PRIORITIZING ETHICAL, ECONOMIC, AND LEGAL DUTIES: A CASE STUDY IN REGULATORY COMPLIANCE

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It is difficult to talk about a business executive's ethical and economic duties without referencing law. A legal duty is enforceable through a legal sanction such as a fine, imprisonment, or civil liability. Ethical duties, by contrast, include duties that are not enforceable through legal sanctions. Holding oneself to high (or low) ethical and legal standards has economic consequences for the business enterprise. In short, ethical, economic, and legal obligations are inextricably intertwined.

Examining a business executive's ethical obligations to comply with business regulations, a number of interesting questions present themselves. For example, when the letter of a regulation is vague or ambiguous, is a businessperson free to exploit that legal ambiguity for economic gain, or must the executive seek to cooperate with the intent or social spirit behind the law? If the regulation is unjust or inane, must the businessperson nonetheless follow it, or is he or she free to engage in a form of civil disobedience and intentionally disobey the law? If the regulation is not effectively enforced by the government, is the executive free to evade it so as to enhance the value of the firm? If the regulation addresses an important topic, but seems inadequate to meet social needs, must a businessperson hold the business enterprise to a higher standard and sacrifice private economic gain for the common good? And, if the answers to these queries depend on other factors, what are these factors?

The analysis of these and similar questions proceeds in three parts. Part I critically examines the ethical duty to obey law. A hierarchy of law is outlined, with the businessperson's ethical obligation to obey law varying with the moral content of the law in question. Part II considers legal and ethical duties in light of a corporate executive's fiduciary obligation to advance the economic interests of the shareholders. Part III offers a case study illustrating the ethical, economic, and legal priorities involved in regulatory compliance. The article closes with pedagogical implications.

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I. ETHICAL DUTY TO OBEY LAW[1]

Philosophical discussions of the ethics of legal obedience trace to Plato's recounting of Socrates's trial and death.[2] Condemned to die, Socrates has an opportunity to escape but chooses instead to drink the fatal hemlock. In response to Crito's questioning, Socrates offers four ethical reasons to obey law. First, Socrates contends that his long residence in Athens shows that he has *consented* to obey Athenian law. Second, he reasons that he owes a debt of *gratitude* to a society from which he has benefitted. Third, he maintains that it would be *unfair* to mistreat his fellow Athenians because Socrates himself has enjoyed the legal obedience of others. Finally, anticipating *rule utilitarianism*, Socrates reasons that if everyone where to disobey the law, then society would surely fail.

Proponents of each of Socrates's four ideas have appeared over the centuries. Socrates's notion of consent found expression in the contract theory of political obligation developed in Hobbes's *Leviathan* and Locke's *Second Treatise of Government*.[3] Echoing Socrates's appeal to gratitude, H. L. A. Hart linked the duty to obey law to a reciprocity norm where the benefits received from society generate a duty to share in society's costs.[4] John Rawls found a deontological first-order duty to support reasonably just social institutions, including the administration of law.[5] A modern rule-utilitarian could contend that the widespread refusal to obey law could erode society's ability to function.

Of course, even if there is a *prima facie* ethical duty to obey *some* laws, that duty it is not absolute. Even among philosophers who find a robust ethical duty to obey, there is room for permissible civil disobedience.[6] Sophocles examined civil disobedience in the play *Antigone*, where his protagonist justifiably defies Creon's decree she deems unjust.[7] Similarly, Harriet Tubman defied slavery laws; Mahatma Gandhi incited a boycott of the British salt tax; and Martin Luther King, Jr. led sit-ins. In each case, history portrays the actor as the hero, not the villain. If the state is unjust,

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[1] The argument in Part I draws upon material previously examined in Daniel T. Ostas, *Ethics of Tax Interpretation*, J. BUS. ETHICS 1-12, https://link.springer.com/article/10.1007%2Fs10551-018-4088-7 (First Online: Dec. 19, 2018).

[2] PLATO, GREAT DIALOGUES OF PLATO 447-60 (W. H. D. Rouse trans., Mentor Book 1956) (400 BCE).

[3] THOMAS HOBBES, LEVIATHAN (1651); JOHN LOCKE, TWO TREATISES OF GOVERNMENT (1689).

[4] H. L. A. Hart, *Are There Any Natural Rights?*, 64 PHIL. REV. 175, 185 (1955).

[5] JOHN RAWLS, A THEORY OF JUSTICE 355-56 (1971).

[6] *See, e.g.,* JOHN RAWLS, CIVIL DISOBEDIENCE 240-55 (1969).

[7] Sophocles, *Antigone in* The Theban Plays (E.F. Watling trams., Penguin Books 1986) (442 BCE).

then there is no political obligation to obey its laws, and individuals must use ethical judgement when deciding which laws to obey even within reasonably just societies.

The question at hand is whether there is an ethical duty to comply with a business regulation promulgated in a reasonably just society, and if so, then what is the proper way to interpret any ambiguity, vagueness, conflicts, or gaps incumbent in that regulation? The answer may depend on the moral pedigree of the law in issue. Laws that address sensible matters in sensible ways would seem to deserve more respect than ones that seem unjust or inane. In addition, laws enacted in accord with due process may carry more moral weight than ones enacted behind closed doors and in response to special interests. The remainder of Part I examines the moral pedigree of regulatory law generally and then addresses alternative techniques of statutory interpretation.

A. *Moral Pedigree of Regulatory Law*

Some laws deserve more respect than others. Consider, for example, the ethical duty to obey workplace safety regulations. If the employer knows that precautions not required by the regulations would significantly protect workers at a reasonable cost, then these additional precautions should be, and hopefully are, taken on ethical grounds, even if the regulations do not require them. Laws that directly implicate human health, safety, and dignity address *malum in se,* that is, they address matters that are wrongful even if the law does not prohibit them.[8] Knowingly subjecting a worker to a preventable health and safety risk is wrongful even if the law permits it. With matters that are *malum in se,* if the legal rule proves inadequate to meet one's ethical obligation, then one should inform the government of the inadequate nature of the regulation while living to the higher standard.[9]

Other laws, by contrast, constitute *malum prohibitum*, that is, the wrongfulness of the act can only be determined with reference to the law itself.[10] Tax law provides the classic example. [11] There is nothing inherently right or wrong with either deducting an expense or amortizing it over time. Whether the expense should be deducted or amortized can only be determined with reference to the law itself. With matters that are *malum*

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[8] *See* Stephen L. Pepper, *Counselling at the Limits: An Exercise in the Jurisprudence of Lawyering*, 104 YALE L.J. 1545, 1576-80 (1995).
[9] *See* Joseph Raz, *The Obligation to Obey: Revision and Tradition*, 1 NOTRE DAME J. L, ETHICS & PUB. POL'Y 139 (1984).
[10] *See* Pepper, *supra* note 8, at 1577-80.
[11] *See* Daniel M. Kahan, *Ignorance of the Law is an Excuse: But Only for the Virtuous*, 96 MICH. L. REV. 127 (1997).

prohibitum, there is no ethical reason to hold oneself to a higher standard than the one specified by law. Hence, the ethical duty to pay tax, if it exists, derives solely from the general *prima facie* ethical obligation to obey reasonably just laws enacted by reasonably just societies.

Reflecting on one's ethical obligations regarding this hierarchy of laws, one finds that when the law in question directly addresses issues of human health, safety, or dignity (*malum in se*), then the law points to an important topic, such as workplace safety, but it does not set the ethical measure. One must go beyond the law when the law is inadequate to meet its moral aim. Similarly, when the law is unjust, as with Creon's decree or the British tax on Indian salt, then once again, the law carries no moral weight. One must be guided by conscience. Regarding matters of *malum prohibitum*, it seems that one would first ask whether the government was legitimate and whether the particular regulation was enacted pursuant to due process. One would then ask whether the specific regulation was reasonably effective in reaching legitimate policy goals. If each of these questions is answered in the affirmative, then one is left with the question as to whether there is an ethical duty to obey a reasonably just law promulgated in a reasonably just society, simply because it is law. And even if one recognizes this duty, questions of legal interpretation remain.

Perhaps none of Socrates's arguments: (1) consent, (2) reciprocity, (3) fairness, or (4) utility, standing alone, is sufficient to establish an ethical obligation to comply with regulations that constitute *malum prohibitum*. Yet, for this writer, each argument offers an intuitive appeal. Hart's reciprocity notion that if one benefits from society then one should share in its costs makes sense. Rawls's assertion of a fundamental duty to support reasonably just social institutions, including the administration of law rings true. And if one is benefiting from the legal compliance of one's fellow citizens, then it appears unfair to cheat. Finally, it would seem that society needs legal compliance to be able to meet its policy objectives. In short, the four Socratic arguments, taken in some combination, seem sufficient to establish a *prima facie* duty to comply with a professionally honest interpretation of most business regulations.

B. *Principles of Statutory Interpretation*

Regulatory law, like all areas of law, has to be interpreted. Disputes over interpretation typically involve a tension between the letter and the spirit of the law. The letter, of course, refers to a literal interpretation of the statute or regulation. But words can have more than one meaning, and ambiguity

makes law difficult to interpret.[12] Words can be vague, requiring the drawing of lines between permissible and impermissible activities without clear guidance.[13] Regulatory laws also can have gaps, conflicts, and inconsistencies. This is particularly true when more than one regulatory authority claims jurisdiction, as one often finds in interstate transactions and in the global arena. Rules written by different sovereigns may be ill-fitting indeed.

Whenever the plain meaning of a regulation seems inadequate to resolve interpretative issues, then recourse to the spirit of the law becomes appropriate. Yet, the spirit of regulatory law is similarly complex. The spirit refers both to the legislative policy goals that inform law and to the balance of competing social norms expressed in the legislative scheme. The policy goals typically reflect a compromise between competing aims, and the social norms are multiple.[14] For example, tax regulations strike a policy compromise between the need for government revenues to fund public services and a societal deference to the prerogatives of private property and entrepreneurship. The regulations also balance a social norm which sees tax as a public benefit with one that sees tax as a private burden.[15] In short, alternative interpretations of regulatory law can often be credibly advanced.

Courts tend to follow the traditional techniques of statutory interpretation.[16] Statutory interpretation begins with due deference to the plain meaning of the language expressed in the legal rule.[17] If that language is clear on its face, then that ends the inquiry, and the fact pattern is simply examined under the literal language of the rule and a judgement is rendered. In most cases, plain meaning analysis suffices, and no further inquiry into meaning is appropriate. In some settings, however, the language of the law seems ambiguous, vague, gap-riddled, or conflicted.[18] In those situations, interpretation requires inquiry into maxims of construction, legislative purpose, and relevant judicial precedents.[19]

Turning to a time-honored treatise, one finds the plain meaning doctrine (*ita lex scripta est*) firmly entrenched as the "Cardinal Rule" of statutory

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[12] *See* F. REED DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 42-49 (1975).
[13] *Id.* at 49-51.
[14] *See* LEO KATZ, ILL-GOTTEN GAINS: EVASION, BLACKMAIL, FRAUD, AND KINDRED PUZZLES OF THE LAW 13-14 (1996).
[15] *See* AXEL HILLING & DANIEL T. OSTAS, CORPORATE TAXATION AND SOCIAL RESPONSIBILITY (2017).
[16] *See generally* HENRY C. BLACK, HANDBOOK ON THE CONSTRUCTION AND INTERPRETATION OF THE LAWS (2d ed. 1911) (chronicling traditional interpretive techniques).
[17] *See* ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW (1997).
[18] *See* DICKERSON, *supra* note 12.
[19] *See* Yule Kim, *Statutory Interpretation: General Principles and Recent Trends*, Congressional Research Report for Congress (2008).

interpretation.[20] Yet, that same treatise specifies that literal interpretations must give way in the face of absurd results.[21] Black writes:

> When the interpretation of a statute according to the exact and literal import of its words would lead to absurd or mischievous consequences, or would thwart or contravene the manifest purpose of the legislature in its enactment, it should be construed according to its spirit and reason, disregarding or modifying, so far as may be necessary, the strict letter of the law.[22]

Similarly, reference to legislative purpose is needed where the language of the statute is "ambiguous, or admits of more than one meaning."[23] There is also an interpretive maxim against ineffectiveness, calling upon an interpretation of law that effectuates legislative purpose rather than frustrates it.[24]

The traditional techniques of statutory interpretation also recognize value in deferring to prior interpretations rendered by the courts. Black notes, "Judicial decisions previously made upon the interpretation of particular terms and phrases used in a statute . . . are generally of controlling force in establishing a correct construction."[25] Of course, courts themselves are honor-bound to interpret statutes in accord with traditional techniques. Yet, once the precedent is established, it provides another source of stability with reference to black letter law.

II. FIDUCIARY OBLIGATIONS TO SHAREHOLDERS[26]

Corporate executives owe a fiduciary duty of loyalty to shareholders.[27] Presumably, shareholders like wealth. Hence, executives are likely to approach the topic of corporate legal strategy with an economic orientation. Yet, the executive's economic goals must be tempered with due respect for the law and widely-shared ethical customs. As Milton Friedman famously stated, the appropriate role for a corporate executive is "to make as much

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[20] BLACK, *supra* note 16, at 46.
[21] *Id.* at 51.
[22] *Id.* at 66.
[23] *Id.* at 76.
[24] *Id.* at 84.
[25] BLACK, *supra* note 16, at 298.
[26] The argument in Part II draws upon material previously examined in Daniel T. Ostas, *Corporate Counsel, Legal Loopholes, and the Ethics of Interpretation*," 18 TX. WESLEYAN L. REV. 703 (2012).
[27] *See generally* Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavior Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1780-95 (2001).

money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom."[28]

Friedman's formulation, though sometimes criticized, continues to be cited as seminal.[29] It also proves useful in assessing the executive's competing responsibilities in setting the corporation's legal strategies. In particular, if an executive discovers that a strained interpretation of a legal text advances the economic interests of the shareholders, then perhaps the executive must adopt that interpretation. It would seem unlikely that asserting a self-serving interpretation of a law, for example, arguing for a literal construction of a statute without reference to legislative intent, would be illegal. Hence, the only meaningful restraint on the exploitation of legal loopholes, if there is one, would come from ethics.

It is important to note that *the ethical, legal, and economic responsibilities of a business executive, as identified by Friedman, form a hierarchy*. In particular, economic motives must be tertiary to ethical and legal concerns. When economics and law conflict, law must prevail. Shareholders never have legal authority, and seldom have moral authority, to empower an executive to violate the law. Though less appreciated, a similar reasoning informs the relation between economics and ethics. Just as shareholders have no legal authority to empower an executive to behave illegally, they similarly have no moral authority to authorize an executive to behave unethically.[30] Hence, even though an executive is a fiduciary for the shareholders, an executive's economic responsibilities are subordinate to legal and moral obligations. In short, law trumps economics, and in the case of civil disobedience, ethics trumps law.

At first blush, the notion that ethical concerns must control a corporate executive's decision, even at the expense of shareholder profit, might seem odd. It should not. The idea is incumbent in Milton Friedman's formula suggested almost fifty years ago. Perhaps the sense of oddity comes from the

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[28] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profit,* N.Y. TIMES MAG., Sept. 13, 1970, at 32.

[29] The impact of Friedman's piece can be attributed to his fame, the placement of the piece, and its rhetorical structure. Friedman, was a Nobel Prize winning economist, a leading monetarist, an author of a widely read defense of libertarian political theory, and an oft-seen commentator in documentaries and various media. He published his essay in the *New York Times Magazine,* presumably to maximize its readership among business leaders. In addition, his title refers to the social responsibilities of "business," but the essay actually discusses the less controversial topic concerning the responsibilities of an executive as an agent of shareholders. *See* CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 74-121 (1974) (recounting the early debate and providing a balanced assessment of Friedman's views).

[30] *See* Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q., 53 68 (1991); Joseph S. Spoerl, *The Social Responsibility of Business*, 42 AM. J. JURIS. 277, 278-79 (1997).

perception that individual ethics are too idiosyncratic and personal to be of much use as a guide to business conduct.[31] It is true that people sometimes differ on ethical questions. If a lie serves the common good, then a utilitarian will lie; a deontologist will not. Yet, most times, ethical assessments align. A lie that advances only the narrow interests of the liar is universally condemned. When all ethical compasses converge, the executive becomes morally required to follow the widely-shared ethical custom.

In his famous treatise, *A Theory of Justice*, philosopher John Rawls explores ethical custom within the contours of a perfectly just society.[32] Although Rawls' treatise focuses primarily on the topics of political economy and political philosophy, it also addresses individual ethics. In Rawls' just society, every citizen embraces a duty of civility.[33] Civility, in turn, requires the support of reasonably just social institutions, including the administration of justice.[34] As a corollary, Rawls addresses the issue of legal interpretation. He writes:

> [We] have a natural duty of civility not to invoke the faults of social arrangements as a too ready excuse for not complying with them, not to exploit inevitable loopholes in the rules to advance our interests. The duty of civility imposes a due acceptance of the defects of institutions and a certain restraint in taking advantage of them.[35]

Hence, for Rawls, the corporate executive remains free to advance shareholder interests, but the executive must support the institutions of pubic justice, not erode them. This would seem to include due deference to the social policies that inform specific business regulations and cooperation with the formulation and implementation of the regulatory environment generally.[36]

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[31] *See* Lynn Sharp Payne, *Law, Ethics, and Managerial Judgment*, 12 J. LEGAL STUD. EDUC. 153, 154-55 (1994) (suggesting that the perception of subjectivity in ethical reasoning is overblown).
[32] JOHN RAWLS, A THEORY OF JUSTICE (1971).
[33] *Id.* at 355.
[34] *Id.*
[35] *Id.*
[36] *See* LEE E. PRESTON & JAMES E. POST, PRIVATE MANAGEMENT AND PUBLIC POLICY (1975) (identifying cooperation with the public policy process as the *sin qua non* of socially responsible corporate behavior).

III. REGULATORY COMPLIANCE[37]

To illustrate how a businessperson's ethical obligations with regard to regulatory law interact with their economic self-interest, the article offers the following hypothetical case. The case involves a businessperson who must decide go beyond, comply with, or evade a series of environmental regulations. The discussion is motivated by the truism that business actors will do what is in their pecuniary self-interest unless they feel a sufficient ethical obligation to do otherwise. Relevant to the discussion are the letter of the law, the moral or social spirit that underlies the law, and the pecuniary self-interest of the businessperson. After presenting the case, pedagogical implications are discussed more fully.

A. *Illustrative Case*

A manufacturing firm is operated as a sole proprietorship.[38] The firm's owner must decide whether to implement costly controls to reduce emissions of a set of chemical compounds. Without controls, emissions of each of four compounds would be 25 parts per million (ppm). The Environmental Protection Agency (EPA) regulates emissions of Compounds A, B, and C, permitting 10 ppm for each compound and providing fines for exceeding those limits. Emissions of Compound D are not regulated (Table 1, Column 1, Letter of Law).[39]

The firm's owner, who is also an environmental engineer and a Ph.D. toxicologist, is convinced that Compounds A, B, and D are dangerous unless sufficiently diluted.[40] In fact, the owner believes emissions of these compounds would only be safe at 10 ppm, not beyond. The owner also believes that Compound C is not dangerous, and is convinced that emitting Compound C at 25 ppm poses no significant harm (Table 1, Column 2, Spirit of Law).

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[37] The material discussed in Part III was also examined in Daniel T. Ostas, *Cooperate, Comply, Or Evade? A Corporate Executive's Social Responsibilities with Regard to Law*, 41 AM. BUS. L.J. 559 (2004).

[38] The choice of sole proprietorship in this hypothetical is designed to deflect attention away from the agency issues associated with a misalignment of shareholder and managerial incentives. The relevance of organizational structure is discussed *infra* Part III.B.1.

[39] The hypothetical does not specify what harm is sought to be prevented by the regulations. Perhaps the regulation seeks to reduce the risks of human birth defects, or perhaps it seeks to protect bird habitat. The relevance of this distinction is discussed *infra* text.

[40] The decision-maker in this hypothetical is an expert. In fact, the owner knows more about the compounds produced by the manufacturing operations than anyone in the world. The relevance of expertise is discussed *infra* Part III.B.1.

Upon conferring with legal counsel, the owner concludes that in both the short run and the long run, after accounting for potential criminal fines, civil liabilities, and the possible economic harm to the firm's reputation, it is not cost effective to control for emissions of Compounds B or D. It is, however, in the owner's pecuniary interests to reduce emissions of A and C to 10 ppm (Table 1, Column 3, Profit Max).

Table 1

What will/should the owner do?	***Letter of Law*** (What do current regulations say?)	***Spirit of Law*** (What should regulations say?)	***Profit Max*** (Which level maximizes profit?)
Compound A: Normal Case	10 ppm	10 ppm	10 ppm
Compound B: Crime Pays	10 ppm	10 ppm	25 ppm
Compound C: Civil Disobedience	10 ppm	25 ppm	10 ppm
Compound D: Legal Loophole	25 ppm	10 ppm	25 ppm

1. General Discussion

Table 1 summarizes the salient facts posed in the hypothetical case. The contents of the first and third columns should be fairly self-evident. The first column (Letter of Law) simply reflects the regulations as specified in the first paragraph of the case. The number "10" indicates that the compound is regulated; "25" indicates that it is not. The third column (Profit Max) identifies whether emitting at 10 ppm or 25 ppm would be in the pecuniary interests of the owner, given the current state of the law. The profit maximizing decision depends on such factors as the likelihood of detection, likely fines and prison terms, potential civil liabilities, and potential economic harms to the firm's reputation if the illegal activities became publicly known. Column 3 reflects the level of emission the owner would choose if his or her only motivation were to maximize his or her own risk adjusted, long-run pecuniary interests.

The second column (Spirit of Law) requires a bit of explanation. The "spirit" of the law refers to the policies that underlie the law with particular emphasis on the social and ethical values that the letter of the law either reflects or seeks to project. Ideally, the spirit of environmental law includes, at least in part, a calculus in which the likely consequences of alternative levels of emissions have been identified and weighed. Relevant consequences include the impact the compounds will have on the ecosystem, wildlife, and ultimately on humans. Other relevant consequences include the

need for economic efficiency in the firm's manufacturing processes. Ideally, the spirit of environmental laws also reflects democratically determined societal values. For example, recognizing that the ultimate consequences of chemical emissions may be hard to predict, regulators may decide that they have a duty to err on the side of public safety.

Hence, the second column of Table 1 reflects the level of emissions that should be allowed given the current state of social mores and the aspirations that the society wishes to realize. More precisely, Column 2 reflects the owner's good faith assessment of what he or she thinks a set of properly balanced and publicly-minded regulations should provide. In other words, the spirit of the law addresses the ethical dimension of environment decisions, specifying what should be done if one were relatively unconcerned with the letter of the law or with one's own economic incentives.

2. Compound A: The Normal Case – Law, Ethics, and Economics Align

Compound A reflects a "normal" state of affairs. EPA regulations specify that Compound A may only enter the environment in diluted form (Letter of Law = 10), and the compound truly is dangerous and needs to be regulated (Spirit of Law = 10). In addition, although it is costly for the firm to reduce emissions, given the current state of the law, including potential fines, the likelihood of detection, and the potential costs to the firm's business reputation, it would be even more costly for the firm not to control these emissions (Profit Max = 10). In this situation, there simply is no incentive to evade. Hence, one can confidently predict that the owner will comply with the law and safely say that the owner should do so. Compound A involves a scenario where legal, ethical and economic motivations align, and serves as a useful baseline with which to consider the other compounds.

3. Compound B: Crime Pays – Under-Enforced Law

The second compound pits economic incentives against legal and ethical ones. The EPA restricts emissions of Compound B (Letter of Law = 10) and the compound truly is dangerous (Spirit of Law = 10). But the owner makes more money by evading the regulation than by complying (Profit Max = 25). Perhaps the likelihood of detection is relatively slight and the potential for civil liability, criminal fines, and the costs to the owner's business reputation are all negligible. In such a setting, it seems unambiguous that the owner *should* comply with the law and restrict output of Compound B. Whether the owner is likely to do so is less clear.

Whether a businessperson will evade a law that is not effectively enforced depends on two competing factors. First, it depends on just how

profitable evading the law appears to be. The greater the expected return, *ceteris paribus*, the more likely the evasion. But the decision also depends on the owner's sense of social obligation to obey law in general, and on the moral saliency of the particular regulation in question.[41] Compare, for example, the likelihood that the owner would knowingly violate a regulation designed to protect migratory bird habitat with one meant to reduce the likelihood of human birth defects.[42] Obviously, the owner would be more likely to evade the former than the latter. This is true because the regulation protecting birds has a lower degree of moral saliency than the one intended to protect newborn children. In fact, it seems that most people would be unwilling to knowingly cause human birth defects regardless of how profitable it appears to be; respect for bird habitat, by contrast, may very well have a price.

4. Compound C: Civil Disobedience – Inane Law

Compound C is regulated (Letter of Law = 10) even though it poses no significant risks to the environment or to society at large (Spirit of Law = 25). Perhaps the regulation resulted from lobbying pressure where a competing firm has captured the law so as to achieve an anti-competitive advantage.[43] Perhaps the regulation is just a mistake. In either event, this regulation is either unjust or inane. The regulation, however, is enforced and given the likelihood of civil fines and potential harms to the firm's business reputation, if the owner evades the law it will hurt the firm (Profit Max =10).

Whether the owner *should* comply with an unjust or inane law is essentially a question of civil disobedience. In the present case, it seems unlikely that the owner would feel ethically compelled to evade the command to reduce emissions. This is because reducing Compound C is unlikely to affirmatively harm the environment. This law is inefficient or inane, but not otherwise harmful, and with regard to inane law, the owner probably has a duty to comply with the letter of the law, unless compliance is

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[41] Tom Tyler examines the competing factors that lead to legal obedience, distinguishing between "instrumental" or deterrence-based reasons and "normative" reasons associated with the sense that law is worthy of following. *See* TOM R. TYLER, WHY PEOPLE OBEY THE LAW 3-5, 32-45 (1990) (articulating the distinction between instrumental and normative motives and reporting previous empirical findings as well as his own). Tyler concludes: "In trying to understand why people follow the law, we should not assume that behavior responds primarily to reward and punishment (as do traditional theories of deterrence). Instead we should recognize that behavior is affected by the legitimacy of legal authorities and the morality of the law." *Id.* at 168 (author's parentheses, citations omitted).

[42] *See* discussion *supra* Part I.A (suggesting a moral hierarchy of regulatory law, with some laws carrying a greater moral imperative than others).

[43] *See* TYLER, *supra* note 41, at 31-32 (discussing empirical work studying the effect that a perception that a law is illegitimate has on one's willingness to comply).

very costly.[44] Of course, if reducing the level of Compound C caused direct and severe harm to the environment, then the owner might have a social responsibility to sacrifice his or her pecuniary interest and refuse to comply with the letter of the law.

Perhaps it is more interesting to ask how the businessperson would react if the regulation regarding Compound C were not effectively enforced, making it cost effective for the owner to evade (C* Profit Max = 25). Here, the only reason the owner might comply with this regulation derives from a generalized habit of obeying law or out of a sense of duty to the "rule of law" in general. Where the regulation is both under-enforced and seemingly inane, these reasons appear relatively weak. As a general rule, people comply with the letter of the law only if compliance is compelled or if the person perceives a sufficient social duty to comply that outweighs his or her economic self-interest. In short, if an inane regulation is not effectively enforced, legal compliance becomes unlikely.

5. Compound D: Legal Loophole – It's Legal, but It Shouldn't Be

Compound D is not regulated (Letter of Law = 25), but it should be (Spirit of Law = 10). In fact, Compound D poses dangers identical to those posed by the first two compounds, and the failure to regulate appears to be an oversight. This oversight has created a "loophole" in the law that enables the owner to comply with the letter of the law while simultaneously violating its spirit. That is, the owner can endanger the public interest without violating the letter of the law. In addition, exploitation of this legal loophole is cost effective (Profit Max = 25).

The prediction regarding whether the owner will exploit an imperfection in the law follows that same logic as the prediction with regard to Compound B, where crime pays. On one hand, the more money there is to be made by exploiting the loophole, the more likely the exploitation. On the other hand, the owner may be willing to sacrifice profit if he or she perceives a sufficiently compelling ethical duty to do so. This perception of an ethical duty is likely to depend on the owner's respect (or disrespect) for environmental regulations in general and his or her assessment of the gravity of the potential harms posed by Compound D. Does Compound D threaten birds or babies?

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[44] The distinction between inane (silly) law and unjust (directly harmful) law is a matter of degree. In a world of scarcity, complying with an inane regulation wastes resources that could have been used to ease human suffering. Hence, an inane regulation that causes extreme waste becomes unjust. An inane law with little cost to the firm, causes less waste, and the waste it causes could be justified with reference to the duty to support reasonably just, but imperfect, social institutions.

It may also be interesting to ask how the businessperson would react if economic reasoning shows that reducing emissions of Compound D is cost effective (D* Profit Max = 10). For example, perhaps market forces have created an economic incentive to hold oneself to a higher environmental standard than required by the letter of environmental law. In such a situation one can confidently predict that the owner will seek to maximize profit by reducing emissions, and because the compound is truly dangerous, this action is socially responsible as well. This illustrates that when economic (10 ppm) and ethical (10 ppm) incentives converge, the letter of the law (25 ppm) becomes largely irrelevant.

B. *Pedagogical Implications*

Reflecting on the case study, a number of implications can be drawn. Three receive attention here. First, the case provides a means to discuss the relevance of both organizational structure and subject matter expertise on business decisions. Second, the case highlights the trade-offs between a firm's profit motive and its ethical obligations. Third, the case provides insights into the relative potency of the letter of the law as a factor in predicting and assessing business conduct. A brief discussion of each topic follows.

1. Irrelevance of Organizational Structure

The manufacturing firm in the hypothetical is a sole proprietorship. It is interesting to ask what effect this choice of organizational structure has on both the positive predictions and the moral assessments with regard to each compound. For example, what changes if one assumes that the decision-maker is the chief executive officer (CEO) of a publicly traded firm rather than a sole proprietor?

Examining the case study, one finds that the social responsibilities with regard to each compound do not change with the firm's organizational structure. That is, the social and ethical responsibilities with regard to law of a CEO are exactly the same as the social and ethical responsibilities of a sole proprietor. The sole proprietor is generally free to maximize the profitability of his or her business operations; however, he or she cannot do so in a way that violates the spirit of high moral content regulation. If the proprietor becomes a passive shareholder and hires the CEO to manage the firm, the proprietor has no moral authority to authorize the CEO to do anything that the proprietor could not ethically do. Because the proprietor has an ethical responsibility to consider the effect that his or her actions would have on society, so too does the CEO.

The change of organizational structure, however, does change the analyst's predictions as to how the firm will behave. The predictions change because the cost-benefit analysis that generates the "Profit Max" column of Table 1 must now be recalibrated from the perspective of the CEO rather than from the perspective of the sole proprietor. Certain activities that may not have been in the best interests of the sole proprietor may be in the interests of the CEO.[45] For example, a CEO may be more willing to engage in a white-collar crime such as financial fraud where the legal liabilities may be passed on, at least in part, to shareholders. In these situations, whether the CEO restrains himself or herself will depend upon whether he or she feels a sense of commitment to the spirit of fiduciary law.

The case study also highlights the relevance of subject-matter expertise on corporate decision making. The sole proprietor in the case study was described as an environmental engineer and a Ph.D. toxicologist. When assessing whether a given regulation made environmental sense, the hypothetical owner could be confident in his or her understanding of the technical issues. Remove that technical certainty, and the owner would seemingly need to err on the side of caution, being more likely to comply with questionable regulations regarding matters of *malum prohibitum*, and to go beyond the letter of the law when addressing matters that constitute *malum in se*.

2. Tradeoff between Pecuniary Self-Interest and Social Responsibility

Although most of this article focuses on normative issues, the case study also provides positive predictions. The positive analysis assumes that businesspeople will do what is in their own pecuniary self-interest unless they feel a sufficient ethical responsibility to restrain themselves. This assumption reflects the truisms that people like money and that they are capable of self-restraint. The various compounds illustrate that the ethical responsibility to comply with the letter of the law, without sufficient respect for the spirit of the law, may be insufficient to motivate self-restraint. Yet, even without the letter of the law, an appeal to the spirit of the law can restrain self-interest, but only if the businessperson places sufficient weight on the purposes that underlie the law (Compound D). The businessperson

[45] The implications of the divergence between the managerial and shareholder interests were first explored in the 1930s. *See generally* ADOLPH A. BERLE, JR., & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); RONALD H. COASE, *The Nature of the Firm*, 4 ECONOMICA 386 (1937). These seminal works spawned contemporary "agency theory." *See generally* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 8 J. POL. ECON. 298 (1980); Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,* 3 J. FIN. ECON. 305 (1976).

must think that the purpose behind the law is sufficiently noble to be willing to sacrifice pecuniary gains.

It also seems reasonable to assume that businesspeople will obey or disobey laws in systematic ways. One the one hand, white-collar crime is positively correlated with the promise of pecuniary gain. The more profitable the crime appears, *ceteris paribus*, the more likely it is to be committed. On the other hand, legal obedience depends on the person's sense of fidelity to the law. The more respect for the law a businessperson has the less likely the crime. The level of respect, in turn, would depend, at least in part, on the moral content of the particular law. A businessperson might sacrifice pecuniary self-interest so as to cooperate with the spirit high moral content laws. But society should not expect self-restraint with low moral content (inane) laws. In fact, society will not get compliance with a low moral content law unless the business actor concludes that compliance is in his or her pecuniary interests (Compound C).

This tradeoff between pecuniary self-interest and ethical self-restraint may help explain recurring spates of business scandals and provide insights to the likely effects of legal reforms. In part, business scandals reflect a lack of effective deterrence. Perhaps business actors do a cost-benefit analysis *ex ante*, and decide that financial fraud and other white-collar crimes appears to pay (Compound B). But equally importantly, it seems that many of these business actors simply fail to restrain themselves. This lack of self-restraint, in turn, reflects a lack of respect for the law. To heighten deterrence of white-collar crime, regulators need to increase the likelihood that violations will be detected and prosecuted, and increase the severity of penalties upon conviction. But even more importantly, businesspeople must embrace an ethical obligation to comply with reasonable regulatory law even if evasion appears cost effective.

3. Relevance of the "Letter of the Law"

Finally, the case study also provides insights into the relevance of the letter of the law as a factor in predicting and assessing business behavior. Collectively, the various compounds illustrate the interdependent nature of legal, ethical, and economic incentives. Compound A is particularly useful for examining the potential for self-serving rationalization. Ask the owner why he or she is reducing emissions of Compound A, and any of three answers could be offered. The owner might say that (1) the letter of the law requires it, (2) the compound is dangerous, or (3) it is economically advantageous to reduce emissions. To tell which of these three motivations is most potent, one needs to examine what the owner would do when the legal, ethical, and economic factors conflict, rather than when they align.

When comparing the relative potency of the letter of the law, the spirit of the law, and the desire to maximize profits, the letter of the law plays the smallest role. The letter of the law impacts economics because there typically is a price associated with breaking the law, and it affects ethics because one presumably has a duty to obey laws that are not demonstrably unjust. But in the final analysis, predictions of business decisions turn less on the letter of the law than on a trade-off between economic incentives and self-imposed ethical restraints. Similarly, a businessperson's ethical duty with regard to law has much more to do with the moral pedigree of the law in question, than with the general duty to obey the law just because it is the law.