Cheating in a Bottom-line Economy

David Callahan

David Callahan's book *The Cheating Culture* deals with all the factors at play in our times that induce people to violate traditional values of fairness and honesty. This reading is excerpted from his chapter on the new pressures in business to increase profits.

Callahan co-founded Demos, a public policy think tank where he is a senior fellow. Besides *The Cheating Culture*, he has authored *The Moral Center* and *Fortunes of Change: The Rise of the Liberal Rich and the Remaking of America.*

Picture yourself as an auto mechanic who works for a national chain of repair shops. You never went to college, but you got some vocational training and you're making about $30,000 a year. In the old days, when your dad was your age, a mechanic's paycheck would have been big enough to afford the down payment on a modest house. It would have been big enough to allow your wife to stay home with the kids, and maybe even big enough to afford a boat.

Those days are long gone. Your paycheck just gets you by, and nothing more. On the other hand, working for a chain ensures a fair level of security. Customers flock to the chains because they trust them more, and heavy advertising and promotions keep drivers coming back. The work is steady and straightforward. Cars come in; you check them out and tell your manager what needs to be done. Then you fix them. When the day ends, the job doesn't come home with you.

Then abruptly something changes. A new set of marching orders is handed down to the repair centers from the chain's corporate headquarters. You're informed that all mechanics and managers will henceforth have their base pay sharply reduced and will have to make up the difference every month depending on how much work they perform. Once you and the other mechanics do the math, you realize that headquarters is expecting everyone to work harder for the same amount of money. Management also makes it clear that anyone who doesn't meet the quotas may be fired. The scant good news in all of this is that if you work really hard, a special incentive in the new system will allow you to make more money than you did before.

Your job becomes very different. You work harder during the day and worry more at night about whether you'll hit your monthly quota. You also face some dicey choices that didn't exist before. Whenever a customer brings a car in you can proceed in one of two ways: The

right thing to do is to take a look and say, honestly, exactly what the car needs. This is your instinct and what you'd prefer to do. After all, you consider yourself an honest person. You've never been in trouble with the law and, except for speeding in your lovingly restored '75 Mustang, you pretty much play by the rules. The problem is that doing the right thing has suddenly gotten a lot harder. You'll suffer a pay cut and risk losing your job if you don't meet your quota – and there's a nice carrot dangling in front of you if you do rack up a lot of extra work.

5 So gradually you start handling things differently. When a car comes in you take a look, say what the car needs, and then also call for a couple of other repairs that weren't necessary. Maybe the car only needs new brakes, but you say that the struts are also shot and should be replaced. Maybe the sputtering of the engine only requires a good tune-up; but you say that a new carburetor or fuel injection system is in order. Ninety-nine percent of customers don't know the first thing about how cars work, so the chances of getting caught seem next to nil. Also, the other mechanics are doing the same thing, and your manager actually encourages the practice. He's under even more pressure than you are.

Pretty soon, everyone at your shop is cheating customers nearly every day and nobody is giving it much thought. It's just the way things are done now that everyone is hustling so hard to keep their head above water. And your shop is nothing unusual. Some estimates of the cost nationwide of auto-repair fraud run as high as $40 billion a year. Maybe none of the customers at your shop ever catch on and this new way of doing business is never challenged. Or maybe state law enforcement agencies get tipped off to the fraud and they mount a sting operation – as happened with Sears.

During the 1990s, Sears was caught up in a huge scandal regarding its automotive repair chain. The circumstances paralleled the hypothetical situation just described. The scandal underscores how a new and intense focus on the bottom line in American business often spawns more cheating, eroding the integrity of people who would rather be playing by the rules.

Twenty years ago, Sears, Roebuck, & Company reigned as one of America's most well-known and beloved large retailers. For over a century it had prospered in good times and weathered hard times. Sears built more than brand loyalty; it shaped America's popular culture. But times became tougher for Sears in the 1980s as it faced challenges from Wal-Mart and Kmart. Then came the economic downturn at the end of that decade, and Sears confronted a serious falloff in earnings as the 1990s began.

In earlier business eras, like the '50s and '60s, the ups and downs of major companies did not have the consequences they do today. Corporations were firmly controlled by their top executives and often employees had a strong voice through labor unions. A company experiencing hard times could decide internally how to deal with the challenge.

All this changed in the 1970s and 1980s, as large outside investors and Wall Street came to wield increasing power over publicly held companies. A company's stock price became the all-important indicator of success, and businesses were expected to do whatever it took to improve their bottom line — now defined not as healthy performance over a period of years but as strong earnings every quarter of every year.

This meant that a company's leadership no longer had much leeway in handling problems. When earnings fell off, intense pressure mounted to take drastic action. Which is exactly what Sears did as its earnings slid. It announced that it would cut 48,000 jobs and it also instituted a new compensation system for those employees who were spared the ax.

The Sears auto repair chain was the largest in the country at the time, servicing 20 million cars annually. Within a year of the new policies taking effect, complaints from customers were rolling in to consumer groups and state watchdog agencies. People complained of getting billed for repairs they didn't want or need, and of pervasive dishonesty at the Sears repair centers. Sears became the target of official investigations in forty-four states and eighteen class action suits were filed against the company. "We had an all-American relationship with Sears," said Michael J. Stumpf, one angry customer. That relationship ended when Stumpf and his fiancée got stuck with a $650 bill for what should have been an $89 strut job. "Trust shaken is not easily gained back," Stumpf said.

What happens when bottom-line practices put ordinary people under intense financial pressure — but provide them with a cheating option that can relieve that pressure?

The Sears mechanics and sales staff spoke out about how the new bottom-line focus had forced them to make unpleasant ethical choices at work. One mechanic talked of being "torn between moral integrity, losing my job, and trying to figure out how to work all this out" and others talked of the "pressure, pressure, pressure to get the dollars."

The evidence unearthed by investigators found nearly identical reports of cheating at one Sears auto repair shop after another. It was almost as if Sears's high command had constructed the perfect natural experiment around personal ethics. Want to know what happens when bottom-line practices put ordinary people under intense financial pressure — but provide them with a cheating option that can relieve that pressure? The answer is not very surprising: They will sacrifice their integrity before their economic security.

. . . The shadow that now hangs over Sears's reputation is rather remarkable, given the company's history. Sears had cultivated a successful love affair with the American consumer for a century. It got through the Depression and many smaller economic downturns without betraying that trust or experiencing serious scandals. And then, during a period of less than fifteen years, Sears squandered public trust, incurred numerous criminal charges and multiple lawsuits, and paid fines and settlements that ultimately totaled over $2 billion. These problems didn't arise because of uniquely bad management or a suicidal impulse on the part of Sears's top executives.

The company and its employees were simply changing with the times.

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The white-shoe corporate law firms of Manhattan wouldn't seem to bear even a passing resemblance to Sears auto repair centers. These firms operate in a rarefied strata of money and power — managing the legal affairs of some of America's largest companies. They are filled with well-compensated professionals bound by oath to abide by a rigorous code of ethics. And yet life at such firms often entails an ongoing clash between integrity and economic well-being not unlike what occurred in the Sears auto centers. Ordinary people are subjected to intense pressure and high financial stakes — all the while enjoying the option to cheat. And how do many lawyers behave under these circumstances? Not any better than the Sears auto mechanics did.

. . . To be a young law associate at a white-shoe New York firm is both a great privilege and a grueling experience. Associates enter a world of dramatic disparities in pay and power, and they are subjected to incredible stress. First-year associates start with a pay package that seems impressive: $125,000 a year and a signing bonus as high as $40,000. This pay becomes less impressive when one considers that associates can spend up to eighty hours a week in the office, the average one-bedroom apartment in New York City costs about $2,200 a month, and the typical law school grad is carrying over $80,000 in student loans. The entry-level pay is not why people join the corporate law world. They join with the hope that someday they will be able to make partner. The average partner at Cravath, Swaine & Moore took home nearly $2 million in bonus pay in 2002. Partners at Wachtell, Lipton, Rosen & Katz took home even bigger bonuses.[1]

But one of the first things associates at top firms learn is that their chances of ascending to partner are next to nil. Only a tiny fraction of associates have any prospect of making partner. The age is long gone when a brilliant young associate could pretty much bank on being elevated to partner. "People will get rejected who are extraordinary lawyers, who have worked long and hard and then get screwed," says a former associate who worked at one of New York's most prestigious firms in the late 1990s. "It's awful and there's awful pressure. For the people really gunning for partner there is a pressure, in addition to working inhuman hours, of trying to beat odds that are incredibly difficult to beat."

20 Associates at top firms put in insanely long hours in reality — and often longer hours on paper. "You're supposed to bill in tenths of an hour — six minute increments," explains the former associate. "But nobody sits there with a stopwatch. You always round up. If you worked seven minutes, you bill twelve; one minute, you bill six. . . . Everybody does it at some point."

The anonymity of corporate law makes the corner cutting less troubling. Unlike the old days, there's little loyalty between law firms and clients. "You're part of a sea of lawyers, you have no contact with anyone related to the client," says the former associate. "Why not err on the side of a higher [billing] number? There's no accountability at all for it in that situation. It never comes back to you in any personal way. All these firms charge by the hour. There's an incentive to overbill for work not done or for things that are unnecessary. There's an incentive not to staff things efficiently.° It's true everywhere."

. . . Lisa Lerman is one of the nation's leading experts on corruption in law. She is director of the Law Public Policy program at Catholic University in Washington, D.C., and her research specialty is candor and deception in the legal profession. She has extensively examined over-billing and other abuses at major law firms, interviewing scores of lawyers. Lerman says that very few lawyers can actually meet the common billing requirements these days of 2,200 to 2,400 hours. "What I've heard over and over again is people say that they can't bill more than 1,700 or 1,800 hours a year honestly, and their bosses remonstrate them. Everyone knows who's billing the most, and it is not always

staff things efficiently: to assign only as many staff members to a task as are really needed to do it.

[1] "The AM 100," *American Lawyer* (July 2003).

the one who's working the most. The ones who are willing to play with the numbers are more likely to achieve their goals." Lawyers who don't meet their billing requirements place year-end bonuses at risk and, in hard times, are more likely to be downsized.

So how do so many lawyers manage to bill the hours? They simply make up the numbers, according to Lerman, William Ross, Macklin Fleming, and many other veteran observers of the legal profession. They round their time upward and forget about the many things they did all day that weren't billable, like arguing with their wife on the phone about why they were going to miss dinner yet again. Says Fleming about the liberal allowances more and more lawyers make on their time sheets: "This development may be described as the new math."[2]

New associates at corporate law firms find themselves sprawling down a slippery slope as they learn the true rules that govern their universe. "Let me tell you how you will start acting unethically," wrote a law school dean, Patrick J. Schiltz, in an article addressed to law students. "One day, not too long after you start practicing law, you will sit down at the end of a long, tiring day, and you just won't have much to show for your efforts in terms of billable hours. It will be near the end of the month. You will know that all of the partners will be looking at your monthly time report in a few days, so what you'll do is pad your time sheet just a bit. Maybe you will bill a client for ninety minutes for a task that really took you only sixty minutes to perform. However, you will promise yourself that you will repay the client at the first opportunity by doing thirty minutes for the client for 'free.' In this way, you will be 'borrowing,' not stealing. And then what will happen is that it will become easier and easier to take these little loans against future work. And then, after a while, you will stop paying back these little loans. . . . You will continue to rationalize your dishonesty to yourself in various ways until one day you stop doing even that. And before long — it won't take you much more than three or four

[2] Macklin Fleming, *Lawyers, Money, and Success* (Westport, Conn.: Quorum Books, 1997), 36. For Lerman's findings, as well as more on the problem of overbilling, see Lerman, "The Slippery Slope from Ambition to Greed"; and Lerman, "Blue-Chip Bilking: Regulation of Billing and Expense Fraud by Lawyers," *Georgetown Journal of Legal Ethics* 12, no. 2 (winter 1999): 205–365; Lerman et al., "Unethical Billing Practices," *Rutgers Law Review* 50, no. 4 (summer 1998): 2153–226; and William G. Ross, "The Ethics of Hourly Billing by Attorneys," *Rutgers Law Review* 44 (fall 1991): 13; William G. Ross, *The Honest Hour: The Ethics of Time-Based Billing by Attorneys* (Durham, N.C.: Carolina Press, 1996); and Andre Gharakhanian and Yvonne Krywyj, "The Gunderson Effect and the Billable Mania: Trends in Overbilling and the Effect of New Wages," *Georgetown Journal of Legal Ethics* 14 (summer 2001): 1001–18.

years — you will be stealing from your clients almost every day, and you won't even notice it."[3]

. . . It's easy for lawyers to get away with outrageous things, and legal experts say that law firms may deliberately pad the bills of clients that are known to be less vigilant. The general laxity around bills is the only way to explain some of the charges that lawyers have tried to slip by their clients. Leona Helmsley once found that her lawyer had billed her for a forty-three-hour day. A lawyer named James Spiotto achieved brief notoriety in the 1990s when he revealed he had billed 6,000 hours a year for four years straight. He claimed his problem was not dishonesty but workaholism. A Los Angeles health-care company found that three different lawyers working on a project had submitted bills for more than fifty hours a day. An Annapolis lawyer named Edward Digges, Jr., a Princeton grad with a 300-acre Maryland estate to maintain, billed a client for $500,000 of nonexistent work and $66,000 for Lexis research that actually cost $394. In one of the biggest overbilling scandals of all, the Federal Deposit Insurance Corporation estimated in the early 1990s that it had been overbilled by as much as $100 million by the private law firms it used for outside contract work. Overbilling was found at nearly every firm the FDIC audited. One lawyer named William Duker overbilled the FDIC and the Resolution Trust Corporation by $1.4 million over a two-year period.

And then there's Webster Hubbell, a confidante of the Clintons who was a partner at the Rose Law Firm and went on to be deputy attorney general. Hubbell bilked clients of hundreds of thousands of dollars during the 1980s and early 1990s. He later explained that the fraud occurred after he had "become overwhelmed" by personal debts and other problems.

In 1998, investigators made public a taped telephone conversation between the imprisoned Hubbell and his wife, Suzanna.

"You didn't actually do that, did you? Mark up time for the client, did you?" Suzanna asked.

"Yes, I did," answered Hubbell. "So does every lawyer in the country."[4]

[3] Patrick J. Schiltz, "On Being a Happy, Healthy, and Ethical Member of an Unhappy, Unhealthy, and Unethical Profession," *Vanderbilt Law Review* 52, no. 871 (1999): 807.

[4] On Helmsley overbilling, see Darlene Ricker, "Greed, Ignorance, and Overbilling," *ABA Journal* (August 1994): 63. On Spiotto's billing, see Lerman, "The Slippery Slope from Ambition to Greed," 905. On L.A. healthcare company, see Amy Stevens, "As Some Clients Grow Bill Savvy, Others May Find They Get the Tab," *Wall Street Journal*, 11 February 1994, B5. On FDIC overbilling, see Linda Himelstein, "FDIC Counsel Routinely Overbill, Audit Finds," *New Jersey Law Journal*, 10 February 1992, 4. On Webster Hubbell's problems and rationales, see Ellen Joan Pollock, "Hubbell Receives

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. . . "Your entire frame of reference will change," says Patrick Schiltz of what happens to people who spend even a short amount of time within a cheating culture. "You will still be making dozens of quick, instinctive decisions every day, but those decisions, instead of reflecting the notions of right and wrong by which you conduct your personal life, will instead reflect the set of values by which you will conduct your professional life — a set of values that embodies not what is right and wrong, but what is profitable, and what you can get away with. The system will have succeeded in replacing your values with the system's values, and the system will be profiting as a result."[5]

The bottom-line emphasis of laissez-faire ideology is not new in the United States. American culture — with its classless mythology and frontier ethos — has proved uniquely hospitable to seductive market ideas about the power of individuals to shape their own economic destiny. Horatio Alger, a Harvard grad and the son of a Unitarian pastor, made a fortune writing inspirational books about overcoming hardship. The United States lagged decades behind European nations in developing a social safety net that could buffer Americans from the harsh ups and downs of a capitalist economy.

The market's dominance in American life began to ebb with the rise of Progressivism and Liberalism in the first three decades of the twentieth century. Then came the national emergencies of the Great Depression, World War II, and the Cold War, which helped justify an activist federal government and locked into place a new liberal order.

But a resurgence of market ideology began during the economic turmoil of the 1970s. This decade witnessed the rising influence of conservative economic ideas, a fierce backlash to decades of government activism, and a growing view within business that companies needed to get leaner and meaner to cope with foreign competition.

. . . Before these changes, back in the 1950s and 1960s, corporate life was pretty laid back. As Paul Krugman writes: "America's great corporations behaved more like socialist republics than like cutthroat capitalist enterprises, and top executives behaved more like public-spirited bureaucrats than like captains of industry." An implicit social

21-Month Prison Sentence for Bilking His Law Firm and Clients," *Wall Street Journal* 29 June 1995, B4; and Adam Liptak, "Stop the Clock? Critics Call the Billable Hour a Legal Fiction," *New York Times*, 29 October 2002, G7.

[5] Schiltz, "On Being a Happy, Healthy, and Ethical Member of an Unhappy, Unhealthy, and Unethical Profession," 807.

contract at most companies bonded workers and management in a web of loyalty. Workers committed themselves to the firm and, in turn, management treated them well. An ethos of equity ruled in what has been called "managerial capitalism," and salaries at the top of the firm were not grossly inflated in comparison to salaries at the bottom. Powerful labor unions helped enforce the terms of this social contract. Many companies also had strong ties to the community, which they saw as another stakeholder, and played a leading role in civic affairs. "The job of management is to maintain an equitable and working balance among the claims of the various directly interested groups," said Frank Abrams in 1951. Abrams was neither a union agitator nor a liberal intellectual. He was chairman of Standard Oil Company.[6]

35 By the 1980s the social contract in business was largely defunct. The top ranks of business management began catering mainly to just two constituencies: shareholders and themselves. Large institutional shareholders like pensions and mutual funds got new clout in the 1980s as a vast amount of money poured into the stock market. The managers of these large funds were under constant pressure to show results from their stock picks and they leaned on corporate leaders to boost profits — over a period not of many years, but of every quarter. To show these profits, corporate leaders became even more focused on being lean and mean. As "investor capitalism" replaced "managerial capitalism," mid-twentieth-century notions of loyalty within the firm were tossed aside.

Corporate leaders also grew more intent on feathering their own nests. The demise of labor unions in the '70s and '80s meant that workers had less leverage over how company profits were spread around. Social norms about pay equity within companies withered during this time. The top ranks of management could effectively behave however they wanted and pay themselves whatever they wanted — as long as the stock did well and investors stayed happy. "Downsizing" became common, even in good times, and the salaries of CEOs rose dramatically. In the late 1940s, no executive in America made over half a million dollars a year in official compensation. By 1968, after two decades of explosive growth and record corporate profits, CEO salaries had climbed only modestly. General Motors chairman James M. Roche was the highest-paid executive in America that year, making $795,000. But ten years later, during a period of sluggish growth, David

[6] Paul Krugman, "For Richer," *New York Times Magazine*, 20 October 2002, 62. Abrams quoted in Robert Reich, *The Future of Success* (New York: Vintage Books, 2002), 71.

Mahoney, chairman of Norton Simon, was the top earner among corporate chiefs, making $3 million a year. By 1988, Michael Eisner, the CEO of Walt Disney Company, made the most of any executive, taking home $40.1 million. Eisner was number one again ten years later, but this time he took home $575.6 million.[7] The new freedom of top executives to funnel more profits into their own pockets gave them an immense incentive to worship the leanest and meanest version of the bottom line, since every new "efficiency" translated directly into personal gain.

The point here is to show how an obsession with competition and profits steamrolled into American life starting in the 1970s. This obsession partly reflected changes in the economy, but it also reflected a shift in values and norms. "The ideal of a free, self-regulating market is newly triumphant," declared Robert Kuttner in his 1996 book *Everything for Sale*. "Unfettered markets are deemed both the essence of human liberty, and the most expedient route to prosperity."[8] . . . As a booming economy pumped rivers of cash into every kind of business organization — and as the carrots for the Winning Class got bigger — bad behavior became more tempting.

[7] "Executive Pay: Up, Up and Away," *Businessweek Online*, 19 April 1999.

[8] Robert Kuttner, *Everything for Sale* (New York: Knopf, 1996), 3. For an excellent overview of the triumph of market ideas in American society during the 1980s and 1990s, see Zachary Karabell, *A Visionary Nation: Four Centuries of American Dreams and What Lies Ahead* (New York: Harper-Collins, 2001), 119–57. See also Thomas Frank, *One Market under God: Extreme Capitalism, Market Populism, and the End of Economic Democracy* (New York: Doubleday, 2000); and David Bollier, *Silent Theft: The Private Plunder of Our Common Wealth* (New York: Routledge, 2002).

Understanding the Text

1. Why do you suppose Callahan pairs an example of cheating in the blue collar world (Sears auto repair shops) with examples in the white collar world (top law firms)?
2. The last seven paragraphs of the Callahan excerpt are devoted to the *history* behind today's cheating in business. Summarize that history in one paragraph.

Reflection and Response

3. Are the blue collar and white collar examples used by Callahan truly parallel instances of cheating? Make your case.
4. Here is a memory that a student retold in a paper:

   "How does this look on me? Be honest." She walks out of the dressing room, and I hope she has not seen the look of horror that just flashed