

Prosocial Fraud

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This Article identifies the concept of prosocial fraud—that is, fraud motivated by the desire to help others. The current incentive-based legal framework focuses on deterring rational bad actors who must be constrained from acting on their worst impulses. This overlooks a less sinister, but more endemic species of fraud that is not driven by greed or the desire to take advantage of others. Prosocial fraud is induced by prosocial motives and propagated through cooperative norms. This Article argues that prosocial fraud cannot be effectively deterred through increased sanctions because its moral ambiguity lends itself to self-deception and motivated blindness. The presence of a beneficiary other than the self allows individuals to supplant one source of morality (honesty), with another (benevolence), providing a powerful source of rationalization that weakens the deterrent impact of legal sanctions.

After examining the types of motives that typify prosocial fraud, this Article identifies structural and situational factors—definitional ambiguity, incrementalism, and third-party complicity—that increase its prevalence. Given the cognitive and psychological biases at play, this Article suggests that any efforts to curb prosocially motivated fraud focus less on adjusting sanctions and more on exploring alternative mechanisms of ex ante, private enforcement.

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I. INTRODUCTION

How should the law regulate fraud that is prosocially motivated? Individuals routinely commit—or help others to commit—fraud that is not in their rational self-interest. Despite the threat of legal sanctions, fraud has proven to be as ubiquitous as it is intractable. The narrative is by now a familiar one: revelations of brazen acts of dishonesty and deception that flourished unchecked for months, if not years. The public predictably reacts with disgust and condemnation, scornful that others could be so unethical and morally bankrupt.

The public's response reflects simplistic assumptions about fraudulent behavior, assumptions that are deeply embedded in the law. According to this narrative, individuals commit fraud for two reasons: (1) a flawed, dishonest character; and (2) greed.¹ The sensational, massive fraud prosecutions of the past century—Bernie Madoff, Kenneth Lay, Jeffrey Skilling, and Charles Ponzi—personify this bad

¹ See, e.g., Alexander Schuchter & Michael Levi, *The Fraud Triangle Revisited*, 29 SEC. J. 107, 110 (2016); DAVID E. SARNA, HISTORY OF GREED: FINANCIAL FRAUD FROM TULIP MANIA TO BERNIE MADOFF 25 (2010); Ann M. Olazabal & Patricia S. Abril, *The Ubiquity of Greed: A Contextual Model for Analysis of Scienier*, 60 FLA. L. REV. 401, 403-404 (2008); see generally CHARLES R. TITTLE, SANCTIONS AND SOCIAL DEVIANC: THE QUESTION OF DETERRENCE (1980); FRANKLIN E. ZIMRING, DETERRENCE: THE LEGAL THREAT IN CRIME CONTROL (1976).

actor theory of fraud. Under this view, because it is rational for an individual to cheat while others cooperate, the law must impose penalties to deter fraud. Optimally, sanctions are set at a level that aligns individual interests with collective ones, making it rational not to cheat. A system of informal sanctions—gossip and social ostracism—complement the formal ones, further increasing the costliness of defection.

Yet the stubborn persistence of fraud suggests a fundamental disconnect between theory and practice. In theory, fear of imprisonment, combined with hefty fines and the prospect of public humiliation ought to dissuade all but the most depraved hearts from engaging in fraud. But while the existing incentive-based framework may deter the rational, calculative *homo economicus*, it has failed to curb fraudulent behavior by those who are more boundedly rational.

Why does fraud proliferate, sometimes for years, in organizations in which numerous individuals either actively participate or are complicit through silence? Can it be that individuals simply cannot control their darker impulses? Or do they just assume they will not get caught (or simply underestimate the risk of detection)? Recent research in behavioral ethics has provided new insights on the situational, social, and emotional forces at work, but the law has not kept pace. Although the law on fraud is purposefully fluid and amorphous, it is rooted on the assumption that fraudulent behavior is driven by financial self-interest. Accordingly, rather than being tailored and responsive, the law on fraud is prescriptive and aspirational, focused on deterring and sanctioning rational bad behavior.

Fraud is perhaps the consummate crime against trust. It impugns an individual's character, signaling dishonesty, opportunism, and untrustworthiness. Because fraud is undefined by design, individuals are left to rely on intuition and a general awareness of social, moral, and religious proscriptions against lying, cheating, and advantage-taking. The opacity of the legal standard, however, makes it particularly susceptible to emotional decision-making, self-deceptive rationalizations, and inconsistent enforcement.

Although legal scholars have attempted subject-specific definitions of fraud,² the aim of this Article is not to propose more specificity in the definition of fraud. Rather, it draws on the insights of behavioral ethics

² See, e.g., Matthew A. Edwards, *The Concept and Federal Crime of Mortgage Fraud*, 57 AM. CRIM. L. REV. 57, 85–90 (2020); Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 520 (2011); Ellen S. Podgor, *Criminal Fraud*, 48 AM. U. L. REV. 729, 746–760 (1999); Ray A. Knight & Lee G. Knight, *Criminal Tax Fraud: An Analytical Review*, 57 MO. L. REV. 175, 179–80 (1992).

to explore the influence of prosocial motives on fraudulent behavior. The current legal framework is tailored primarily toward the atomistic, calculative fraudster who is motivated by self-interest. This ignores broad swaths of fraudulent activity, including morally ambiguous fraud that is not triggered by the profit motive.

This Article challenges the paradigm of the rational, self-interested fraudster, focusing instead on one type of non-calculative fraudster—the prosocial fraudster. Prosocial fraud appears to be a contradiction in terms: no amount of fraud can be socially beneficial. As used in this Article, the term references not the effect, but the motive for engaging in fraud. As opposed to fraud induced by greed, prosocial fraud refers to fraud induced by prosocial motives and emotions such as altruism, empathy, loyalty, and love.

Emerging research suggests that prosocial fraud is a far more prevalent and compelling force than previously recognized, afflicting small and large cons alike.³ Unlike other species of fraud, however, reputational sanctions and the impact on trust are attenuated. Where there is dissonance between legal penalties on the one hand, and social sanctions and internal values on the other, legal sanctions lose part of their moral and practical force. Accordingly, the current incentive-based approach, which relies heavily on definitional ambiguity and prosecutorial discretion to address different species of fraud, is particularly ill-equipped to deal with prosocial fraud.

This Article argues that the deterrent aims of the current legal framework cannot be fully achieved without accounting for the influence of prosocial motives and cooperative norms on fraudulent behavior. Human behavior is as much influenced by internal motivation as by external sanctions and social norms. Ideally, legal sanctions, social sanctions, and intrinsic motivation should work in concert to produce prosocial behavior. But in the context of prosocial fraud, intrinsic motivation and social sanctions often undercut the effectiveness of legal sanctions. This Article explores this inherent tension.

The law imposes liability for failure to behave in prosocial ways, but the impulse to act prosocially can sometimes have perverse effects. Prosocial fraud is particularly unresponsive to legal sanctions because of the interaction of two powerful cognitive biases—self-deception and motivated blindness. Self-deception undermines the effectiveness of legal sanctions by providing an alternate source of intrinsic motivation, while motivated blindness subverts social sanctions. This Article argues

³ See *infra* Part II.

that the moral ambiguity of prosocial fraud facilitates self-deceptive rationalizations that do not respond to increased sanctions.

Part I analyzes the role of intrinsic motivation, arguing that the impulse to help can often override the impulse to act ethically. It identifies mechanisms of self-deception and catalogues the types of prosocial motives that can lead to fraudulent behavior. Part II discusses certain structural and situational factors—definitional ambiguity, incrementalism, and third-party complicity—that increase the prevalence of prosocial fraud. Part III sets out a normative framework for curbing prosocial fraud through ex ante private enforcement. Parts I and II highlight the inadequacy of direct deterrence, attempting to answer the question of *why* prosocial fraud should be treated differently. Part III deals with *how* it can be curtailed, focusing on the comparative advantages of third-party monitors in disrupting misconduct.

II. INTRINSIC MOTIVATION

The current doctrinal framework assumes that fraudulent behavior derives from inherent character flaws, lapses of judgment, and the weighing of incentives. But a wealth of social science research has demonstrated that this conception of human behavior is unduly narrow. In recent years, researchers in psychology, economics, behavioral ethics, and other disciplines have demonstrated that numerous psychological mechanisms and processes underlie unethical conduct. Not only are many bad acts not the product of rational, deliberative decision-making, but also cognitive biases such as self-deception, motivated reasoning, and motivated blindness vitiate the impact of legal and social sanctions.

A. *Mechanisms of Self-Deception*

Accumulating evidence suggests that individuals' emotional, unconscious, and affective states play a far more prevalent role in unethical behavior than previously thought.⁴ A combination of explicit and implicit mental processes impact behavior:⁵ the mechanistic, automatic, heuristic, and unconscious system on the one hand ("System 1"), and the deliberative, conscious, evaluative system on the other

⁴ See Dolly Chugh et al., *Bounded Ethicality as a Psychological Barrier to Recognizing Conflicts of Interest*, in *CONFLICTS OF INTEREST: CHALLENGES AND SOLUTIONS IN BUSINESS, LAW, MEDICINE, AND PUBLIC POLICY* 74, 75 (Don A. Moore et al. eds., 2005).

⁵ See *id.*

("System 2").⁶ Automatic and deliberate processes "often work in concert to produce judgments and decisions."⁷ Under the conventional view, the impulse to act selfishly is an automatic System 1 process, whereas the impulse to act ethically is a deliberative System 2 process.⁸ Experimental evidence suggests that in anonymous settings with little accountability, individuals tend to lie to advance their self-interests.⁹

In recent years, behavioral ethicists have demonstrated that unethical behavior can result from automatic and reflexive processes.¹⁰ Individuals make many decisions and take many actions on the basis of impulse and intuition.¹¹ Many moral judgments result from "quick, automatic, evaluations" that are justified and rationalized post hoc.¹² In social contexts, people tend not to make calculated utilitarian judgments, but instead respond intuitively to "up close and personal" aspects of their environment.¹³ Individuals often have reflexive feelings about reciprocity, loyalty, equality, or suffering that are shaped by social and cultural forces.¹⁴ Prosocial impulses—not just self-interest—can motivate unethical behavior under System 1 automatic processes. When automatic and controlled judgments conflict, automatic processing often prevails.¹⁵ Moreover, some individuals may act unethically without full consciousness that they are doing so.¹⁶ Researchers have demonstrated how "the illusion of conscious will" may lead individuals to attribute responsibility and intention to actions over which they in fact have little or no control.¹⁷

⁶ See DANIEL KAHNEMAN, THINKING, FAST AND SLOW 20–21 (2011); CRISTINA BICCHIERI, THE GRAMMAR OF SOCIETY: THE NATURE AND DYNAMICS OF SOCIAL NORMS 4–5 (2006); see also YUVAL FELDMAN, THE LAW OF GOOD PEOPLE: CHALLENGING STATES' ABILITY TO REGULATE HUMAN BEHAVIOR 2 (2018).

⁷ See Don A. Moore & George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflicts of Interest*, 17 SOC. JUST. RSCH. 189, 192 (2004).

⁸ *Id.* at 190.

⁹ Shaul Shalvi et al., *Honesty Requires Time (and Lack of Justifications)*, 23 PSYCH. SCI. 1264, 1268 (2012); see also EYAL ZAMIR & DORON TEICHMAN, BEHAVIORAL LAW AND ECONOMICS 72 (2018).

¹⁰ See ZAMIR & TEICHMAN, *supra* note 9.

¹¹ See Moore & Loewenstein, *supra* note 7, at 194; Max H. Bazerman & Mahzarin R. Banaji, *The Social Psychology of Ordinary Ethical Failures*, 17 SOC. JUST. RSCH. 111, 112 (2004).

¹² See Moore & Loewenstein, *supra* note 7, at 194.

¹³ See J.D. Greene et al., *An fMRI Investigation of Emotional Engagement in Moral Judgment*, 293 SCI. 2105, 2106 (2001).

¹⁴ See J. Haidt, *The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 PSYCH. REV. 814, 826 (2001).

¹⁵ See Moore & Loewenstein, *supra* note 7, at 192.

¹⁶ See MAX H. BAZERMAN & ANN E. TENBRUNSEL, BLIND SPOTS: WHY WE FAIL TO DO WHAT'S RIGHT AND WHAT TO DO ABOUT IT 6–12 (2011) [hereinafter BLIND SPOTS].

¹⁷ See DANIEL M. WEGNER, THE ILLUSION OF CONSCIOUS WILL 318 (2017).

In addition, psychological mechanisms such as motivated reasoning and self-deception can undermine the deterrent effect of legal and social sanctions. Motivated reasoning refers to how motivation affects reasoning by influencing the types of information that individuals pay attention to and rely on.¹⁸ When individuals wish to arrive at a particular conclusion, they construct justifications for that conclusion by accessing only a biased subset of relevant information.¹⁹ “In other words, one’s preferred course of action provides a directional motivation to search for, attend to, and weight more heavily any evidence that supports the preference.”²⁰ Accordingly, people are more likely to arrive at conclusions they wish to arrive at.²¹

These findings are consistent with other studies showing that individuals’ perceptions of their own morality are highly fluid and pliable, impacting future behavior.²² Individuals manage their memories to maintain a favorable self-image. Those who have engaged in dishonesty often engage in “moral forgetting”—unconsciously forgetting or misremembering actual behavior and moral norms meant to guide that behavior.²³ As Max Bazerman and Ann Tenbrunsel noted, “[b]ecause we are motivated by a desire to see ourselves as ethical people, we remember the actions and decisions that were ethical and forget, or never even process, those that were not, thereby leaving intact our image of ourselves as ethical.”²⁴ Similarly, “ethical fading” involves overlooking the ethical dimension of a decision to avoid the moral implications of that decision.²⁵ Self-deception—“active misrepresentation of reality to the conscious mind” or “lying to oneself”—allows individuals to disregard accurate assessments of their behavior.²⁶ Self-serving justifications allow individuals to act in their

¹⁸ See Ziva Kunda, *The Case for Motivated Reasoning*, 108 PSYCH. BULL. 480, 480 (1990).

¹⁹ *Id.* at 493.

²⁰ Celia Moore & Ann E. Tenbrunsel, “Just Think About It”? Cognitive Complexity and Moral Choice, 123 ORG. BEHAV. & HUM. DECISION PROCESSES 138, 140 (2014) (citations omitted).

²¹ Kunda, *supra* note 18, at 495.

²² See Jennifer Jordan et al., *The Moral Self-Image Scale: Measuring and Understanding the Malleability of the Moral Self*, 6 FRONTIERS PSYCH. 1, 1 (2015).

²³ Lisa L. Shu & Francesca Gino, *Sweeping Dishonesty Under the Rug: How Unethical Actions Lead to Forgetting of Moral Rules*, 6 J. PERSONALITY & SOC. PSYCH. 1164, 1164 (2012).

²⁴ BLIND SPOTS, *supra* note 16, at 58.

²⁵ Ann E. Tenbrunsel & David M. Messick, *Ethical Fading: The Role of Self-Deception in Unethical Behavior*, 17 SOC. JUST. RSCH. 223, 224 (2004).

²⁶ Robert Trivers, *The Elements of a Scientific Theory of Self-Deception*, 907 ANNALS N.Y. ACAD. SCIS. 114, 114 (2000).

self-interest without feeling or appearing immoral. Similarly, third parties are more likely to excuse or overlook such behavior.²⁷

B. Motive

This research suggests that assumptions implicit in the legal system's treatment of fraud are deeply flawed. The law largely disregards motive, but motive profoundly influences an individual's perception of his or her own culpability. Individuals evaluate the morality of their own actions differently when those actions derive from prosocial motives.²⁸ An intent to mislead is an element of fraud in the common law of crimes and torts, but the motive for intentional misrepresentations is not an element of fraud. Common law fraud requires a showing of knowledge of the representation's falsity or reckless disregard of its truth and an intent to deceive the victim.²⁹ Intent refers to an actor's state of mind—whether the act was performed purposefully, knowingly, or recklessly. Motive, however, refers to a defendant's reasons for acting.³⁰ A growing body of research indicates that motives other than greed—in particular, prosocial motives such as altruism, equity, collegiality, loyalty, and love—may have a significant impact on fraudulent behavior.

Examples abound of individuals who commit fraud where the expected costs exceed any perceived benefits. Auditors assist clients in misrepresenting their finances; doctors misrepresent patients' health; insurance administrators approve uncovered expenses; and employees lie to protect coworkers.³¹ The impulse to help is so deeply engrained that individuals have been willing to lie, cheat, and commit fraud to increase others' welfare.³² The desire to help implicates numerous related prosocial motives—empathy, altruism, fairness, loyalty, sense of belonging, and love, among others. Each is discussed in turn.

²⁷ See BLIND SPOTS *supra* note 16, at 63.

²⁸ See Francesca Gino & Lamar Pierce, *Lying to Level the Playing Field: Why People May Dishonestly Help or Hurt Others to Create Equity*, 95 J. BUS. ETHICS 89, 90 (2010) [hereinafter *Lying to Level*].

²⁹ W. KEETON ET AL., PROSSER AND KEETON ON TORTS 740–41 (5th ed. 1984); see also RESTATEMENT (SECOND) OF TORTS § 525 (A.L.I. 1977).

³⁰ Carissa Byrne Hessick, *Motive's Role in Criminal Punishment*, 80 S. CAL. L. REV. 89, 95 (2006).

³¹ See *Lying to Level*, *supra* note 28, at 89.

³² See generally DAN ARIELY, THE (HONEST) TRUTH ABOUT DISHONESTY: HOW WE LIE TO EVERYONE—ESPECIALLY OURSELVES (2012).

1. Empathy and Altruism

Although empathy has often been associated with cooperative and other prosocial behaviors, it may also drive dishonest behavior. Empathy may be defined as “a vicarious emotion that one person experiences when reflecting on the emotion of another,”³³ or understanding and relating to the situation of others.³⁴ It is “a second-order, affective response to another’s pain”³⁵ or an other-oriented emotional response to others’ welfare—e.g., feeling sympathetic and compassionate towards another in need.³⁶ It has thus been used interchangeably with terms such as sympathy, compassion, and kindness.³⁷ It is technically not itself an emotion, but a means of processing and experiencing the emotions of others.³⁸

“[A]ltruism—acting with the goal of benefiting another”³⁹—is related to empathy in that empathy can produce altruistic motivation.⁴⁰ When we relate to another’s suffering (empathy), “we hurt in a way that frequently leads to helping” (altruism).⁴¹ Altruism has been defined as “behavior that benefits another organism, not closely related, while being apparently detrimental to the organism performing the behavior”;⁴² “self-destructive behavior performed for the benefit of others”;⁴³ or “a motivational state with the ultimate goal of increasing another’s welfare.”⁴⁴ In contrast to benevolence, it generally requires

³³ Jesse Prinz, *Against Empathy*, 49 S.J. PHIL. 214, 214 (2011).

³⁴ See Lynne N. Henderson, *Legality and Empathy*, 85 MICH. L. REV. 1574, 1576 (1987).

³⁵ See Robert B. Cialdini, *Altruism or Egoism? That Is (Still) the Question*, 2 PSYCH. INQUIRY 124, 124 (1991).

³⁶ See C. Daniel Batson et al., *Immorality from Empathy-Induced Altruism: When Compassion and Justice Conflict*, 68 J. PERSONALITY & SOC. PSYCH. 1042, 1042 (1995).

³⁷ See Norma Deitch Feshbach, *Empathy in Children: Some Theoretical and Empirical Considerations*, 5 COUNSELING PSYCH. 25, 25 (1975).

³⁸ See Terry A. Maroney, *Law and Emotion: A Proposed Taxonomy of an Emerging Field*, 30 LAW HUM. BEHAV. 119, 127 (2006).

³⁹ See J.A. Piliavin & H.W. Charng, *Altruism: A Review of Recent Theory and Research*, 16 ANN. REV. SOCIO. 27, 27 (1990).

⁴⁰ See C. Daniel Batson, *Empathy-Induced Altruistic Motivation*, Remarks at the Inaugural Herzliya Symposium on “Prosocial Motives, Emotions, and Behavior” (Mar. 24–27, 2008), at 11 (draft of lecture on file with author).

⁴¹ Cialdini, *supra* note 35.

⁴² Robert L. Trivers, *The Evolution of Reciprocal Altruism*, 46 Q. REV. BIO. 35, 35 (1971).

⁴³ Edward O. Wilson, *The Genetic Evolution of Altruism*, in ALTRUISM, SYMPATHY, AND HELPING: PSYCHOLOGICAL AND SOCIOLOGICAL PRINCIPLES 11, 11 (Lauren Wispé ed., 1978).

⁴⁴ C. DANIEL BATSON, *THE ALTRUISM QUESTION: TOWARD A SOCIAL-PSYCHOLOGICAL ANSWER* 6 (1991).

some form of self-sacrifice or other act that is costly for the actor.⁴⁵ It has been contrasted with egoism—acting in one’s own self-interest—i.e., seeking self-benefit and self-gratification.⁴⁶

Although the literature on altruism and empathy is vast, only recently have scholars focused on their role in motivating deceitful and fraudulent behavior. Studies show that people cheat more when there are beneficiaries in addition to themselves, even if the beneficiaries are anonymous strangers.⁴⁷ When individuals’ dishonesty benefits others, they are more likely to perceive their actions as justified and feel less guilt.⁴⁸ By focusing on how their actions are benefiting others, individuals are able to view their actions in positive terms and avoid negatively impacting their moral self-image.⁴⁹ When faced with competing moral principles—honesty versus benevolence—individuals prioritizing benevolence over honesty feel they have acted morally. Indeed, some evidence exists that people view individuals with altruistic intentions—those who lie to help others—as *more* moral than those who choose honesty over benevolence.⁵⁰

Similarly, considerable research has shown that when individuals feel empathy for others in need, they act to increase others’ welfare, even at a cost to themselves.⁵¹ When individuals feel empathy for “a particular individual experiencing a particular need in a particular situation,” they often seek to benefit that individual to the detriment of others.⁵² Experimental subjects induced to feel empathy are significantly more likely to engage in unethical behavior.⁵³ In low-empathy conditions, individuals tend to act in accordance with principles of fairness and justice.⁵⁴ But when they are induced to feel

⁴⁵ See Emma E. Levine & Maurice E. Schweitzer, *Are Liars Ethical? On the Tension Between Benevolence and Honesty*, 53 J. EXPERIMENTAL SOC. PSYCH. 107, 108 (2014).

⁴⁶ See BATSON, *supra* note 44, at 5.

⁴⁷ See Francesca Gino et al., *Self-Serving Altruism? The Lure of Unethical Actions that Benefit Others*, 93 J. ECON. BEHAV. ORG. 285, 285 (2013); Scott Wiltermuth, *Cheating More When the Spoils Are Split*, 115 ORG. BEHAV. & HUM. DECISION PROCESSES 157, 157 (2011).

⁴⁸ See *id.*

⁴⁹ See *id.*

⁵⁰ See Levine & Schweitzer, *supra* note 45, at 109, 115.

⁵¹ See C. Daniel Batson & Tacia Moran, *Empathy-Induced Altruism in a Prisoner’s Dilemma*, 29 EUR. J. SOC. PSYCH. 909, 911 (1999); Dennis Krebs, *Empathy and Altruism*, 32 J. PERSONALITY & SOC. PSYCH. 1134, 1134 (1975).

⁵² See Batson & Moran, *supra* note 51, at 921.

⁵³ See Batson et al., *supra* note 36, at 1042; Francesca Gino & Lamar Pierce, *Dishonesty in the Name of Equity*, 20 PSYCH. SCI. 1153, 1153–54 (2009).

⁵⁴ See Batson et al., *supra* note 36, at 1052.

empathy for a person in need, they show partiality toward that person, even when they know the person's need is not as great as others.⁵⁵

Examples abound of individuals who act dishonestly or unethically because of altruism or empathy. Two classic examples include doctors who approve uncovered expenses and professors who give unearned grades to low-income students.⁵⁶ As another example, consider fraud in the liver transplant market. Data suggests that doctors, motivated by empathy for their patients, engaged in fraud to game the liver transplant market.⁵⁷ Prior to March 2002, doctors began sending relatively healthy patients to ICUs because ICU patients jumped to the top of priority lists regardless of sickness level.⁵⁸ Once this policy changed and liver allocation was based solely on patients' sickness levels, the number of patients in ICUs at the time of their transplants dramatically declined, while sickness levels of the average patient increased.⁵⁹ This suggests that prior to the change, doctors used ICUs more often for patients who were relatively healthy in order to assure their patients' access to livers.⁶⁰ Similar instances of empathetic fraud are common, including false reporting of diagnoses on hospital claims⁶¹ and auditors' misrepresentation of client finances.⁶²

2. Equity

Empathy and altruism may also play a role in dishonest helping behavior motivated by the desire to restore equity.⁶³ Whereas negative inequity produces feelings of envy, positive inequity induces feelings of guilt, which motivates individuals to dishonestly help others.⁶⁴ Particularly where the risks of being caught are low, individuals are more prone to act on emotions such as envy, guilt, and empathy.⁶⁵

⁵⁵ *Id.*

⁵⁶ *See Lying to Level, supra* note 28, at 89.

⁵⁷ Jason Snyder, *Gaming the Liver Transplant Market*, 26 J.L. ECON. & ORG. 546, 547 (2010).

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *See id.*

⁶¹ *See* Ching-to Albert Ma & Thomas G. McGuire, *Optimal Health Insurance and Provider Payment*, 87 AM. ECON. REV. 685, 687 (1997).

⁶² *See* Max H. Bazerman et al., *Why Good Accountants Do Bad Audits*, 80 HARV. BUS. REV. 97, 97 (2002).

⁶³ *See Lying to Level, supra* note 28, at 89.

⁶⁴ *See id.* at 91–92.

⁶⁵ Francesca Gino & Lamar Pierce, *Robin Hood Under the Hood: Wealth-Based Discrimination in Illicit Customer Help*, 21 ORG. SCI. 1176, 1177 (2010) [hereinafter *Robin Hood*].

Moreover, when individuals act dishonestly to restore equity, they subjectively “discount the immorality of their actions.”⁶⁶

Take, for instance, fraud in the vehicle emissions testing market. The Environmental Protection Agency (EPA) requires states to implement vehicle emissions programs, but allows states to outsource some or all testing to privately-owned licensed firms.⁶⁷ Inspectors have ample opportunities to cheat, as polluting cars can be certified clean by making temporary adjustments or by simply substituting other cars during testing.⁶⁸ Financial incentives to cheat also exist—customers are more likely to return to inspection firms that have previously passed them, and older cars with problems tend to need future mechanical repairs.⁶⁹ Financial self-interest, however, does not fully explain existing data.

In the strictly regulated emissions testing market, inspectors are prohibited from systematically treating certain types of cars more leniently than others.⁷⁰ Yet, a notable number of emissions testers illegally assist customers driving standard vehicles over those driving luxury ones. In a series of laboratory studies, Gino and Pierce manipulated and measured how emotions such as envy and empathy influenced individuals’ propensity to illegally help their peers.⁷¹ They found that individuals’ likelihood of illicitly assisting others varied based on the beneficiary’s wealth, with the majority illegally helping those who exhibited less wealth.⁷² These results demonstrate that employees’ emotional reactions to customer wealth can often lead to discriminatory and fraudulent behavior.

Related research has shown that individuals routinely act against their own self-interests and are motivated by concerns over fairness, reciprocity, and equity.⁷³ For instance, researchers in economics have shown that subjects are willing to change the distribution of outcomes they perceive as unfair, even at a personal cost.⁷⁴ They consistently reward cooperators, punish defectors, and are willing to reject highly

⁶⁶ *Lying to Level*, *supra* note 28, at 101.

⁶⁷ *Robin Hood*, *supra* note 65, at 1180.

⁶⁸ *Id.*

⁶⁹ See Thomas N. Hubbard, *How Do Consumers Motivate Experts? Reputational Incentives in an Auto Repair Market*, 52 J. L. & ECON. 437, 437 (2002).

⁷⁰ *Robin Hood*, *supra* note 65, at 1181.

⁷¹ *Id.* at 1189.

⁷² *Id.*

⁷³ Ernst Fehr & Klaus M. Schmidt, *The Economics of Fairness, Reciprocity, and Altruism – Experimental Evidence and New Theories*, in 1 HANDBOOK OF THE ECONOMICS OF GIVING, ALTRUISM, AND RECIPROCITY 615, 615 (2006).

⁷⁴ See Ernst Fehr & S. Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSP. 159, 159 (2000).

uneven proposals.⁷⁵ Under equity theory, individuals compare the ratio of their own inputs and outcomes with the ratio of inputs and outcomes of others. If they perceive inequity in these ratios, they respond by modifying their inputs or withdrawing.⁷⁶ Other studies have demonstrated that inequity generates emotional reactions that result in dishonest helping or hurting behavior.⁷⁷ Even more surprisingly, individuals “judge actions that restore equity as morally appropriate and ethical even when they involve lying and stealing.”⁷⁸

3. Loyalty and Sense of Belonging

Individuals may also engage in fraud out of a sense of loyalty to their organization, friends, families, or other group members.⁷⁹ Studies have shown how organizational norms and influences can alter an individual’s personal ethics.⁸⁰ Peer pressure can motivate employees to conform their behavior to those of their peers.⁸¹ As individuals move from one employer to another, their willingness to engage in unethical behavior appears “to shift with the inclinations of the respective employer.”⁸² Moreover, loyalty influences the way people judge their own behavior—those who are dishonest out of loyalty to their organization, family, or group feel they acted ethically and morally.⁸³ When evaluating the behavior of others, outsiders view loyalty-driven deceit as immoral and unethical.⁸⁴ Moral judgments shift, however, when the outsiders become insiders. When called on to be loyal to their group, people are not only more willing to lie, but also to view their lies as ethical, and more ethical than those who act honestly, but disloyally.⁸⁵ A competing virtue—loyalty—overcomes honesty, allowing individuals

⁷⁵ *Id.* at 171–172.

⁷⁶ See J. Stacy Adams, *Inequity in Social Exchange*, in 2 *ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY* 267, 284–292 (L. Berkowitz ed., 1965).

⁷⁷ Francesca Gino & Lamar Pierce, *Dishonesty in the Name of Equity*, 20 *PSYCH. SCI.* 1153, 1157 (2009).

⁷⁸ See *Lying to Level*, *supra* note 28, at 92.

⁷⁹ See V. Anand et al., *Business As Usual: The Acceptance and Perpetuation of Corruption in Organizations*, 19 *ACAD. MGMT. EXEC.* 9, 13 (2005).

⁸⁰ See L. Treviño et al., *Behavioral Ethics in Organizations: A Review*, 32 *J. MGMT.* 951, 965–968 (2006).

⁸¹ See *id.* at 966; Alexandre Mas & Enrico Moretti, *Peers at Work*, 99 *AM. ECON. REV.* 112, 143 (2009).

⁸² See Lamar Pierce & Jason Snyder, *Ethical Spillovers in Firms: Evidence from Vehicle Emissions Testing*, 54 *MGMT. SCI.* 1891, 1900 (2008).

⁸³ See John A.D. Hildreth & Cameron Anderson, *Does Loyalty Trump Honesty? Moral Judgments of Loyalty-Driven Deceit*, 79 *J. EXPERIMENTAL SOC. PSYCH.* 87, 87 (2018).

⁸⁴ See *id.* at 87; see also Uri Gneezy, *Deception: The Role of Consequences*, 95 *AM. ECON. REV.* 384, 390 (2005).

⁸⁵ See Hildreth & Anderson, *supra* note 83, at 87.

to rationalize their unethical behavior and maintain a positive self-image.⁸⁶ Individuals fear the consequences of disloyalty—disgust, contempt, moral outrage, and social ostracism—and therefore act to support their group.⁸⁷

Many examples exist of individuals who commit fraud out of loyalty to friends, colleagues, or loved ones. Often, white-collar criminals initiate their schemes by taking advantage of friendships and family relationships.⁸⁸ Consider the case of former KPMG partner Scott London, who was sentenced to fourteen months in prison for providing confidential, nonpublic information to a friend, Bryan Shaw, in return for cash, a Rolex watch, jewelry, and Bruce Springsteen tickets.⁸⁹ The fascinating aspect of the case was not the brazenness of the illicit activity—he was photographed accepting bags of cash in a Starbucks parking lot—but the irrationality of it. Although the payments established that London had personally profited from the scheme, the case was unusual in that London appeared to be motivated at least in part by the desire to help Shaw. The cash and gifts, worth anywhere from \$50,000 to \$70,000, were relatively small in comparison to his estimated \$650,000 to \$900,000 annual salary.⁹⁰ London did not need the cash and did not use the Rolex watch, having always preferred watches with leather bands.⁹¹ In later interviews, London rationalized, “I was thinking about trying to help out a friend. I thought what we were doing was small. I only thought of myself and the other individual. I didn’t ever want anything.”⁹²

Relatedly, the need for a sense of belonging can motivate dishonest, fraudulent, and illegal behavior. “Belongingness” has been defined as a “personal involvement (in a social system) to the extent that the person feels himself to be an indispensable and integral part of the system.”⁹³

⁸⁶ See TAMAR FRANKEL, *THE PONZI SCHEME PUZZLE: A HISTORY AND ANALYSIS OF CON ARTISTS AND VICTIMS* 16–18 (2012).

⁸⁷ See Hildreth & Anderson, *supra* note 83, at 88.

⁸⁸ See Helen A. Garten, *Insider Trading in the Corporate Interest*, 1987 WIS. L. REV. 573, 585 (1978).

⁸⁹ See Stuart Pfeifer, *Former KPMG Partner Sentenced for Insider Trading*, L.A. TIMES (Apr. 24, 2014), <https://www.latimes.com/business/la-fi-kpmg-london-20140425-story.html>.

⁹⁰ See *id.*

⁹¹ See Quentin Fottrell, *Confessions of Insider Trader Scott London*, MARKET WATCH (June 25, 2014, 12:01 PM), <https://www.marketwatch.com/story/confessions-of-an-insider-trader-2014-06-21>.

⁹² *Id.*

⁹³ Santokh S. Anant, *Belongingness and Mental Health: Some Research Findings*, 26 ACTA PSYCHOLOGICA 391, 391 (1967) (quoting *The Need to Belong*, 14 CANADA’S MENTAL HEALTH 22–23 (1966)).

The need to belong is “a fundamental human motivation”: “human beings have a pervasive drive to form and maintain at least a minimum quantity of lasting, positive, and significant interpersonal relationships.”⁹⁴ Indeed, “much of what human beings do is done in the service of belongingness.”⁹⁵ Individuals are extremely averse to breaking social bonds, reacting with distress and resistance to the ending of relationships, even temporary ones.⁹⁶ Perhaps one of the most well-known illustrations of the power of belongingness is gang membership. Gangs provide a “sense of belonging, self-identity, status, and emotional support,” and an “opportunity to gain peer respect, group respect, and a sense of security.”⁹⁷ Studies have shown that youths “who do not experience a sense of belongingness to their own families” seek out gangs for social support and a sense of connection.⁹⁸ Gangs function, in effect, as surrogate families.⁹⁹

This same need for solidarity, belongingness, and group identity may explain participation and complicity in fraudulent schemes. Perhaps one of the most disturbing and shocking aspects of massive organizational fraud is the sheer breadth and extent of the fraud. Rarely is it ever the case of a few bad apples. Individuals go to extraordinary lengths to help their colleagues, even when doing so violates moral, social, and legal proscriptions against lying, cheating, and stealing. Even those with misgivings go along or turn a blind eye rather than risk rejection from the group. This behavior has been demonstrated both in and out of the laboratory setting. For instance, in one group problem-solving experiment, participants who learned that there would be other beneficiaries inflated their scores even more than when their cheating benefited only themselves.¹⁰⁰ In another experiment, college students acquiesced to an assigned group partner’s cheating, and then actively lied to conceal the cheating.¹⁰¹ In another, lying was more pronounced

⁹⁴ Roy F. Baumeister & Mark R. Leary, *The Need to Belong: Desire for Interpersonal Attachments as a Fundamental Human Motivation*, 117 PSYCH. BULL. 497, 497 (1995).

⁹⁵ *Id.* at 498.

⁹⁶ *See id.* at 502; *see also* Cindy Hazan & Phillip R. Shaver, *Attachment as an Organizational Framework for Research on Close Relationships*, 5 PSYCH. INQUIRY 1, 14 (1994).

⁹⁷ Michael M. Omizo et al., *A Phenomenological Study with Youth Gang Members: Results and Implications for School Counselors*, 1 PROF. SCH. COUNSELING 39, 39 (1997).

⁹⁸ *See* Thomas W. Baskin et al., *Family Belongingness, Gang Friendships, and Psychological Distress in Adolescent Achievement*, 92 J. COUNSELING & DEV. 398, 399 (2014).

⁹⁹ *See* Danny Malec, *Transforming Latino Gang Violence in the United States*, 18 PEACE REV.: J. SOC. JUST. 81, 85 (2006).

¹⁰⁰ *See* ARIELY, *supra* note 32, at 226.

¹⁰¹ *See* F.L. Geis & T.H. Moon, *Machiavellianism and Deception*, 41 J. PERSONALITY & SOC. PSYCH. 766, 766 (1981).

under team incentives, presumably because individuals can diffuse their responsibility.¹⁰²

These results have borne out in practice. Enron, WorldCom, Tyco, Bernie Madoff, and other major fraud scandals could not have been effectuated without the cooperation of numerous employees over an extended period. In Madoff's case, members of his inner circle—including his secretary, back-office workers, computer programmers, and other employees—willfully lied, falsified documents, hid evidence, and back-dated transactions.¹⁰³ More recently, in June 2019, the SEC charged KPMG LLP with altering past audit work after KPMG obtained confidential Public Company Accounting Oversight Board (PCAOB) lists of inspection targets.¹⁰⁴ In an elaborate scheme, KPMG auditors who passed training exams sent their answers to colleagues to help them obtain passing scores and manipulated an internal server to lower the score required for passing.¹⁰⁵ Perversely, the affective ties that bound these workers played a vital role in the propagation of the fraud.

4. Love

Finally, the impulse to help those we love can be a powerful motivator. Fraud motivated by love is particularly insidious because the emotional and social bonds that initially induce the fraud also make deterrence more elusive. The 2019 college admissions scandal, in which dozens of parents conspired to fraudulently have their children admitted to top colleges and universities, has been reviled as brazen illustrations of dishonesty, corruption, privilege, and entitlement.¹⁰⁶ For the ultra-rich, getting into an elite college conferred social standing, status, privilege, and bragging rights.¹⁰⁷ But what else could have motivated these otherwise law-abiding, prominent, and wealthy parents to risk everything to get their children into the school of their choice? Interviews with parents implicated in the scandal revealed stories of parents desperate to go to extraordinary lengths to help their

¹⁰² See Julian Conrads et al., *Lying and Team Incentives*, 34 J. ECON. PSYCH. 1, 1–2 (2013).

¹⁰³ See Rodger Adair, *Bernie Madoff's Inner Circle: Cases and Commentaries*, in FOLLOWERSHIP IN ACTION 215, 215–223 (2016).

¹⁰⁴ See Press Release, Sec. & Exch. Comm'n., KPMG Paying \$50 Million Penalty for Illicit Use of PCAOB Data and Cheating on Training Exams (June 17, 2019), <https://www.sec.gov/news/press-release/2019-95>.

¹⁰⁵ *Id.*

¹⁰⁶ See Graham Kates, *Lori Loughlin and Felicity Huffman Among Dozens Charged in College Bribery Scheme*, CBS NEWS (Mar. 12, 2019, 8:35 PM), <https://www.cbsnews.com/news/college-admissions-scandal-bribery-cheating-today-felicity-huffman-arrested-fbi-2019-03-12/>.

¹⁰⁷ See MELISSA KORN & JENNIFER LEVITZ, UNACCEPTABLE: PRIVILEGE, DECEIT & THE MAKING OF THE COLLEGE ADMISSIONS SCANDAL 29–30 (2020).

loved ones succeed.¹⁰⁸ They were invested in every aspect of their children's lives, proactively intervening and implementing fixes whenever challenges presented themselves. Having done everything for their children their entire lives, the parents seemingly lost trust and faith in their children's ability to do things on their own.¹⁰⁹

Social comparisons and competitive fears also played pivotal roles. Acceptance rates at highly selective colleges plummeted, making the "college admissions mania" a crisis for the roughly 3 percent of students aspiring to schools admitting fewer than half their applicants.¹¹⁰ Parents were led "to believe that the elite colleges are the only choices for their student to have the best education and to 'make it' in life and in their chosen career path."¹¹¹ Watching other parents go to extraordinary lengths to help their children get ahead created a sense of urgency that their own children would be left behind. Even those disinclined to cheat felt compelled to cheat to compete with those who did.¹¹² The presence of a beneficiary—their loved ones—allowed the parents to rationalize their dishonesty in a way that preserved their self-image.

C. Moral Ambiguity

Hence, prosocial fraud presents an inherent moral dilemma. Lying, deception, and fraud are universally seen as immoral acts, and honesty is extolled as an important component of moral character.¹¹³ But in the context of prosocial fraud, an alternate source of intrinsic motivation—benevolence and care—can eclipse legal strictures. In moral psychology, justice and care have formed two central pillars of moral exemplarity.¹¹⁴ Justice prioritizes fairness, honesty, and adherence to overarching moral principles and rules, such as in the maxim "do not

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 30.

¹¹⁰ Alia Wong, *The Absurdity of College Admissions: How Did Getting Into an Elite School Become a Frenzied, Soul-Deadening Process?*, ATLANTIC (Mar. 28, 2016), <https://www.theatlantic.com/education/archive/2016/03/where-admissions-went-wrong/475575/> (quoting Derek Thompson, *'It Doesn't Matter Where You Go to College': Inspirational, but Wrong*, ATLANTIC (Apr. 2, 2015), <https://www.theatlantic.com/business/archive/2015/04/the-3-percent-crisis/389396/>).

¹¹¹ Brennan Barnard, *The College Admission Scandal: Voices of Reason Part One*, FORBES (Mar. 30, 2019, 7:17 AM), <https://www.forbes.com/sites/brennanbarnard/2019/03/30/the-college-admission-scandal-voices-of-reason-part-one/>.

¹¹² KORN & LEVITZ, *supra* note 107, at 77.

¹¹³ See IMMANUEL KANT, *FOUNDATION OF THE METAPHYSICS OF MORALS* (L.W. Beck transl., 1959) (1785).

¹¹⁴ See Jonathan Haidt & Jesse Graham, *When Morality Opposes Justice: Conservatives Have Moral Intuitions that Liberals May Not Recognize*, 20 SOC. JUST. RSCH. 98, 100 (2007).

lie.”¹¹⁵ Care, on the other hand, prioritizes the duty to help and protect others.¹¹⁶ Although both are united in the view that morality centers on protecting individuals, they vary in the primacy accorded to each attribute.¹¹⁷ The justice imperative correlates closely with the deontological view that lying is immoral because it violates the right to the truth and respect for individual autonomy.¹¹⁸ Deontologists believe the goodness of a result does not determine the morality of an act; other factors may also be relevant.¹¹⁹ Consequentialists, on the other hand, believe that morality requires performing the act with the best consequences.¹²⁰ Utilitarianism, the most famous consequentialist theory, holds that an act is right if and only if it results in the greatest total amount of well-being.¹²¹ Under this view, the ethicality of lying ultimately depends on its consequences. Lies that help others may therefore be justified.¹²²

In situations where justice/honesty and care/benevolence conflict, some individuals instinctively privilege benevolence over honesty.¹²³ Emerging research indicates that individuals judge deception motivated by benevolence differently from purely self-interested deception. In fact, it may be that those who lie to help others are perceived to be *more* moral and trustworthy than those who privilege honesty.¹²⁴ Individuals discount the wrongness of dishonest behavior when their actions can be described as helping others. While they may theoretically espouse the deontological view that lying is immoral, they easily shift to a utilitarian focus on consequences to justify their helping, but dishonest, behavior.

III. STRUCTURAL AND SITUATIONAL FACTORS

This self-deceptive rationalization process is further facilitated by structural, social, and situational forces that can undermine the impact of legal sanctions. This Part identifies three factors that increase the pervasiveness of prosocial fraud: (a) definitional ambiguity; (b)

¹¹⁵ See Levine & Schweitzer, *supra* note 45, at 108.

¹¹⁶ *Id.*

¹¹⁷ See Haidt & Graham, *supra* note 114, at 100.

¹¹⁸ IMMANUEL KANT, *Of Ethical Duties Towards Others, and Especially Truthfulness*, in LECTURES ON ETHICS 200, 200–01 (Peter Heath & J.B. Schneewind eds., Peter Heath trans., 1997).

¹¹⁹ See SHELLY KAGAN, NORMATIVE ETHICS 74 (1997).

¹²⁰ *Id.* at 61.

¹²¹ *Id.*; see also JEREMY BENTHAM, AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION, 6–7 (1843).

¹²² See Levine & Schweitzer, *supra* note 45, at 115.

¹²³ See *id.*

¹²⁴ *Id.*

incrementalism; and (c) third-party complicity. Each is discussed in turn.

A. *Definitional Ambiguity*

For a concept as ubiquitous as fraud, the law surprisingly provides no definition. The lacuna is purposeful; its aim is to cover a broad swath of novel and constantly evolving forms of wrongdoing. Black's Law Dictionary defines it as "[a] knowing misrepresentation or knowing concealment of a material fact made to induce another to act to his or her detriment."¹²⁵

Some courts have defined it as:

Any artifice whereby he who practises it gains, or attempts to gain, some undue advantage to himself, or to work some wrong or do some injury to another, by means of a representation which he knows to be false, or of an act which he knows to be against right or in violation of some positive duty.¹²⁶

Others have defined fraud as any attempt to "gain an advantage over another by false suggestions or by the suppression of truth."¹²⁷ Still others have defined it even more broadly to include any conduct that strays from "moral uprightness, . . . fundamental honesty, fair play and right dealing in the general and business life of members of society."¹²⁸

With such a broad standard, however, it is unclear what the distinction is between lying and deceit.¹²⁹ Lying can be viewed as a subset of deception, but deception does not necessarily involve lying. "Lying" has been defined as "a statement made by one who does not believe it with the intention that someone else shall be led to believe

¹²⁵ *Fraud*, BLACK'S LAW DICTIONARY (11th ed. 2019).

¹²⁶ *Commonwealth v. Tuckerman*, 76 Mass. 173, 203 (1857).

¹²⁷ *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000) (quoting *Stapleton v. Holt*, 207 Okla. 443, 445 (1952)).

¹²⁸ *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958); *see also* *United States v. Bishop*, 825 F.2d 1278, 1280 (8th Cir. 1987) (quoting *United States v. States*, 488 F.2d 761, 764 (8th Cir. 1973)); *United States v. Hathaway*, 798 F.2d 902, 908 (6th Cir. 1986) (quoting *United States v. Van Dyke*, 605 F.2d 220, 225 (6th Cir. 1979)).

¹²⁹ Fraud has often been used synonymously with the term deceit. *See* Ellen S. Podgor, *Criminal Fraud*, 48 AM. U. L. REV. 729, 737 n.57 (1999) (quoting 1 EDWARD J. DEVITT ET AL., FEDERAL JURY PRACTICE AND INSTRUCTIONS § 16.08 (4th ed. 1992)).

it”¹³⁰ or simply making “an untrue statement with intent to deceive.”¹³¹ The basic elements are a false statement and an intent to mislead. Although lying is viewed as wrongful conduct, the law does not proscribe it except in certain contexts, such as perjury or defamation.

Deception, on the other hand, can involve not only affirmative misrepresentations, but also omissions and non-verbal behavior.¹³² Fraud is legally actionable deception—intentional deception where there is damage to the party deceived.¹³³ Fraud can be brought as a civil action, criminal action, or both. As a civil wrong, it can be brought as a private action in tort or contract, with the injured party bringing suit for damages.¹³⁴ Although requirements vary by jurisdiction, generally the requisite elements of common law civil fraud include an affirmative misrepresentation or omission of material fact, an intent to deceive, reliance on the misrepresentation, and loss proximately caused by the misrepresentation.¹³⁵ Some jurisdictions require parties to prove each element by clear and convincing evidence, making it difficult to bring successful fraud claims.¹³⁶

The current structural framework consists of subject-specific definitions superimposed on catch-all generic definitions, such as mail fraud,¹³⁷ wire fraud,¹³⁸ and conspiracy to defraud.¹³⁹ The statutes are staggering in breadth, providing little guidance on what conduct is proscribed. For instance, the mail fraud statute prohibits the use of the post office or interstate carrier for the execution of a scheme or artifice to defraud, but does not provide a definition of the term “defraud.”¹⁴⁰ Although the statute was originally intended “to criminalize counterfeit

¹³⁰ Arnold Isenberg, *Deontology and the Ethics of Lying*, 24 PHIL. & PHENOMENOLOGICAL RSCH. 463, 466 (1964); see also Bryon H. Druzin & Jessica Li, *The Criminalization of Lying: Under What Circumstances, If Any, Should Lies Be Made Criminal*, 101 J. CRIM. L. & CRIMINOLOGY 529, 533 (2011).

¹³¹ *Lie*, MERRIAM-WEBSTER DICTIONARY (2021), <https://www.merriam-webster.com/dictionary/lie> (last visited Oct. 8, 2021).

¹³² See Druzin & Li, *supra* note 130, at 565.

¹³³ See Milton D. Green, *Fraud, Undue Influence and Mental Incompetency*, 43 COLUM. L. REV. 176, 179 (1943).

¹³⁴ See RESTATEMENT (SECOND) OF TORTS § 525 (1976) (defining elements of liability for fraudulent misrepresentation); RESTATEMENT (SECOND) OF CONTRACTS § 162 (1981) (defining when a misrepresentation is fraudulent or material).

¹³⁵ See *Scaife Co. v. Rockwell-Standard Corp.*, 285 A.2d 451, 454 (Pa. 1971), *cert. denied*, 407 U.S. 920 (1972); *Sevin v. Kelshaw*, 611 A.2d 1232, 1236 (Pa. Super. Ct. 1992).

¹³⁶ See *Pittsburgh Live, Inc. v. Servov*, 615 A.2d 438, 441 (Pa. Super. Ct. 1992).

¹³⁷ See 18 U.S.C. § 1341.

¹³⁸ See 18 U.S.C. § 1343.

¹³⁹ See 18 U.S.C. § 1341.

¹⁴⁰ See *id.*

schemes that were using the postal system,”¹⁴¹ it has since been expanded to encompass any fraudulent schemes utilizing an interstate carrier.¹⁴² The government need only show (1) a scheme to defraud, (2) intent to defraud, and (3) use of the mails to further the fraudulent scheme.¹⁴³ The wire fraud statute is similarly broad in scope, prohibiting “any scheme or artifice to defraud, or [to obtain] money or property by means of false or fraudulent pretenses . . . by means of wire, radio, or television communication in interstate or foreign commerce.”¹⁴⁴ In contrast to common law civil fraud, federal criminal fraud does not require a showing of reliance or detriment.¹⁴⁵

Other fraud statutes, such as computer fraud,¹⁴⁶ health care fraud,¹⁴⁷ bank fraud,¹⁴⁸ and securities fraud,¹⁴⁹ focus on specific types of fraud. For instance, the bank fraud statute prohibits schemes to “defraud a financial institution” and schemes to obtain money or property “owned by, or under the custody or control of, a financial institution.”¹⁵⁰ Similarly, the securities fraud statute prohibits the use of “any manipulative or deceptive device or contrivance” in connection with the “purchase or sale of any security.”¹⁵¹ Like the mail and wire fraud statutes, however, they define fraud by reference to the term “defraud” or a “scheme or artifice to defraud” without providing further guidance on the meaning of that term.¹⁵²

The lack of a definition has resulted in an intricate, conflicting, and inconsistent body of common law characterized by a progressive blurring of the civil-criminal divide.¹⁵³ The job of policing this divide has fallen on prosecutors, who individually make subjective determinations of moral culpability and societal harm. But prosecutors often have

¹⁴¹ Ellen S. Podgor, *Tax Fraud—Mail Fraud: Synonymous, Cumulative or Diverse?*, 57 U. CIN. L. REV. 903, 906 (1989).

¹⁴² See 18 U.S.C. § 1341; see also Podgor, *supra* note 129, at 753.

¹⁴³ See 18 U.S.C. § 1341; see also *Pereira v. United States*, 347 U.S. 1, 8 (1954).

¹⁴⁴ 18 U.S.C. § 1343.

¹⁴⁵ See Miriam H. Baer, *Linkage and the Deterrence of Corporate Fraud*, 94 VA. L. REV. 1295, 1323 (2008).

¹⁴⁶ See 18 U.S.C. § 1030.

¹⁴⁷ See 18 U.S.C. § 1347.

¹⁴⁸ See 18 U.S.C. § 1344.

¹⁴⁹ See 18 U.S.C. § 1348; see also Podgor, *supra* note 129, at 756.

¹⁵⁰ 18 U.S.C. § 1344.

¹⁵¹ Securities and Exchange Act of 1934, ch. 404, § 10(b), 48 Stat. 881, 891 (codified as amended at 15 U.S.C. § 78j(b)).

¹⁵² See 18 U.S.C. § 1346.

¹⁵³ See Dan M. Kahan, *Is Chevron Relevant to Federal Criminal Law?*, 110 HARV. L. REV. 469, 476 (1996).

bureaucratic or personal incentives to selectively prosecute higher profile defendants, resulting in sporadic and uneven enforcement.¹⁵⁴

In addition, a lack of statutory gradation facilitates the motivational biases discussed above.¹⁵⁵ The current statutory scheme fails to distinguish low-level fraud from massive, organizational fraud, other than at the sentencing stage. As Miriam Baer has noted, “There is no such thing as first- or second-degree mail or wire fraud. Rather, all of the major fraud offenses, whether they threaten the evisceration of an entire industry or defraud an unfortunate few, fit under the same statutory umbrella.”¹⁵⁶ When all the variegated forms of fraud are subsumed under one category—the “scheme or artifice to defraud”—it creates problems of identification, monitoring, and deterrence.

Consider gradations of intent. Federal fraud law criminalizes “willful [and] specific intent to defraud.”¹⁵⁷ But courts interpreted this language very broadly to include not only purposeful frauds, but also impulsive and reckless ones. For instance, statements made in reckless disregard of their truth satisfy the requirement of purposefully deceptive conduct.¹⁵⁸ Similarly, conspiracy and accomplice liability statutes do not distinguish states of mind and “treat accomplices and principals identically.”¹⁵⁹ But studies have shown that many ordinary people engage in fraud non-deliberatively, and sometimes subconsciously.¹⁶⁰ When the law conflates the reluctant, non-calculative fraudster with the calculative one, individuals are more likely to engage in motivated reasoning and euphemistic categorizations.

Rather than deterring individuals from acting opportunistically, this ambiguity in the substance, structure, and contours of fraud can have the opposite effect: it can encourage individuals to choose interpretations that advance their self-interests.¹⁶¹ In addition to increasing the likelihood of selfish behavior, ambiguity encourages

¹⁵⁴ See John C. Coffee, Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models—and What Can Be Done About It*, 101 YALE L.J. 1875, 1888 (1992).

¹⁵⁵ See Miriam H. Baer, *Sorting Out White-Collar Crime*, 97 TEX. L. REV. 225, 227 (2018).

¹⁵⁶ *Id.* at 228.

¹⁵⁷ *Id.* at 248 (quoting *United States v. Dearing*, 504 F.3d 897, 903 (9th Cir. 2007)).

¹⁵⁸ See Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 556–59 (2011).

¹⁵⁹ See Baer, *supra* note 155, at 252 (citing *Rosemond v. United States*, 134 S. Ct. 1240, 1245 (2014)).

¹⁶⁰ See FELDMAN, *supra* note 6, at 129.

¹⁶¹ See Maurice E. Schweitzer & Christopher K. Hsee, *Stretching the Truth: Elastic Justification and Motivated Communication of Uncertain Information*, 25 J. RISK & UNCERTAINTY 185, 185 (2002); see also FELDMAN, *supra* note 6, at 195.

people to feel more confident in their own ethicality.¹⁶² Definitional ambiguity allows individuals to engage in “euphemistic labeling” and mental categorizing to “justify their opportunistic behaviors,” both to themselves and to others.¹⁶³ For instance, when stealing is reclassified as “shifting resources” or “creative accounting,” individuals are able to reap the benefits of stealing while maintaining their self-identity as moral, ethical, law-abiding citizens.

B. Incrementalism

In addition to the above structural factors, tolerance of incremental dishonesty works in conjunction with prosocial motivation to produce perverse results. Incrementalism refers to the process of modifying the status quo through minor changes.¹⁶⁴ Research demonstrates that “getting people to perform a small, seemingly inconsequential task can be an effective strategy for changing subsequent attitudes and behaviors.”¹⁶⁵ Often, massive organizational fraud begins with a seemingly harmless and minor modification—an added zero here, a fudged date there. The more minor the initial modification, the easier it is to justify and ignore. The justifications, though at times self-serving, also tend to be prosocial in nature—helping a coworker; saving a job; being a team player. Max Bazerman and Ann Tenbrunsel found that individuals are more likely to accept unethical behavior by others “as long as each violation is only incrementally more serious than the preceding one.”¹⁶⁶ In their experiment, participants acting as “auditors” were twice as likely to approve guesses if the “estimators” arrived at the guesses through incremental increases rather than abrupt ones.¹⁶⁷

Take the case of Toby Groves, the one-time owner of a mortgage brokerage business, Groves Funding Corp., who was sentenced in November 2008 for defrauding several financial institutions and falsifying income tax filings.¹⁶⁸ The fraud started small. When his

¹⁶² See FELDMAN, *supra* note 6, at 195.

¹⁶³ See Yuval Feldman & Henry E. Smith, *Behavioral Equity*, 170 J. INST. & THEORETICAL ECON. 137, 146 (2014).

¹⁶⁴ *Incrementalism*, MACMILLAN DICTIONARY (2021), <https://www.macmillandictionary.com/us/dictionary/american/incrementalism> (last visited Oct. 8, 2021).

¹⁶⁵ Jerry M. Burger, *Situational Features in Milgram's Experiment That Kept His Participants Shocking*, J. SOC. ISSUES 489, 491 (2014).

¹⁶⁶ Max H. Bazerman & Ann E. Tenbrunsel, *Ethical Breakdowns*, 89 HARV. BUS. REV. 58, 63 (2011).

¹⁶⁷ See *id.* at 64.

¹⁶⁸ See Laura Baverman, *Former Mortgage Broker Groves to Be Sentenced for Fraud*, CIN. BUS. COURIER (Aug. 7, 2008, 2:11 PM), <https://www.bizjournals.com/cincinnati/stories/2008/08/04/daily48.html>.

business began experiencing financial difficulties in 2003, Groves took out a home equity loan.¹⁶⁹ Realizing that he would not be approved for the loan if he truthfully reported his income, Groves rationalized: “If I just fudge the number a little, I’ll fix this big problem. I’ll save the company, save jobs.”¹⁷⁰ However, the fraud did not end there. To pay off the first loan, he documented a loan for a fictitious home with the willing help of his employees and other companies.¹⁷¹ Not a single person whom he approached expressed any reservations: “They didn’t see it as a crime, but rather as helping a friend out of a tight spot.”¹⁷²

The power of incrementalism is perhaps most strikingly demonstrated by Stanley Milgram’s famous experiment on obedience to authority. Participants playing the role of “teacher” were told to administer electric shocks of increasing magnitude whenever actors playing the role of “learner” answered questions incorrectly.¹⁷³ While the experiment is famous for its demonstration of the extraordinary lengths that individuals will go to obey authority, it is also a powerful demonstration of the power of incrementalism.¹⁷⁴ Although more than half of the teachers eventually administered shocks of over 300 volts, after which point the learner went silent and presumably lost consciousness, each of the teachers began by giving only a mild shock of fifteen volts. Teachers received instructions to punish subsequent wrong answers with slightly stronger shocks in fifteen-volt increments up to 450 volts.¹⁷⁵ Each gradual increase changed the baseline, becoming “the new normal” and making it easier to justify the next fifteen-volt increase.¹⁷⁶

Incrementalism addresses the human need to be considered—and to see oneself—as honest and ethical, while at the same time serving one’s self-interests. It is easier to fool oneself when the cheating is small and incremental. When fraud operates incrementally, it is even more difficult to detect. Low-level cheating is notoriously difficult to monitor. Indeed, “[u]ncovering evidence of ethically dubious strategies is quite difficult because these practices are usually hidden under a veil of

¹⁶⁹ Devon M. Zuegel, *Empathy for the Devil*, MEDIUM (Oct. 8, 2017), <https://medium.com/by-the-bay/empathy-for-the-devil-5b7cc3c1613a>.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ See Stanley Milgram, *Behavioral Study of Obedience*, 67 J. ABNORMAL & SOC. PSYCH. 371, 371–72 (1963).

¹⁷⁴ See Steven J. Gilbert, *Another Look at the Milgram Obedience Studies: The Role of the Graded Series of Shocks*, 7 PERSONALITY & SOC. PSYCH. BULL. 690, 690–91 (1981).

¹⁷⁵ See *id.*; see also Burger, *supra* note 165, at 492.

¹⁷⁶ See Jennifer Crocker, *The Road to Fraud Starts with a Single Step*, 479 NATURE 151, 151 (2011).

secrecy.”¹⁷⁷ Many of the largest fraud scandals began with small scale manipulations that eventually took on a life of their own. Enron began exaggerating earnings and hiding losses by recognizing gains on sales of assets to special purpose vehicles (“SPVs”) before realizing profits and by moving portions of its debt onto the SPVs’ balance sheets.¹⁷⁸ For instance, in a partnership with Blockbuster to provide movies directly through telephone lines, dubbed Project Braveheart, Enron recorded \$110.9 million in profits before profits were ever realized.¹⁷⁹ These instances of creative accounting were viewed as timing issues, not ethical ones.¹⁸⁰ To ensure that these SPVs would not be considered subsidiaries, Enron exploited a Financial Accounting Standards Board (“FASB”) rule that independently managed partnerships would not be considered subsidiaries if 3 percent of their equity came from outside investors.¹⁸¹

Small infractions allow fraudsters to operate under the radar and test the waters. If the infraction goes unnoticed, this opens the door to incrementally larger instances of fraud. If the infraction is caught, the fraudster can simply claim ignorance or mistake. But all too often, victims of small cheats never detect the cheating. As Emily Kadens noted, “[I]f victims discover the breach, the cheat may be minor enough that they may not be sure whether a trading partner had merely made a mistake she will happily correct, committed an inadvertent breach that will never happen again, or deliberately wronged them.”¹⁸²

Moreover, when fraud operates incrementally, it is much less likely to be punished, both formally through legal sanctions and informally through social sanctions. The legal system is constrained by finite resources, and as a result, enforcement tends to be selective and sporadic, with tremendous discretion accorded to prosecutors. The common law principle of *de minimis non curat lex* (“the law does not concern itself with trifles”) in effect allows much low-level fraud to go unpunished. In securities law, the concept of materiality operates as a broad threshold requirement for both the disclosure requirements and antifraud provisions of the securities laws.¹⁸³ If a misstatement or omission is not material—i.e., significant to the reasonable investor

¹⁷⁷ Snyder, *supra* note 57, at 547.

¹⁷⁸ See Ronald R. Sims & Johannes Brinkmann, *Enron Ethics (Or: Culture Matters More than Codes)*, 45 J. BUS. ETHICS 243, 245 (2003).

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ See *id.*

¹⁸² Emily Kadens, *Cheating Pays*, 119 COLUM. L. REV. 527, 530 (2019).

¹⁸³ See Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1, 62 (2003).

given the total mix of information—it is not legally actionable.¹⁸⁴ In other words, if a false statement or omission is relatively minor, it will likely go unpunished. Where, as in the case of prosocial fraud, the wrongdoing is morally ambiguous, the likelihood of prosecution and punishment is greatly reduced.

C. Third-Party Complicity

While formal sanctions are constrained by resource limitations, informal sanctions tend to be uneven and unreliable. Why do third parties so often fail to sanction dishonest and fraudulent behavior? In the case of low-level fraud, third parties who hear negative gossip “may not be confident whether the cheater actually cheated or the alleged victim was complaining unjustifiably about imperfect performance caused by a mistake or some inadvertent or unavoidable situation.”¹⁸⁵ Concern for reputation does not effectively deter opportunistic behavior because the end result is often competing reputations, not ostracism.¹⁸⁶ Further, in many situations, wrongdoing occurs in the context of complex organizations, where many different stakeholders, including board of directors, managers, and employees, share decision-making and responsibility.¹⁸⁷ Diffusion of responsibility, in which individuals feel less compelled to act in the presence of others, contributes to their ability to morally disengage, particularly in ambiguous contexts.¹⁸⁸ Studies show the presence of others makes individuals feel less responsible for their actions, particularly the negative consequences of group decisions.¹⁸⁹

In addition, when offenses involve harms and victims that are difficult to identify or quantify—e.g., loss of investor confidence—it is easier to morally disengage from them. Particularly where there are “small harms” to “large number[s] of victims” that “are significant only in the aggregate,” individuals can convince themselves that such

¹⁸⁴ See, e.g., 16 C.F.R. § 240.10b-5 (2021) (“It shall be unlawful for any person, directly or indirectly . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading.”).

¹⁸⁵ Kadens, *supra* note 182, at 538.

¹⁸⁶ See *id.*

¹⁸⁷ See Stuart P. Green, *Moral Ambiguity in White Collar Criminal Law*, 16 NOTRE DAME J.L. ETHICS & PUB. POL’Y 501, 510 (2004).

¹⁸⁸ See Frederike Beyer et al., *Beyond Self-Serving Bias: Diffusion of Responsibility Reduces Sense of Agency and Outcome Monitoring*, 12 SOC. COGNITIVE & AFFECTIVE NEUROSCIENCE 138, 144 (2017).

¹⁸⁹ See *id.* at 138; see also Albert Bandura, *Social Cognitive Theory of Self-Regulation*, 50 ORG. BEHAV. & HUM. DECISION PROCESSES 248, 281 (1991); D.R. Forsyth et al., *Responsibility Diffusion in Cooperative Collectives*, 28 PERS. & SOC. PSYCH. BULL. 54, 54 (2002).

conduct is not morally wrong.¹⁹⁰ Studies have shown that individuals are more willing to hurt people who are “unknown and probabilistic,” than people who they know.¹⁹¹ Individuals are better able to mentally and emotionally disengage from general, as opposed to specific targets.¹⁹² Indeed, in what has become known as the “identifiable victim effect,” Thomas Schelling observed that the death of a particular person invokes “anxiety and sentiment, guilt and awe, responsibility and religion, [but] . . . most of this awesomeness disappears when we deal with statistical death.”¹⁹³

Studies have demonstrated how easily and readily third parties can turn a blind eye. Motivated blindness refers to the tendency to fail to notice unethical behavior in others when it is not in our interest to do so.¹⁹⁴ Individuals have well-documented cognitive biases that predispose them to “see what they want to see” and “miss contradictory information when it’s in their interest to remain ignorant . . .”¹⁹⁵ Indeed, “people who have a vested self-interest in a situation have difficulty approaching the situation without bias, even when they view themselves as honest.”¹⁹⁶ Significant numbers of people routinely observe, but disregard—whether consciously or unconsciously—unethical behavior.¹⁹⁷ Motivated blindness can thus contribute to the propagation of prosocial fraud by undermining the effectiveness of social sanctions.

Third-party complicity is motivated by self-interest, fear, or laziness, and it can take a number of different forms—the calculating opportunist (“Type A”), the slavish sycophant (“Type B”), the team player (“Type C”), and the lazy, distracted, or selfish pacifist (“Type D”). I examine each in turn.

1. Type A: The Calculating Opportunist

The calculating opportunist observes dishonest or fraudulent behavior and weighs the costs and benefits of sanctioning the fraudster.

¹⁹⁰ See Green, *supra* note 187, at 509–10.

¹⁹¹ See Moore & Loewenstein, *supra* note 7, at 197; see also Deborah A. Small & George Loewenstein, *Helping a Victim or Helping the Victim: Altruism and Identifiability*, 26 J. RISK UNCERTAINTY 5, 5 (2003).

¹⁹² See Small & Loewenstein, *supra* note 191, at 6.

¹⁹³ Small & Loewenstein, *supra* note 191, at 5 (quoting Thomas C. Schelling, *The Life You Save May Be Your Own*, in PROBLEMS IN PUBLIC EXPENDITURE ANALYSIS 142 (Samuel B. Chase ed., 1968)).

¹⁹⁴ Bazerman & Tenbrunsel, *Ethical Breakdowns*, *supra* note 166, at 5

¹⁹⁵ *Id.*

¹⁹⁶ BLIND SPOTS, *supra* note 16, at 64.

¹⁹⁷ See *id.* at 63.

Fully knowledgeable about the fraudster's dishonesty, he turns a blind eye because doing so will serve his self-interests. As a general matter, he seeks to be on good terms with those in positions of authority and to avoid conflict with others in case they may be useful to him in the future.¹⁹⁸ Perhaps he believes that demonstrating his loyalty will advance his career interests and prospects for advancement. Perhaps he is lured by the prospect of financial enrichment or fears that confronting the fraud will be more costly to him than ignoring it. His thought process is coldly rational and distinctly Machiavellian.

The Machiavellian pursuit of self-interest has become "uniquely synonymous with amoral action, sharp dealing, hidden agendas, and unethical excess."¹⁹⁹ In 1970, Richard Christie and Florence Geis constructed a theory of Machiavellianism that distinguished between "High Machs" and "Low Machs": "High Machs manipulate more, win more, [and] are persuaded less" and believe that people are fair game for any means of exploitation.²⁰⁰ They "take a calculated [and] analytical view of situations" and individuals, prepared to do whatever it takes to advance their own objectives.²⁰¹ Their strategic bent also translates into skill at concealing their true personal convictions.²⁰² They fail to sanction the fraudster because of situational opportunism, further contributing to the propagation of the fraud.

2. Type B: The Slavish Sycophant

Relatedly, the slavish sycophant ("Type B") actively seeks out those in positions of authority. Anxious to demonstrate his loyalty, he showers his subject with praise and hangs on his every word. Both calculating opportunists and slavish sycophants are motivated by self-interest. But while the calculating opportunist makes a conscious and deliberate decision to turn a blind eye, the slavish sycophant appears incapable of acknowledging inconvenient information. In his classic study of sycophancy, Edward E. Jones identified three types of ingratiation: other-enhancement, opinion conformity, and self-presentation.²⁰³ Other-enhancement involves flattery and other efforts

¹⁹⁸ See Mark Travers, *Crucial Red Flags of Dark Triad Traits*, PSYCH. TODAY (Aug. 9, 2020), <https://www.psychologytoday.com/us/blog/social-instincts/202008/how-spot-dark-personality>.

¹⁹⁹ See George Nelson & Diana Gilbertson, *Machiavellianism Revisited*, 10 J. BUS. ETHICS 633, 633 (1991) (citing P. RALPH, *THE RENAISSANCE IN PERSPECTIVE* 23-24 (1973)).

²⁰⁰ See *id.* at 633-34 (quoting RICHARD CHRISTIE & FLORENCE GEIS, *STUDIES IN MACHIAVELLIANISM* 312 (1970)).

²⁰¹ See *id.* at 635.

²⁰² See *id.* at 636.

²⁰³ See EDWARD E. JONES, *INGRATIATION: A SOCIAL PSYCHOLOGICAL ANALYSIS* 24 (1964).

to convey admiration of the target. Opinion conformity involves agreeing “with the target’s attitudes, norms, and beliefs.”²⁰⁴ And self-presentation refers to the sycophant’s efforts to present himself in a positive manner. Jones surmised that ingratators disguise their true attitudes and beliefs, employing various strategic tactics to manipulate others to view them favorably.²⁰⁵

Research has shown not only that individuals are highly susceptible to flattery, but also that sycophancy can be effective.²⁰⁶ Indeed, both laboratory and field studies indicate that “supervisor-focused impression-management tactics” enhanced supervisor liking for the subordinate.²⁰⁷ Liking, in turn, often translates into positive performance ratings.²⁰⁸ Perhaps for this reason, sycophants in some form persist in every organization. Their presence undermines the ability of social sanctions to reliably gain a foothold to deter and punish fraudulent behavior.

3. Type C: The Team Player

The team player (“Type C”) fears accountability and values conformity, particularly in situations where he is unsure of what to do. “Conformity refers to the act of changing one’s behavior to match the responses of others.”²⁰⁹ Social psychologists have identified two types of conformity—informational conformity and normative conformity. Informational conformity refers to relying on others for information and guidance.²¹⁰ Normative conformity refers to conforming in order to be liked or accepted by the group.²¹¹ When faced with ambiguity, Type C individuals observe others’ actions as a guide to how they should behave, imitating those who they believe are better informed. They disregard readily available facts and data to do what others are doing, fearing that even small deviations from the norm will impair their ability

²⁰⁴ See Kayyum A. Bohra & Janak Pandey, *Ingratiation Toward Strangers, Friends, and Bosses*, 122 J. SOC. PSYCH. 217, 218 (1984).

²⁰⁵ See *id.* at 45; see also Bohra & Pandey, *supra* note 204, at 218.

²⁰⁶ See Sandy J. Wayne & Gerald R. Ferris, *Influence Tactics, Affect, and Exchange Quality in Supervisor-Subordinate Interactions: A Laboratory Experiment and Field Study*, 75 J. APPLIED PSYCH. 487, 495 (1990).

²⁰⁷ See *id.*

²⁰⁸ See *id.*; see also Robert L. Cardy & Gregory H. Dobbins, *Affect and Appraisal Accuracy: Liking as an Integral Dimension in Evaluating Performance*, 71 J. APPLIED PSYCH. 672, 676 (1986) (indicating that affective reactions influence the performance-appraisal process).

²⁰⁹ See Robert B. Cialdini & Noah J. Goldstein, *Social Influence: Compliance and Conformity*, 55 ANN. REV. PSYCH. 591, 606 (2004).

²¹⁰ *Id.*

²¹¹ *Id.*

to be liked and accepted.²¹² Solomon Asch's classic experiment on conformity encapsulates this mindset. For as simple of a task as comparing the length of different lines, approximately one-third of participants conformed to a clearly incorrect majority consensus.²¹³ Later interviews affirmed that the subjects conformed because (i) they wanted to fit in with the majority; or (ii) they believed the majority had better information.²¹⁴ Conforming subjects reported fearing that the majority would think they were "queer"; others simply wanted to avoid being the center of attention or being disapproved of by others.²¹⁵

4. Type D: The Distracted Pacifist

The distracted pacifist ("Type D") is a catchall category that encompasses third parties who fail to sanction the fraudster because of laziness, selfishness, exhaustion, or simple distraction. The distracted pacifist refuses to impose sanctions because accountability is costly—in both time and effort. He prefers to take the path of least resistance, leaving it up to others to impose sanctions. He fails to sanction the fraudster not because of the prospect of personal gain, but because of perceived time constraints or fear of others' disapproval. Indeed, studies have shown that many individuals feel compelled to remain silent when faced with concerns or problems.²¹⁶ They fear being labeled as a "troublemaker" or "tattletale"; many fear no longer being liked by their colleagues or no longer being seen as credible.²¹⁷

In addition, individuals are more likely to cheat when "resources for self-control have been depleted by prior exertion."²¹⁸ For third parties, the natural inclination to do nothing is a powerful one—one that is supported by structural and environmental conditions. Type D pacifists contribute to the perpetuation of misconduct simply through inaction.

²¹² See B. Douglas Bernheim, *A Theory of Conformity*, 102 J. POL. ECON. 841, 864 (1994).

²¹³ See Solomon E. Asch, *Studies of Independence and Conformity: A Minority of One Against a Unanimous Majority*, 70 PSYCH. MONOGRAPHS 1, 69–70 (1956).

²¹⁴ *Id.*

²¹⁵ See *id.* at 31.

²¹⁶ See Elizabeth W. Morrison & Frances J. Milliken, *Organizational Silence: A Barrier to Change and Development in a Pluralistic World*, 25 ACAD. MGMT. REV. 706, 706 (2000).

²¹⁷ See Frances J. Milliken et al., *An Exploratory Study of Employee Silence: Issues that Employees Don't Communicate Upward and Why*, 40 J. MGMT. STUD. 1453, 1463 (2003).

²¹⁸ See Nicole L. Mead et al., *Too Tired to Tell the Truth: Self-Control Resource Depletion and Dishonesty*, 45 J. EXPERIMENTAL SOC. PSYCH. 594, 594, 596 (2009).

IV. NORMATIVE IMPLICATIONS

If, as the emerging research suggests, the impulse to help others often overrides the impulse to be honest, how should the law respond? The law impacts behavior directly through sanctions, and indirectly through social norms and intrinsic motivation. Prosocial fraud presents unique challenges because its defining characteristics—prosocial motivation and moral ambiguity—render it less responsive to traditional legal and social sanctions. If prosocial motives predispose us to act against our rational self-interest, it suggests that the current incentive-based legal framework does not accurately or adequately capture human behavior. The law adopts an atomized, individualistic conception of fraudulent behavior: autonomous, rational actors who must be constrained by legal strictures to curb their instinctive pursuit of self-interest. Liability rests on proof of prescribed and immutable formulae centered on the actor's intent, reliance, and loss. Outside of the sentencing stage, the law pays little attention to motive and situational context.

In part, this formulistic approach is a product of necessity. If every fraud prosecution were saddled with fact-based determinations of motive and culpability, the result could be paralyzing. Evidence of a person's motives would be difficult to establish, and every self-interested defendant could claim prosocial motives post hoc. But the current approach is at odds with evidence of how individuals actually behave. Where individual morality diverges from legal strictures and pronouncements, the law can lose some of its moral and practical force. The resulting arbitrariness can undermine trust and impair deterrence.

This Part argues that the solution is not to supplant the existing framework, but to supplement it. The first step is to recognize and understand the problem of prosocial fraud. Not all fraud is motivated by financial self-interest. Prosocially motivated fraud is particularly insidious because it leverages our emotional need to help others with a psychological tendency to manipulate information and memories in self-serving ways. Some solutions to counteract these tendencies include making ethics salient *before* actors engage in decision-making processes, such as requiring signatures at the beginning rather than end of a self-report.²¹⁹ Simple triggers, such as reading the Ten Commandments, have proven effective, presumably because they place

²¹⁹ Lisa L. Shu et al., *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. NAT'L ACAD. SCI. U.S. 15,197, 15,197 (2012).

individuals in an ethical frame.²²⁰ But in the context of prosocial fraud, greater education and awareness remain limited by the same biases and constraints that have rendered it such an elusive enforcement target.

Ultimately, lasting and effective change would require a systematic shift in the values and preferences that give rise to prosocial fraud. Prosocial fraud presents unique challenges because of a fundamental disconnect between the legal system's judgment of culpability and the perpetrator's perception of his or her culpability. In this situation, the law imposes liability not for failure to behave prosocially, but because of it. How can the legal system change the social meaning of benevolence-based fraud and influence individuals' beliefs about its inherent morality? Below, I analyze two classic levers developed by Gary Becker—adjusting the severity of punishment versus increasing the likelihood of enforcement. After arguing against the effectiveness of increased sanctions, this Article explores the relative merits of different enforcement tools—private causes of action, whistleblowers, and gatekeepers.

A. *Adjusting Sanctions*

One approach to curbing prosocially motivated fraud is to target sanctions. Many scholars have argued for the deterrent, retributive, and expressive value of harsh punishments, while others have cautioned against the perils of over-criminalizing non-willful, morally ambiguous conduct.²²¹ Proposed reforms include systematic accounting of motive during sentencing,²²² enacting misdemeanor and low-level felony statutes,²²³ or individualizing punishment based on blameworthiness.²²⁴ Increasing the severity of punishment could have a strong expressive effect, signaling the law's moral condemnation of prosocially motivated fraud. Lowered sanctions, on the other hand, could reflect the law's recognition of the non-deliberative components of prosocial fraud and would bring legal sanctions in harmony with social sanctions and internal motivation.

But there are several reasons that adjusting sanctions may not have the intended effect. First, prosocial fraud is often not the product of

²²⁰ Nina Mazar et al., *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MKTG. RSCH. 633, 636 (2008). Of course, the religious context of the Ten Commandments would pose substantial barriers to any effort to mandate use of this trigger.

²²¹ See, e.g., Coffee, *supra* note 154, at 1881.

²²² See Hessick, *supra* note 30, at 91–92.

²²³ See Baer, *supra* note 155, at 232.

²²⁴ See Richard A. Bierschbach & Stephanos Bibas, *Constitutionally Tailoring Punishment*, 112 MICH. L. REV. 397, 429 (2013).

conscious and deliberative decision-making. Individuals do not always engage in a rational cost-benefit analysis, weighing the potential gains from fraudulent activity against the probability of getting caught, multiplied by the anticipated punishment.²²⁵ Considerable research has shown that this concept of intent does not comport with a large portion of fraudulent and unethical behavior. In many cases, people respond instinctively and emotionally to the needs of those around them and do not make a deliberate choice to engage in wrongdoing.²²⁶ In fact, they often lack awareness that they are doing anything wrong. They “do not think of themselves as wrongdoers whose behavior is punishable.”²²⁷

Second, prosocial fraud presents a case study of behavior that does not respond properly to incentives. Fear of criminal prosecution should serve as a powerful deterrent to fraudulent behavior, but fraud continues to be endemic and ubiquitous. This suggests that the current framework does not adequately capture how and why individuals engage in fraudulent behavior. Indeed, “factual data on which a deterrent system must be founded do not exist. Reliable findings about the marginal general deterrent effects of various types and levels of penalty for various crimes are hard to find.”²²⁸ Most studies indicate that increasing penalties for wrongdoing has only a marginally deterrent effect.²²⁹ Dishonest behavior does not appear to change when the magnitude of stakes or consequences are altered.²³⁰ Only about 20 percent of the population lie fully and consistently when it is in their material self-interests.²³¹ About 39 percent remain honest and resist monetary incentives to lie, and 20 percent of individuals lie partially—that is, they do not tell the truth, but they also do not lie maximally. These results have remained constant across experiments.²³²

Moreover, imposing sanctions can alter an individual's decision frame from an ethical to a business one, reducing overall levels of cooperation.²³³ In one study, participants playing the role of manufacturers reached a voluntary agreement to limit toxic emissions.

²²⁵ See Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 176 (1968).

²²⁶ See FELDMAN, *supra* note 6, at 40.

²²⁷ FELDMAN, *supra* note 6, at 153.

²²⁸ See ANDREW ASHWORTH, *SENTENCING AND CRIMINAL JUSTICE* 64, 76 (4th ed. 2005).

²²⁹ See FELDMAN, *supra* note 6, at 153.

²³⁰ See Urs Fischbacher & Franziska Föllmi-Heusi, *Lies in Disguise—An Experimental Study on Cheating*, 11 J. EUR. ECON. ASS'N 525, 542–43 (2013).

²³¹ *Id.* at 527.

²³² *Id.*

²³³ See Russell Korobkin, *Behavioral Ethics, Deception, and Legal Negotiation*, 20 NEV. L.J. 1209, 1247 (2020); see also Tenbrunsel & Messick, *supra* note 234, at 684.

Counterintuitively, participants who faced monitoring and modest fines cheated more than those who faced no sanctions.²³⁴ In another study, the introduction of a fine in Israeli day-care centers increased the incidence of tardy parent pick-ups, an outcome that did not change when the fine was removed.²³⁵ Similar results have been found with studies of taxpayer compliance, where appeals to conscience were more effective than the threat of sanctions.²³⁶ The introduction of sanctions can change individuals' perception of the social context, replacing moral considerations with economic ones.²³⁷ Hence, sanctions, even small ones—can crowd out intrinsic motivation.²³⁸ In addition, sanctions may be perceived as a sign that noncompliance is widespread, undermine individuals' sense of autonomy, and frustrate a desire to signal altruism.²³⁹ Finally, numerous studies have shown that individuals have little knowledge of legal penalties, and their perceptions of the severity of punishment or the likelihood of getting caught have little impact on behavior.²⁴⁰

B. Enforcement

Given the limited effectiveness of legal and social sanctions, this subpart explores the relative merits of different approaches to ex ante private enforcement. Because prosocial fraud is particularly difficult to detect and prosecute, supplemental private enforcement is necessary to counteract the problems of definitional ambiguity, incrementalism, and third-party complicity. What form should this private enforcement take? Existing mechanisms prohibit, authorize, or mandate particular action. First, the law may *prohibit* third parties from participating in fraud. One example is aiding and abetting liability, whereby one who aids another in committing fraud can be found guilty of the crime. Second, the law may *authorize* third parties to take action, as in the case of *qui tam* lawsuits. Finally, the law may *mandate* an affirmative duty, such as whistleblowing duties or gatekeeping liability. This Part compares and assesses several private enforcement mechanisms in the context of prosocial fraud: (1) private causes of action; (2)

²³⁴ See Ann E. Tenbrunsel & David M. Messick, *Sanctioning Systems, Decision Frames, and Cooperation*, 44 ADMIN. SCI. Q. 684, 694-96 (1999).

²³⁵ See Uri Gneezy & Aldo Rustichini, *A Fine is a Price*, 29 J. LEGAL STUD. 1, 15 (2000).

²³⁶ See Richard D. Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 U. CHI. L. REV. 274, 298-99 (1967).

²³⁷ See FELDMAN, *supra* note 6, at 65.

²³⁸ *Id.*

²³⁹ *Id.* at 64-65.

²⁴⁰ *Id.* at 69.

whistleblowing duties; (3) traditional fraud gatekeepers; and (4) alternative fraud gatekeepers.

1. Private Causes of Action

One means of enlisting third-party monitors is to authorize third parties to bring suit. Authorization may be statutory, as in the case of the Sherman Act, the Racketeer Influenced and Corrupt Organizations (RICO) Act, and the Clean Air and Clean Water Acts. The False Claims Act (FCA), which targets fraud by government contractors, represents another type of statutory authorization—the *qui tam* action. *Qui tam* actions involve private parties (“relators”) bringing suit on behalf of the government to rectify public wrongs.²⁴¹ Other private causes of action are judicially implied, such as private antifraud suits under Section 10(b) and Rule 10b-5 of the Securities and Exchange Act.

There are several reasons why private rights of action are not an effective means of curbing prosocial fraud. Although private parties can more effectively detect and monitor instances of small-scale fraud, they are constrained by the same types of limitations that afflict government actors. While incentives to bring suit exist—for instance, the ability to recoup a portion of the recovery—the impulse to do nothing is all too compelling. Collective action problems hamper the willingness to bring suit, as the cost of bringing a lawsuit is typically greater than the plaintiff’s pro rata benefit.²⁴² Given the morally ambiguous nature of prosocial fraud, the disincentive to sue takes on increased salience. Empathy for the prosocially motivated perpetrator and ambivalence as to the culpability of the act further contribute to the default of inaction. At the other extreme, private rights of action can sometimes result in excessive and inefficient enforcement that drains judicial resources and strains overburdened defendants.²⁴³ The securities fraud class action is a prototypical example of private rights of action that have resulted in a surfeit of frivolous suits.²⁴⁴

²⁴¹ See Matthew C. Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 VA. L. REV. 93, 99 (2005).

²⁴² See Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J. L. ECON. & ORG. 55, 55 (1991).

²⁴³ See Gary S. Becker & George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1, 13 (1974); Steven Shavell, *The Fundamental Divergence Between the Private and Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575, 577–78 (1997).

²⁴⁴ See, e.g., John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1534 (2006).

2. Whistleblowing

A related mechanism of private enforcement—whistleblowing—involves a statutorily imposed duty on third parties to disclose misconduct. A whistleblower is “[a]n employee who reports employer wrongdoing to a governmental or law-enforcement agency.”²⁴⁵ The definition has since expanded to include “other person[s] in a contractual relationship with a company who report[] misconduct to outside firms or institutions.”²⁴⁶ Some well-known whistleblower provisions include those contained in the False Claims Act (FCA), Whistleblower Protection Act,²⁴⁷ the Occupational Safety and Health Act, Surface Transportation Assistance Act, Federal Railroad Safety Act, and Sarbanes-Oxley Act.²⁴⁸ Whistleblowing statutes seek to incentivize third parties to disclose misconduct through monetary rewards and protection from retaliation. For instance, the FCA imposes liability on individuals and companies who defraud the federal government.²⁴⁹ Whistleblowers must be made whole, which would include “reinstatement with the same seniority status” that the employee “would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys’ fees.”²⁵⁰

Some evidence exists that these safeguards and incentives have had their intended effect. For the fiscal year ending September 2019, of the over \$3 billion recovered for fraud and false claims under the False Claims Act, over \$2.1 billion, or 70 percent, was recovered in cases initiated by whistleblowers.²⁵¹ The Securities and Exchange Commission (SEC) “has awarded over \$500 million to 83 individuals since issuing its first award in 2012.”²⁵² Whistleblowers qualify for awards when they provide “original, timely and credible information

²⁴⁵ *Whistleblower*, BLACK’S LAW DICTIONARY (11th ed. 2019).

²⁴⁶ Jonathan Macey, *Getting the Word Out About Fraud: A Theoretical Analysis of Whistleblowing and Insider Trading*, 105 MICH. L. REV. 1899, 1903 (2007).

²⁴⁷ *See id.* at 1904–05.

²⁴⁸ *See* OSHA Fact Sheet: OSHA’s Whistleblower Protection Program, OCCUPATIONAL SAFETY & HEALTH ADMIN., U.S. DEP’T OF LABOR, <https://www.osha.gov/sites/default/files/publications/OSHA3638.pdf>.

²⁴⁹ False Claims Act, 31 U.S.C. § 3729.

²⁵⁰ *Id.* at § 3730(h)(2).

²⁵¹ *See Justice Department Recovers Over \$3 Billion from False Claims Act Cases in Fiscal Year 2019*, U.S. DEP’T OF JUST. (Jan. 9, 2020), <https://www.justice.gov/opa/pr/justice-department-recovers-over-3-billion-false-claims-act-cases-fiscal-year-2019>.

²⁵² *See* Press Release, Sec. & Exch. Comm’n, SEC Awards Record Payout of Nearly \$50 Million to Whistleblower (June 4, 2020), <https://www.sec.gov/news/press-release/2020-126>.

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that leads to a successful enforcement action.”²⁵³ The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) protects the confidentiality of whistleblowers and grants awards ranging from 10 to 30 percent of the funds collected when monetary sanctions exceed \$1 million.²⁵⁴ Prohibitions against retaliation include protection against discharge, demotion, suspension, harassment, or adverse consequences in the terms and conditions of employment.²⁵⁵ The Dodd-Frank Act authorizes the SEC to take action against employers who retaliate against whistleblowers. It also creates a private right of action that allows whistleblowers to sue their employers in federal court and seek double back pay with interest, reinstatement, reasonable attorneys’ fees, and reimbursement for certain costs.²⁵⁶

Despite such protections, whistleblowing suffers from inherent limitations. First, whistleblowing accounts for a relatively small fraction of fraud that is uncovered. For instance, according to the PricewaterhouseCoopers 2018 Global Economic Crime and Fraud Survey, whistleblowing hotlines accounted for 7 percent of total detected fraud and internal and external tip-offs accounted for 20 percent.²⁵⁷ By contrast, corporate controls detected 52 percent of frauds, law enforcement uncovered 4 percent, and 8 percent were discovered by accident.²⁵⁸ Second, only a small fraction of cases results in awards. Although civil recoveries for fraud under the FCA totaled over \$2.1 billion for the fiscal year ending September 2019,²⁵⁹ approximately 80 percent of cases filed under it resulted in no reward.²⁶⁰ Similarly, although the SEC’s whistleblower program has awarded approximately \$387 million since its inception, those rewards have gone to only sixty-seven individuals. By comparison, the Commission received over 5200 whistleblower tips in fiscal year 2019

²⁵³ See Press Release, Sec. & Exch. Comm’n, SEC Issues Record \$114 Million Whistleblower Award (Oct. 22, 2020), <https://www.sec.gov/news/press-release/2020-266>.

²⁵⁴ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 922, 124 Stat. 1376, 1841, 1842, 1846 (2010).

²⁵⁵ See *id.* § 922, 124 Stat. at 1845.

²⁵⁶ See *id.* § 922, 124 Stat. at 1846.

²⁵⁷ See PRICEWATERHOUSECOOPERS, PULLING FRAUD OUT OF THE SHADOWS: GLOBAL ECONOMIC CRIME AND FRAUD SURVEY 26 (2018), <https://www.pwc.com/gx/en/news-room/docs/pwc-global-economic-crime-survey-report.pdf>.

²⁵⁸ See *id.*

²⁵⁹ See *Justice Department Recovers Over \$3 Billion From False Claims Act Cases in Fiscal Year 2019*, U.S. DEP’T OF JUST. (Jan. 9, 2020), <https://www.justice.gov/opa/pr/justice-department-recovers-over-3-billion-false-claims-act-cases-fiscal-year-2019>.

²⁶⁰ See Eric L. Young, *Key Stats and Figures on Whistleblowing*, MCELDREW YOUNG PURTELL MERRITT (Mar. 18, 2016), <https://www.mceldrewyoung.com/whistleblower-statistics/>.

alone.²⁶¹ Third, although prohibited on the books, retaliation persists in practice. According to a 2018 Ethics and Compliance Initiative Global Business Ethics Survey, 44 percent of employees who reported misconduct nevertheless reported being retaliated against.²⁶² Retaliation was the most frequently filed complaint with the EEOC in fiscal year 2019, at 53.8 percent of all charges filed.²⁶³ Congress directed that agencies protect whistleblowers against retaliation, but the Secretary of Labor has proven reluctant in litigating whistleblower retaliation claims, leaving it to private parties to litigate amongst themselves.²⁶⁴

In addition to these resource and enforcement limitations, whistleblowing imposes psychological and emotional costs that are more difficult to quantify. Society continues to stigmatize whistleblowers, referring to them derisively as “snitches” and “rat[s].”²⁶⁵ Whistleblowers are often treated with disdain and contempt, and all too often “become targets of harassment, intimidation . . . [and] persecution.”²⁶⁶ Working with regulators is often seen as a betrayal of one’s colleagues and clients. Those who are discovered experience difficulties attracting business or finding alternative employment.²⁶⁷ As a case in point, Pav Gill—Wirecard’s whistleblower who exposed one of Europe’s biggest corporate frauds—was presented with a choice of resigning with a positive reference or being fired. Even after resigning, he was targeted “professionally” and “emotionally,” given bad references, and publicly attacked for having “malicious intent.”²⁶⁸ In a later interview, Pav stated, “I don’t like the term whistleblower,

²⁶¹ See U.S. SEC. & EXCH. COMM’N, 2019 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 1–2 (2019), <https://www.sec.gov/files/sec-2019-annual-report-whistleblower-program.pdf> [hereinafter SEC 2019 ANNUAL REPORT].

²⁶² See ETHICS & COMPLIANCE INITIATIVE, THE STATE OF ETHICS AND COMPLIANCE IN THE WORKPLACE 9 (2018), <https://mk0ecihomepagexcvllh.kinstacdn.com/wp-content/uploads/2018-ECI-GBES-State-of-Ethics-Compliance-in-Workplace.pdf>.

²⁶³ This number reflects total retaliation statistics, not just against whistleblowers. See U.S. EQUAL EMP. OPPORTUNITY COMM’N, CHARGE STATISTICS (CHARGES FILED WITH EEOC) FY 1997 THROUGH FY 2019 (2019), <https://www.eeoc.gov/statistics/charge-statistics-charges-filed-eeoc-fy-1997-through-fy-2019> (last visited Nov. 30, 2020).

²⁶⁴ See David Kwok, *The Public Wrong of Whistleblower Retaliation*, 69 HASTINGS L. J. 1225, 1227 (2018).

²⁶⁵ See Naseem Faqih, *Choosing Which Rule to Break First: An In-House Attorney Whistleblower’s Choices After Discovering a Possible Federal Securities Law Violation*, 82 FORDHAM L. REV. 3341, 3351 (2014) (alteration in original).

²⁶⁶ ANGIE ASH, WHISTLEBLOWING AND ETHICS IN HEALTH AND SOCIAL CARE 11 (2016).

²⁶⁷ See Stavros Gadinis & Colby Mangels, *Collaborative Gatekeepers*, 73 WASH. & LEE L. REV. 797, 817 (2016).

²⁶⁸ Dan McCrum et al., *Wirecard’s Reluctant Whistleblower Tells His Story: ‘They Tried to Destroy Me,’* FIN. TIMES (May 19, 2021), <https://www.ft.com/content/1d74221e-1321-4f8c-9ca9-a4371629f178>.

honestly. I think it has some stigma, or negative connotations attached to it. It implies you are going against the company which is feeding you, it involves a breach of trust.”²⁶⁹ Moreover, whistleblowing targets “have a powerful incentive to withhold information from potential whistleblowers and to refrain from transacting with anyone of suspect loyalties.”²⁷⁰ The result is an erosion of trust that can undermine compliance and enforcement efforts.

3. Traditional Fraud Gatekeepers

These drawbacks point to the comparative advantage of gatekeeper liability regimes. Gatekeepers—attorneys, accountants, credit rating agencies, investment bankers, and other intermediaries—can disrupt misconduct by withholding cooperation.²⁷¹ At least in theory, they serve as “independent professionals who pledge their reputational capital” in order “to protect the interests of dispersed investors who cannot easily take collective action.”²⁷² Unlike whistleblowers, the law punishes gatekeepers for reneging on their statutory obligations, rather than rewarding them for compliance.²⁷³ Reputational concerns also provide a powerful incentive for gatekeepers to report wrongdoing. By certifying disclosures and verifying the accuracy of representations made by their clients, they have the power to screen out bad actors and correct informational asymmetries.²⁷⁴

Yet in practice, gatekeepers can be as susceptible to the influence of prosocial motives as primary violators. As the financial scandals of the late 1990s and early 2000s demonstrated, gatekeepers all too often acquiesce in misconduct, whether through active collaboration or willful blindness. Take, for instance, the case of Arthur Andersen. Although a “decline in business morality” and “infectious greed” have often been cited for the firm’s downfall,²⁷⁵ less attention has been paid to the influence of friendship, camaraderie, and loyalty. Close ties bound many of Andersen’s auditors and Enron’s employees, who shared a floor

²⁶⁹ *Id.*

²⁷⁰ Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J. L. ECON. & ORG. 53, 60 (1986).

²⁷¹ *See id.* at 53–54.

²⁷² John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 302 (2004).

²⁷³ *See* Kraakman, *supra* note 270, at 60.

²⁷⁴ *See id.* at 58; *see also* Gadinis & Mangels, *supra* note 267, at 802.

²⁷⁵ *See* Coffee, *supra* note 272, at 302–03 (citations omitted).

together in Enron tower.²⁷⁶ Anderson's lead partner on its Enron account, David Duncan, was good friends with Enron's chief accounting officer, Rick Causey, a former Andersen audit manager. Interviews with former employees of the two firms revealed a symbiotic relationship:

Many of Andersen and Enron's top number crunchers took annual golf vacations together, making friendly bets on each round. They went on ski outings, schussing down the slopes together. Others would sneak away from the office for Astros games at Enron Field and take turns buying margaritas at Mama Ninfa's, a local Mexican restaurant chain. They played fantasy football against each other over the office computers.²⁷⁷

Andersen routinely signed off on Enron's use of off-balance-sheet partnerships to conceal debt and inflate profits. Even after concerns began to rise and Enron's shares plummeted, Duncan and his team remained loyal to Enron, shredding more than a ton of documents and deleting roughly 30,000 emails and computer files.²⁷⁸

The interlocking web of personal relationships that characterize many business partnerships create conditions ripe for gatekeeper complicity in fraud. Stories such as Andersen's are all too common. A similar dynamic was at play between WorldCom and its investment bank, Salomon Smith Barney, Citigroup's brokerage unit. WorldCom's Bernie Ebbers and Jack Grubman, a star Salomon Smith Barney telecommunications analyst, shared a close relationship. Grubman boasted of attending Ebbers' wedding in 1999 and became part of his inner circle, routinely attending WorldCom board meetings.²⁷⁹ In addition to aggressively promoting WorldCom's stock and lending Ebbers vast sums of money, Salomon granted both Ebbers and WorldCom CFO Scott Sullivan privileged IPO allocations, with Ebbers

²⁷⁶ See Flynn McRoberts, *Ties to Enron Blinded Andersen*, CHI. TRIB. (Sept. 3, 2002, 2:00 AM), <http://www.chicagotribune.com/news/chi-0209030210sep03-story.html>.

²⁷⁷ *Id.*

²⁷⁸ See *id.*; see also Susanne Craig & Charles Gasparino, *Ex-Broker Says Salomon Gave IPOs to CEOs to Win Business*, WALL ST. J. (July 18, 2002, 12:54 AM), <https://www.wsj.com/articles/SB1026958035301738840>.

²⁷⁹ See *The WorldCom-Wall Street Connection*, FRONTLINE: THE WALL STREET FIX, <https://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/wcom/cron.html> (last visited July 29, 2021); James P. Miller, *WorldCom Exec Faults Andersen*, CHI. TRIB. (July 9, 2002), <http://www.chicagotribune.com/news/ct-xpm-2002-07-09-0207090072-story.html>; Gretchen Morgenson, *Market Watch; More Clouds Over Citigroup in its Dealings with Ebbers*, N.Y. TIMES (Nov. 3, 2002), <https://www.nytimes.com/2002/11/03/business/market-watch-more-clouds-over-citigroup-in-its-dealings-with-ebbers.html>.

pocketing \$11 million in profits over a four-year period on shares received from Salomon.²⁸⁰

Regulators targeted these and other conflicts of interest between gatekeepers and their clients in the Sarbanes-Oxley Act of 2002,²⁸¹ the Dodd-Frank Act,²⁸² and numerous agency regulations.²⁸³ Firms have also implemented various self-regulatory solutions, such as erecting so called “Chinese walls”—virtual information barriers to structurally isolate individuals with privileged information and separate units with conflicts of interest.²⁸⁴

Although these reforms may have addressed some of the more egregious abuses, gatekeeper complicity in fraud has stubbornly persisted. For instance, in March 2018, the SEC charged Merrill Lynch with failure to properly perform its gatekeeping duties in the unregistered sales of nearly \$38 million in securities of Longtop Financial Technological Limited (“Longtop”).²⁸⁵ Merrill allegedly ignored numerous red flags indicating that the sales could be part of an unlawful unregistered distribution, including an online report that accused Longtop of financial fraud.²⁸⁶ Similarly, in October 2016, the SEC charged Ernst & Young (“E&Y”) with failing to question numerous suspicious tax adjustments in its audit of Weatherford International.²⁸⁷ E&Y also violated auditor independence requirements, including “excessively friendly” relations between the E&Y partner and Chief Financial Officer of the client, such as “taking frequent, overnight out-of-

²⁸⁰ See *The WorldCom-Wall Street Connection*, FRONTLINE: THE WALL STREET FIX, <https://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/wcom/cron.html> (last visited Oct. 8, 2021).

²⁸¹ See Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 747 (2002) (codified at 15 U.S.C. § 7201).

²⁸² See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 5301).

²⁸³ See, e.g., FINRA RULE 2241(c)(4)(i) (requiring firms to disclose “any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report”); FINRA RULE 2242(c)(4)(H) (requiring disclosure of conflicts of interest with respect to debt research analysts and research reports).

²⁸⁴ See, e.g., H. Nejat Seyhun, *Insider Trading and the Effectiveness of Chinese Walls in Securities Firms*, 4 J. L. ECON. & POL’Y 369, 392–93 (2008).

²⁸⁵ See Press Release, Sec. & Exch. Comm’n, Merrill Lynch Charged with Gatekeeping Failures in the Unregistered Sales of Securities (Mar. 8, 2018), <https://www.sec.gov/news/press-release/2018-32>.

²⁸⁶ See *Merrill Lynch, Pierce, Fenner & Smith Inc.*, Securities Act Release No. 10,465, Exchange Act Release No. 82,826 (Mar. 8, 2018), <https://www.sec.gov/litigation/admin/2018/33-10465.pdf>.

²⁸⁷ *Ernst & Young LLP*, Exchange Act Release No. 78,872 (Sept. 19, 2016), <https://www.sec.gov/litigation/admin/2016/34-78872.pdf>.

town trips,” attending sporting events, and socializing “to an excessive degree.”²⁸⁸ Attorneys have fared no better. For instance, in December 2020, the SEC filed an enforcement action against Richard J. Rubin and Thomas J. Craft alleging that over a three-year period, they submitted fraudulent attorney opinion letters in connection with registering securities for sale to the public.²⁸⁹ Attorneys routinely advise clients engaged in corporate fraud and fail to report such conduct.²⁹⁰ Indeed, attorney whistleblower provisions instituted pursuant to the Sarbanes-Oxley Act and Dodd-Frank Act largely have gone unenforced.²⁹¹

4. Alternative Fraud Gatekeepers

The limitations of relying on traditional fraud gatekeepers highlight the need for alternative measures. Optimally, an effective system of enforcement would leverage the resources of monitors who are de facto external, independent, relatively unconstrained by resource limitations, and excluded from existing social networks. Governmental and quasi-governmental regulators, whistleblowers, and traditional fraud gatekeepers are suboptimal on one or more of these dimensions. Regulators are external and not embedded in intra-firm social networks, but they are constrained by resource limitations and subject to capture by the industries they regulate. As discussed above, whistleblowers (both internal and external) and traditional fraud gatekeepers are often so deeply embedded in networks of personal relationships that they are anything but independent.

What type of monitor would be better positioned to divorce itself of the personal networks that facilitate prosocially motivated fraud? One intriguing possibility is the insurance industry. Fraud loss insurance, also known as business crime insurance or commercial crime insurance, provides coverage for losses due to employee dishonesty, fraud, embezzlement, theft, robbery, forgery, computer fraud, or any other business crime.²⁹² Enlisting insurers as gatekeepers is not a new concept. For instance, regulations promulgated under the Resource Conservation and Recovery Act of 1976 requires operators of hazardous waste management facilities to purchase pollution liability insurance.²⁹³

²⁸⁸ *Id.*

²⁸⁹ See *Craft*, Exchange Act Release No. 88,280 (Feb. 25, 2020); *Richard Jeffrey Rubin*, Exchange Act Release No. 88,258 (Feb. 21, 2020).

²⁹⁰ See Carliss N. Chatman, *Myth of the Attorney Whistleblower*, 72 SMU L. REV. 669, 722 (2019).

²⁹¹ *Id.* at 672–73.

²⁹² See, e.g., *Crime, Theft & Fraud Insurance*, ERIE INSURANCE, <https://www.erieinsurance.com/business-insurance/crime> (last visited July 29, 2021).

²⁹³ See 40 C.F.R. §§ 264.140–264.147 (2021).

Similarly, the Employee Retirement Income Security Act (ERISA) requires employers to carry a type of insurance known as an ERISA fidelity bond, which protects retirement plans from fraud or dishonesty by the plan's managers.²⁹⁴

The most obvious objection to greater use of insurers as monitors is the problem of moral hazard—that is, the danger that when individuals are insured against risk, it reduces their incentive to avoid that risk. Under this view, by transferring the risk of loss to an insurer, individuals do not internalize the costs of risky behavior, making them more likely to engage in that behavior.²⁹⁵ For instance, one well-known study found that police departments carrying liability insurance were less likely to adopt best practices on the use of force or to take corrective actions against problematic officers.²⁹⁶ A vast literature catalogues the dangers of moral hazard and will not be reproduced here. My aim in this subpart is not to advocate for the use of fraud loss insurance or any variant thereof; it is simply to explore the potential of insurance as an alternative avenue of private monitoring.

A growing body of literature has studied the insurance industry's ability to regulate behavior notwithstanding the perils of moral hazard.²⁹⁷ Insurance companies have a litany of tools available to protect against moral hazard and manage risk, including premium differentials, deductibles, coinsurance, exclusions, and experience ratings.²⁹⁸ A deductible involves a certain amount of expense being excluded from coverage. Coinsurance involves requiring the insured to pay part of each dollar of cost.²⁹⁹ By imposing part of the cost on insureds, they—at least theoretically—would be incentivized to prevent harms. Because insurers can lower payouts and increase profits by lowering risk, insurers have a financial incentive to implement loss

²⁹⁴ See 29 C.F.R. §§ 2550.412-1, 2580 (2021).

²⁹⁵ See Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AM. ECON. REV. 531, 535 (1968); Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 238–39 (1996).

²⁹⁶ See CHARLES R. EPP, *MAKING RIGHTS REAL: ACTIVISTS, BUREAUCRATS, AND THE CREATION OF THE LEGALISTIC STATE* 134–35 (2009).

²⁹⁷ See, e.g., Steven Shavell, *Minimum Asset Requirements and Compulsory Liability Insurance as Solutions to the Judgment-Proof Problem*, 36 RAND J. ECON. 63, 63–64 (2005); Haitao Yin et al., *Risk-Based Pricing and Risk-Reducing Effort: Does the Private Insurance Market Reduce Environmental Accidents?*, 54 J. L. & ECON. 325, 326 (2011).

²⁹⁸ See Pauly, *supra* note 295, at 535; see also Omri Ben-Shahar & Kyle D. Logue, *Outsourcing Regulation: How Insurance Reduces Moral Hazard*, 111 MICH. L. REV. 197, 199 (2012).

²⁹⁹ See Pauly, *supra* note 295, at 535 n.4.

prevention measures.³⁰⁰ Insurers who lower risk can offer lower premiums and attract more customers. By managing risk, they can influence policies, practices, and procedures that in turn impact behavior.³⁰¹ Despite the dangers of moral hazard, insurers may be better positioned than government regulators and traditional fraud gatekeepers to counteract those aspects of prosocial fraud that have rendered it such an elusive regulatory target—definitional ambiguity, incrementalism, and third-party complicity.

i. Definitional Ambiguity

Insurers may be better equipped than government monitors to translate ambiguous standards into more rule-like requirements. First, their policy-making process is often far more flexible than the types of lawmaking processes available to the government. Governments require legislative majorities or burdensome administrative rulemaking processes, such as the federal notice-and-comment rulemaking process.³⁰² Moreover, when governments promulgate rule-like requirements, those requirements remain static until revised through future legislation or administrative process. By contrast, insurers can promulgate and revise their policy requirements either by fiat, assuming clients accept the revisions, or by negotiation. In those negotiations, insurers and clients have at least three items to negotiate—the content of the policy requirements, the price at which the insurance policy is sold, and the amount of coverage provided by the policy. These multiple targets of negotiation make it more likely that negotiation will be successful; an objection to a particular policy, for example, can be accommodated through concession on price or amount of coverage.

Second, when rule-like policy requirements are violated, insurers have penalties at their disposal that are not available to government actors.³⁰³ Available sanctions include raising the price at which a policy is renewed, raising premiums, or dropping coverage entirely. The organization suffers higher costs for failing to monitor its employees and in turn, the organization can discipline or terminate problematic employees. These private remedies have the advantage of being easier to enforce than criminal prohibitions, which can entail trial by jury and proof beyond a reasonable doubt. Because the sanctions imposed by an

³⁰⁰ See John Rappaport, *How Private Insurers Regulate Public Police*, 130 HARV. L. REV. 1539, 1543 (2017).

³⁰¹ See *id.* at 1549, 1553.

³⁰² See, e.g., 5 U.S.C. § 553.

³⁰³ An exception to this could be when government itself is functioning as an insurer.

insurer do not include the possibility of imprisonment, the stakes are also lower.

Third, insurers have greater flexibility than governments to tailor their policies to individual circumstances or industries. Government actors typically face pressure for equal treatment that limits their ability to tailor legal requirements. An agency regulating an entire industry can tailor at the industry level, but would face resistance to tailoring its policies to individual companies or groups of companies.³⁰⁴ An agency regulating multiple industries, or differently-situated actors within a single industry, will have more difficulty tailoring legal requirements even at an industry level. Insurers are unlikely to face these pressures at the same level. Dissatisfied clients would always have the option of seeking alternative coverage if they feel they have been treated unfairly.³⁰⁵

These advantages have already been leveraged to privately regulate public action. Take, for instance, police liability insurance: municipalities now routinely purchase insurance to indemnify themselves in the event they are sued for common law and constitutional torts committed by their police officers.³⁰⁶ Because insurers benefit from risk reduction measures taken by insureds after a policy is issued, insurers have an incentive to reduce risk. By translating vague governmental standards into rule-like requirements, insurers provide the insureds with concrete standards of conduct. They have done so by implementing detailed policies; distributing educational literature, such as newsletters, white papers, and emails; and conducting workshops with training resources.³⁰⁷

For instance, insurers have taken the notoriously abstract Fourth Amendment excessive force doctrine and specified what degree of force to use in different scenarios according to a “use-of-force continuum.”³⁰⁸ After the Supreme Court rejected a Fourth Amendment challenge to strip searches of imprisoned detainees in *Florence v. Board of Chosen*

³⁰⁴ Congress requires some agencies—like the Food and Drug Administration—provide specific guidance, and sometimes differing legal requirements for smaller businesses. *See, e.g.*, 21 U.S.C. § 350g (requiring FDA to promulgate certain regulations in a manner that “provide[s] sufficient flexibility to be practicable for all sizes and types of facilities, including small businesses”); FDA, Small Business Assistance, <https://www.fda.gov/industry/small-business-assistance> (last updated Sept. 28, 2020_ (providing information on various FDA programs intended to assist small businesses in regulatory compliance). But this is the exception rather than the rule.

³⁰⁵ This option, of course, will have some moderating incentive on the impact of any insurance industry efforts to increase the rigor of their policies.

³⁰⁶ *See* Rappaport, *supra* note 300, at 1542.

³⁰⁷ *Id.* at 1576–77.

³⁰⁸ *See id.* at 1579–80.

Freeholders, one major reinsurer clarified that a reasonable search “should be conducted in a professional manner using a searcher of the same sex, conducted without physical contact under sanitary conditions, and done with a degree of privacy.”³⁰⁹

Similarly, insurers have translated the general “due care” standard in tort law into particularized safety measures and rules.³¹⁰ A network of insurance claim adjusters and other agents follow uniform guidelines developed with the help of legal experts.³¹¹ They make use of rule-like requirements for ascertaining fault, causation, and loss.³¹² They also impose safety standards that are stricter than standards required by the government. Environmental liability insurers, for instance, either require or offer premium discounts for implementation of private safety codes that exceed government standards.³¹³ In the realm of traffic safety, insurers operationalize the duty of reasonable care into formulas and “mechanical presumptions,” such as the presumption of liability for rear-end collisions.³¹⁴

ii. Incrementalism

In addition, insurers may be better positioned to detect incremental changes in behavior. Insurers often have access to detailed data about the industries they regulate. In the process of underwriting, they acquire and process vast amounts of information about their insureds. They are in the business of acquiring, sorting, and evaluating complex and sophisticated information. They use this data to assess and price the impact of different precautions and to generate detailed policies with tiered, differentiated premiums that correlate with different levels of risk.³¹⁵ Insurers, after all, cannot operate profitably unless they can make accurate actuarial determinations on which to price their policies. Ex post, insurers operate vast networks of adjusters who investigate, compute, and negotiate claims using standardized charts and tables to quantify nonpecuniary losses.³¹⁶

Moreover, clients may be more willing to provide information to their insurers than to governments. Disclosure of information to governments is complicated by the desire of companies to maintain

³⁰⁹ See *id.* at 1580.

³¹⁰ See Ben-Shahar & Logue, *supra* note 298, at 234.

³¹¹ See *id.*

³¹² See *id.* at 214.

³¹³ See *id.* at 211.

³¹⁴ See *id.* at 235.

³¹⁵ See Rappaport, *supra* note 300, at 1589.

³¹⁶ See Ben-Shahar & Logue, *supra* note 298, at 213.

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trade secrets. While there are typically trade-secret exceptions to freedom of information laws,³¹⁷ companies cannot always be confident that agency FOIA officers or courts will agree with their view of what is protected information. In at least some circumstances, companies may be more willing to disclose information to insurers under contractual confidentiality provisions than to governments.

Insurers' expertise in minutiae and incremental change could easily be leveraged to tackle incremental dishonesty. Insurers not only have the infrastructure to detect low-level cheating, but also can regulate conduct that is too de minimis to trigger legal sanctions. Insurers have proven adept at regulating in the interstices of law, often imposing standards of conduct that are higher than what the law requires. Dishonesty is not illegal, and fraud results in liability only when intent to deceive, reliance, and loss can be proven. But insurers have tools at their disposal that go beyond what is available to governmental actors. For instance, insurers impose harsh sanctions on individuals who misrepresent information on their insurance applications. These sanctions can range from increased premiums to loss of coverage, fines, and other penalties. The threat of enforcement is real, as insurers employ a vast network of claims adjusters and other representatives to monitor compliance with various government and insurer-imposed guidelines and rules.³¹⁸

iii. Third-Party Complicity

Finally, insurers could be better positioned than governmental regulators or traditional fraud gatekeepers to address the problem of third-party complicity. The insurance industry has long suffered from a negative public perception problem: insurers are often reviled as greedy automatons intent on maximizing profits by finding pretexts to avoid paying legitimate claims.³¹⁹ A study commissioned by the American Association for Justice found that insurance companies routinely go to extreme lengths to avoid paying claims, including lying, forging signatures, and altering reports. Although publicly traded insurance companies have an obligation to seek a return for their shareholders, this duty to shareholders often comes at the expense of policyholders. In some situations, when policyholders file a claim, those policyholders

³¹⁷ See The Freedom of Information Act (FOIA), 5 U.S.C. § 552 (2012).

³¹⁸ See Ben-Shahar & Logue, *supra* note 298, at 237.

³¹⁹ See *The Ten Worst Insurance Companies in America: How They Raise Premiums, Deny Claims, and Refuse Insurance to Those Who Need It Most*, AM. ASS'N FOR JUST., <https://www.decof.com/documents/the-ten-worst-insurance-companies.pdf> (last visited July 29, 2021).

who do not accept initial lowball offers receive what is known as the “boxing gloves” strategy: deny, delay, and defend.³²⁰ Distrust of the insurance industry has also been fueled by corporate scandals involving bid rigging, price-fixing, collusion, and improper accounting methods.³²¹ For instance, in 2004, New York filed a civil suit against Marsh & McLennan, the world’s largest insurance broker, for rigging bids and steering business to insurers that paid it the largest incentives, known as “contingent commissions.” In 2006, AIG, the world’s largest insurer, paid over \$1.6 billion to settle charges of improper accounting, bid rigging, securities fraud, and improper practices involving workers’ compensation funds.³²²

Paradoxically, the mix of contempt, revulsion, and distrust of insurance agents and the insurance industry more generally could be an asset in combatting prosocial fraud. The social bonds and social networks that bind individuals and their monitors necessarily hinders effective monitoring of prosocial fraud. Enlisting monitors who are not only external, but also distrusted and disliked, could render them more effective monitors. When combined with existing conflicts-of-interest laws such as the Sarbanes-Oxley Act, which regulates the role of gatekeepers more generally, insurers’ independence could be further bolstered.

The emergence of insurers as private monitors of fraudulent activity holds at least some promise. Insurers have the resources, infrastructure, expertise, and incentives to assist in policing prosocial fraud. They have demonstrated an ability to change behavior in such diverse fields as police liability, consumer protection, traffic, workplace, and food safety, among others. Desocializing fraud and stripping it of the emotional and social ties that have heretofore hindered robust enforcement could be a potentially fruitful avenue. But the dangers of moral hazard are real, and the enlistment of private insurers is no panacea. Other strategies to counteract the problem of prosocial fraud include enhancing private aiding and abetting liability, implementing greater education and transparency initiatives, and decreasing the costliness of accountability. More systematic and robust enforcement

³²⁰ See *id.* at 3.

³²¹ See Henri-Claude de Bettignies et al., *The Insurance Business and Its Image in Society: Traditional Issues and New Challenges* 29 (INSEAD, Working Paper Series, 2006/28/ABCM), <https://sites.insead.edu/facultyresearch/research/doc.cfm?did=2016>.

³²² See Press Release, Sec. & Exch. Comm’n, AIG to Pay \$800 Million to Settle Securities Fraud Charges by SEC (Feb. 9, 2006), <https://www.sec.gov/news/press/2006-19.htm>.

of whistleblower retaliation laws may be a means of shifting the social stigma of whistleblowing and decreasing the costs of accountability.

V. CONCLUSION

This Article has sought to identify the problem of prosocial fraud and explain the situational context in which it operates. The existing legal framework is tailored toward one species of fraud—individualistic fraud motivated by greed. But social science research has shown that financial incentives and personal ethics, which stem from an individual's religious and family background, culture, education, and upbringing, only forms part of the story. Prosocial fraud is embedded in structures of social relations that are inadequately accounted for in the current legal framework. Motives matter. A person's intentions influence both internal and external judgments of moral character. A person who commits fraud to help others can more easily convince himself that he has not acted wrongfully or against his moral precepts. The presence of a beneficiary other than the self facilitates a rationalization process that allows individuals to supplant one source of morality—honesty and integrity—with another—kindness and benevolence. This rationalization process undermines the deterrent impact of legal sanctions. The moral ambiguity of prosocial fraud, combined with cognitive biases such as self-deception and motivated blindness, not only provides an alternate source of intrinsic motivation, but also weakens the operation of social sanctions.

The Article has suggested that the ends of the legal system may be better attained not by increasing sanctions, but by exploring supplemental mechanisms of ex ante private enforcement. We are all capable of ethical lapses, whether in the commission of the offense or through complicity in its propagation. A certain measure of humility, combined with recognition that prosociality can operate in unexpected ways, would be a necessary antecedent to crafting an effective solution. Ultimately, the deterrent aims of the current doctrinal framework cannot be fully achieved without an appreciation for—and accounting of—the impact of social ties and social motives on fraudulent behavior.