholders.[16]

In these scandals, the problem is not lawless selfishness, corruption or poorly socialized sociopaths. The evil is not normlessness but the wrong norm in the wrong place at the wrong time. It is a complex problem that will require complex analysis and complex solutions.

V. MEDIATING THE CONFLICTING NORMS

Combining Professor Treviño's contribution with Professor Darley's, we can take the point further. Corporate

[16] The court in *Kamin v. American Express* accepted precisely this explanation of a corporate manager's decision to account for a transaction in a way that cost the company real money but made its profit appear greater, and therefore, if the stock market was deceived, would keep its stock price higher. *See* 383 N.Y.S. 2d 807 (N.Y. Sup. Ct. 1976).

wrongdoing often results from a conflict of norms, rather than a simple refusal to act ethically. In these cases, the problem is not "bad apples" rejecting the norms they are expected to apply, but institutions imposing inappropriate norms (as in Lewis's case) or a corporate actor making what we—after the fact—view as inappropriate choices among conflicting normative demands each of which requires setting aside the employee's own interests or desires. Importantly, when this happens, actors may experience their wrong-doing as self-sacrificing, ethical and externally constrained, not as an act of selfish evil at all.

To be sure, sometimes bad apple explanations are correct. Employees sometimes place their own self-interest above their obligations to others—Bering Bank failed when a trader made a bad trade and then covered it up rather than admit to his mistake, and many of the top executives who falsified their books profited directly from the artificially high stock prices resulting from their lies.

But the articles by Professor Treviño and Professor Darley suggest that this type of corruption—variants on embezzlement—is not the most useful paradigm for corporate wrongdoing. Without ignoring outright criminals, we should focus our primary attention on ordinary people caught in a web of conflicting norms—norms that are mediated, explained and ultimately enforced by corporate structures under the control of the CEO.

The contradictory norms are fundamental. First, we operate under a background regime that glorifies self-help, even at the expense of others. The basic market norm encourages hard bargaining, thinking of yourself and your needs without any consideration of others except as tools to your own ends: that is what we call arms-length bargaining, and success at it *is* success in the business world. Competing hard is a good thing, not a bad one.

Of course, at the same time that we glorify strong competitors, we expect them to observe certain limits. Athletes should play fair, not beat up their opponents or take performance-enhancing drugs. Businessmen should create better products for less, not lie about the product, falsify their books, or shake-down competitors. These rules act as constraints to a game otherwise structured by a different set of norms.

Predictably, a certain number of people will fail to observe the limits, getting so caught up in the game that they

forget that winning is not everything. Basketball players foul, seemingly patriotic commanders condone or order torture, publicists and advertisers spin, and accountants stretch. But they do so to benefit the team, not necessarily to benefit themselves. Perhaps they are "bad apples" in the sense that they have lost their sense of where playing hard meets playing fair, but more importantly, they may also be altruistic team players—they are cheating for the glory of the team, not themselves. Perhaps this is why we often seem so conflicted about punishing them.

Second, corporations create their own internal norms of accepted and expected behavior. To be a professional requires, in most instances, putting aside your own beliefs and adopting the goals of your client. Agency law principles (and their ordinary morality equivalents) usually say the same thing for employees: An employee, on the job, acts ethically and properly if she puts aside her values and adopts her employer's. Enron famously took these potentially conflicting rules to the paradoxical extreme, telling its employees that the way to be team players—to work for the firm—was to compete as hard and ruthlessly as possible—for themselves as individuals.[17]

Corporations, like other groups and bureaucracies, can be structured to maximize group solidarity or not. In this age of the imperial CEO, the corporate world seems especially intent on creating solidarity in the work force. Managers train in the techniques of creating team spirit, team norms, team ethics and team loyalty. Whether by Professor Tom Tyler's procedural justice, tent-revival meeting style hortatory, or simple "us against them" competition, well-run firms work to create and maintain norms of employee loyalty to the firm.

Group loyalty has well-known problems—most importantly, for our purposes, group-think. Tightly knit groups tend to develop their own internal norms, as Professor Darley points out, with most group members recreating themselves to fit their understanding of the demands of the group. But a group that adopts a uniform and closed analysis of the world will be poorly equipped to deal with changing external challenges. When everyone thinks the same way, no one will see the errors in the standard thinking, whether the problem is

[17] Enron was famous for its harsh intra-firm competition, in which employees were regularly required to rank each other, with the winners receiving bonuses and promotions and the losers being fired.

false analysis of the external world (seeing weapons of mass destruction where there are none, or not seeing competitive threats where they are clear) or normative drift.

With the collapse of the unions, the main external countervailing force to corporate loyalty is the corrosive individualism of the market itself. Employees are not only members of the team influenced by norms of team spirit and mutual responsibility, but also potentially out for themselves in a market governed by self-interest. Thus, market norms suggest, as the *Wall Street Journal*'s career management column regularly does, that the intelligent employee will always focus on creating the appearance of team loyalty without succumbing to its reality, and, as Dilbert teaches each day, a cynical distrust of anything "the Boss" might say. These market norms limit the power of group loyalty and group-think, but may not do so in particularly useful ways. Cynical self-interestedness leads to conformity, not to the sort of brave dissent that functional institutions need.

One aspect of corporate wrongdoing then, is the difficulty of mediating fundamentally contradictory norms. We demand that corporate agents cause the corporation to compete hard, treat the people they contract with at arms length as tools to the end of profit, set aside their personal political and moral beliefs while on the job in order to do the work they are paid for. We demand that employees be team players and make clear that the team is the firm, regardless of the needs of the greater society. Paradoxically, that is, we demand that employees altruistically and selflessly serve—but the cause they are to serve is simply the self-interested firm, which is free to treat employees as competitive opponents rather than teammates. It is not surprising that some fail at this difficult game.

Moreover, one key way in which we identify ethical behavior in ourselves and others is self-denial. Kant claimed that the highest form of moral behavior is that which does not benefit the actor at all. I suspect he was wrong,[18] but the kernel

[18] The Kantian formulation, in my view, fails to capture the importance of other-directed team behavior, which is deeply satisfying to the actor. Mothers do sacrifice for their children as patriots do for their country, but the sacrifice is not the essence or the test of the morality of their actions. Rather than sacrificing our own good, within a team we treat the other as ourself, the good of any team member as our own good. Moreover, emphasizing sacrifice suggests, as I note in the text, that selfishness is the main cause of evil, missing the important point that each form of good self-sacrifice has an accompanying evil form. People are often happy to sacrifice

of truth is clear. The clearest instance of unethical and unprofessional behavior is pure self-interested selfishness: stealing from the client.

This agency understanding that the ethical thing to do is to set aside your own views and instead adopt the profit-maximizing norm of the corporation is so strong that it may cause decision-makers to act contrary to their views as citizens even when profit is *not* at stake. It is often difficult to tell what the right thing to do is and even more often difficult to tell what the profitable thing to do is. But the Kantian understanding that "morality hurts" allows a quick (if often misleading) heuristic. The one time that I know I am acting as a good agent, setting aside my own views in the interest of the team, is when I do something I know that I (in my citizen role) would disapprove of. The easiest way to show that I am acting properly is to act improperly. And in the corporate context, this means I should do what is profitable, regardless of whether it is socially useful.

Moreover, I believe the heuristic is commonly taken one step further. Often I may be unsure whether something is profitable, but confident that it is wrong. The agency understanding powerfully (if illogically) suggests that I should pick the wrong action. Virtue hurts; agents are supposed to set aside their own beliefs. By picking something I know I would disapprove of in my private role, I know I am acting as an agent, even if profit remains elusive.

It may be hard to prove whether the strictures of the corporate social responsibility movement increase or decrease long term profit. But it is easy to see that as citizens, we will find many of them attractive. Rejecting them, even in the absence of any actual evidence regarding their costs or benefits to the firm, is an easy and psychologically clear way of proving that the decision-maker is acting in role, as a team member. Perversely, then, actors attempting to do the right thing (in their role as agents) may end up making decisions they know are wrong (in their role as citizens) and which do not even maximize profit.

Team players act on behalf of the team, not themselves. When the subcontractors described by Professor Darley decided to falsify test results, they knew they were risking their

themselves for evil causes, as every student of the virulent forms of nationalism, religion, fascism and communism knows.

personal careers and freedom. They were setting aside their own interests in favor of the interests of a whole greater than themselves. Professor Darley describes this as adopting a social role and proposes various villains. But in a very simple and clearly understandable sense, the role adopted is simply the good and loyal team player. This is ethical behavior—self sacrifice for a cause. Good employees don't shirk and they don't tattle either.

The problem, then, is not (only) bad apples, selfishness or insufficiently socialized individuals who do not understand how to play fair. It is also morality in the cause of the firm—a type of local patriotism. Self-sacrifice in the cause of profit. Setting aside your own moral views to do what the job requires, distasteful as that may be. Enron's traders viewed themselves as heroes, and on this level they were right: heroes fighting to oppress the ratepayers on behalf of the firm and its shareholders.

We have then this paradox. If the purpose of the corporation is to make a profit, as many have claimed, then the way that an employee fulfills her ethical obligation on the job is by promoting the corporation's profit. But despite Milton Friedman's famous claim that the ethical obligation of business is profit, placing profit above all is precisely the definition of *un*ethical behavior in the corporate context.[19] Ethical behavior in the corporate context means understanding that loyalty, honesty and relationships with your customers, your suppliers, your employers, your country, even the earth itself, are sometimes more important than short-term (or even long term) profits. Ethical behavior on the individual level means knowing when to buck the group norms, when to stand up for one normative system in opposition to another, when to violate the agency norm of setting aside your own sense of right and wrong and to selfishly follow your own lights. On the institutional level, ethical behavior requires building in safeguards against group-think, limits to the pursuit of short-term profit,

[19] Even Friedman acknowledges that pursuit of profit must be restrained by external legal norms of "deception and fraud," although he does not explain why these violations differ from the additional ethical obligations ones he rejects. "There is one and only one social responsibility of business—to use it 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, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES, Sept. 13, 1970) (magazine).

commitments to particular relationships and focus on products and services rather than stock market prices.

When an entire institution goes bad, it is not the result of a "bad apple." Rather, it is the result of employees or corporate agents doing exactly what they think they are supposed to do under the circumstances, even when they have strong misgivings about whether the actions are proper from a societal point of view. As Professor Darley notes, in several of the most famous cases of corporate wrongdoing, the employees who did the bad acts were perfectly aware that they were acting improperly according to social norms, and even worried about criminal liability. The point is, however, that as they took actions they knew were wrong—falsifying test results, falsifying financial data, distorting the California electric market to "steal" from Aunt Millie—these employees saw themselves as acting properly within their job. Much as soldiers learn to kill in the cause of the nation, Enron's employees learned to pillage in the cause of the firm. The moral thing to do, at least so long as you have not resigned from your job, appeared to be to set aside individual morality and act in the interests of the team, to do what was necessary to win.

Team loyalty and internal corporate norms trumped national patriotism and national norms. Indeed, in the end, they even trumped profit: Profit, like happiness, is one of those things best achieved by aiming elsewhere. The exclusive emphasis on short term profit in each of the institutions caught up in the great turn of the century scandals is not accidental. In the end, a corporation can only out-compete markets by being good at things markets are not good at, and the most important of those is long term relationships. But short term profit demands treating all relationships instrumentally, and that, in turn, destroys them, and with them, the basis of future profits. Laser-like focus on profits, as Enron demonstrates, is fundamentally incompatible with actually earning them.

The issue, then, is corporate culture, and as Professor Treviño has pointed out, corporate culture starts at the top. CEOs have enormous influence on the way in which their corporations respond to these normative demands, through modeling as well as their decisions about how to structure the corporation, about what measures of success to emphasize, about how and who to promote or not, about how to resolve conflicts between the alternative norms and identities "on offer." Even if corporate culture is never entirely under CEO control, the contributors to this Symposium make clear that in

fact CEOs do matter, that it is not enough to simply dismiss them either as rapacious kleptocrats or as absent minders unfairly held responsible for the wrongdoings of subordinates.

VI. CONCLUSION

From a regulatory perspective, several consequences follow from this discussion of normative conflict.

First, we should not fall into the mistake of thinking that the problem is centrally one of sociopaths, or to be dealt with by criminal law. Soldiers kill but they are not murderers (unless they are soldiers for a particularly evil state). Many of our corporate wrongdoers, particularly at the lower levels, are not motivated by selfishness but by selflessness. This means that obtaining convictions under conventional criminal law is going to be difficult: Some of the worst malefactors will be able to demonstrate that they were not thinking of themselves as they did their destruction. In the manner Hannah Arendt called the "banality of evil," they were good bureaucrats, doing their jobs as they understood them, according to the norms of the job. Criminal law looks for corruption—self-interest where loyalty is required—but the problem here may often be loyalty where rebellion was needed.

Relatedly, and more tentatively, it is time for further examination of whether criminal law and regulatory control of the corporation ought to focus more on the CEO as an individual and less on the firm as a legal person. Currently, the corporation itself is often the target of regulatory law: fines are imposed on it, injunctions are entered against it, and so on. Unfortunately, when firms are penalized, many humans who were not in positions of authority are likely to suffer. Thus, for example, when Enron went bankrupt due to institutional wrongdoing, thousands of lower level employees lost their jobs and pensions. Professor Treviño's research suggests that we might do better—causing less disruption to the economy and less harm to innocent corporate participants—if regulatory and criminal law took more account of the internal workings of corporations. If CEOs are important, then we should be able to reform corporations by changes at the top before writing off the particular corporation as incorrigible.[20] To the extent that CEOs

[20] Warren Buffett's reform of Salomon Brothers following its bond trading scandal might be an example.

can affect the corporate culture, then they, rather than the institution, ought to be held liable for its misdeeds.

Second, both at the legal level and within the organization, we need to think harder about what works and what does not.

Corporate law is silent on ethics. The state law that creates our corporations and governs their basic decision-making processes does not require any consideration of the claims of stakeholders, society as a whole or even the real human beings who own shares. We rely on the price mechanism and external regulation to control our corporations, but build nothing into the firms to prevent them from seeking to subvert those systems or to induce them to explicitly consider any countervailing values.

For several decades, corporate law scholars, even more than the case law, have taught that the only ethical course of behavior for a corporation is the unmitigated pursuit of profit. This laser-like focus on profit is precisely our problem, not the solution.

Corporate law scholarship can most usefully aid this project of creating a more profitable and more committed corporate sector by exploring the ways in which the law structures our existing markets, to their benefit and detriment, rather than by pretending that markets somehow exist abstracted from a legal framework. We have no agreement on how to resolve the conflicts among our normative systems (and perhaps such agreement is impossible). Still, we can have a fuller discussion of what it means to be ethical, of when market pressures ought to be resisted, of short term and long term conflicts, and so on, if we escape the trap of market determinism and the unfounded faith that in the end markets will automatically take us where we want to go.

CEOs, it is now clear, are critical. They, along with corporate law and both legal and business scholarship, can begin to engage the challenge of a richer understanding of corporate purpose, or they can insist that the stock ticker must rule. They can reinforce the cultural influences suggesting that the only proper role of a corporate employee is to help report a quarterly profit, or they can counter them. They can treat their employees as disposable means to a corporate end, or as the corporation itself. They can, by their choices about their own compensation, further the cynical view that the corporate world is only about getting your own, or they can join the corporate team and make it a more genuine enclave in the market.

Corporate law itself could start by abandoning the internal affairs doctrine, so that a genuine competition between the states, seeking to affect market incentives instead of simply pandering to them, can develop. Once the larger states begin to take responsibility for the governance of their largest economic entities, a thicker corporate law might move us in the direction of a more functional set of norms, practices and incentives.

Specifically, corporate law should begin exploring mandatory internal compliance mechanisms. Although courts eventually concluded that it might be a breach of fiduciary duty for a bank to hand cash to tellers with no safeguards, they have imposed no parallel requirement that firms have an ethics manager. We know that group-think is a problem in all bureaucratic organizations. Now legislatures need to consider mandating ombudsmen or similar parallel reporting systems to lessen the likelihood of group-think and to catch outright corruption. Similarly, courts need to consider whether corporate law fiduciary norms require more than avoiding unprofitable illegality while maximizing profit—whether, indeed, it isn't a corporate law requirement that firms observe the spirit and not merely the letter of our other regulatory schemes.

More fundamentally, the profit maximization norm itself is dysfunctional even in the narrowest sense. Part of our problem is that too close a focus on profit maximization focuses firm actors on the wrong parts of our normative systems and, in the end, is not profit maximizing at all. While courts generally do not require anything resembling a strong version of short-term profit-maximization, the market structure in which publicly traded corporations operate, and the ethos of our business and law schools, often do press managers in that direction.

We need countervailing power structures within the corporation. Profit is best pursued indirectly, by commitment to the products and services that create demand, together with commitments to the relationships that make a corporation a viable alternative to markets. Currently, the corporate decision-makers—upper management—are answerable to a board elected only by shares. The short-termism and narrow focus of the stock market become overly influential almost automatically as a result. Boards need to have built-in pressures to respond to other values and other commitments as well, including both representatives of those values and interests and answerability to them.

We need an external reporting system, modeled after successful practices of the airline accident reporting system or the CDC's emerging hospital error reporting systems, to generate systematic knowledge about which ethical breaches regularly repeat and under what circumstances.

We need restrictions on corporate interventions in the regulatory system. An organization that has as its central mission the pursuit of profit restrained only by the limits imposed by law will always have a tendency to subvert the restrictions on it. Business corporations by their nature need to be policed; we need to keep them out of the business of eliminating their policemen.

We need to seek ways to increase team behavior inside the corporation: mutual commitment and joint enterprise. This is mainly an issue for management and those who educate them, rather than the law, but not entirely. The current structure of the public corporation invites too close an alliance between short-term profit oriented institutional shareholders (reflecting the problematic dynamics of any market and our particular stock market) and managers bribed and beaten into a similar view.[21]

We need limits on CEO compensation relative to ordinary employees for the simple reason that too big an income gap automatically creates distance and the "out of touch" CEO identified by Professor Treviño as the source of ethics problems and bad business decisions alike. While there is strong evidence that in at least some cases CEO

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[21] In theory, of course, institutional shareholders, being permanent investors, ought to be concerned about the long term prospects of the corporations they invest in, and quarterly results should be important only to the extent that they accurately predict those. If the newer theories are correct that excessive focus on short-term results is bad for long-term results, institutional investors ought to see this and correct their behavior. Indeed, the success of Berkshire-Hathaway and the current popularity of hedge funds may reflect those investors' ability to take long term views. But more often, institutional investors are structurally incapable of ignoring short-term fluctuations. Mutual funds, for example, must respond to the short-term vagaries of their own investors. Even institutions with more stable investment pools are typically staffed by decision-makers whose careers depend on beating the market every quarter. Our longest term investors, therefore, are famous for too often acting as if they were the shortest-term ones.

Moreover, there is little reason to believe that this market can self-correct. It is notoriously difficult to distinguish good investment managers (including in the underlying corporations) from poor ones, a problem made more difficult by the end-game problems posed by the fact that both on Wall Street and in the chief executive offices most actors are already contemplating retirement by the time they arrive. Thus, high reliance on quarterly results is not obviously irrational from an individual perspective even though it is harmful from a social one.

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compensation has become so large that it materially affects corporate profits directly, that problem seems to me less likely to demand urgent legal intervention: When the market concludes that CEO compensation is hurting the prospects of future returns to stock ownership, stock price drops are a fairly effective method of enforcing its will.

And because any reform that empowers employees or relationships relative to the stock market will tend to reduce the constant revolution of commitment-less capitalism, we need to work to lessen some external sources of friction in our system. We need to allow our industrial unions to organize by industry rather than by plant, so that they can stop being a lobbying force for obsolete plants and so that managers do not have a constant incentive to churn physical capital simply to union bust. We need to separate health and retirement benefits from specific firms for exactly the same reason, so that employees can change jobs more readily and less traumatically and so that employers don't function under constant stock market pressure to find new and creative ways to abandon past commitments.

But most of all, we need to recognize that market Darwinism, like the natural kind, can lead to success, to extraordinarily strange, creative and unexpected uses of existing resources (the panda's thumb, the bat's wing), or simply to extinction. Fitness in a Darwinian world means only that you've survived so far. Stock market success comes from maximizing stock price, not from maximizing ethics, human decency, or even wealth—except to the extent that we can figure out how to make stock prices reflect human values. If we are to harness the wonderful power of the market to our own good—to human values of well-being, justice and the good life—we must always remember that the invisible hand is ours, and that if it is leading us in directions we don't like, we can redirect it elsewhere. The choice is not between market or law, but between legally regulated markets that mandate or encourage us to abandon our other commitments and different regulation that could better harness the power of the market to work for us. We are the masters; the question is how to use our mastery.