Can breaking the law be good for business?

In the late 1990s, a West Virginia farmer was disturbed to find his cows were dying one by one.

This is 153 of these animals that I've lost on this farm.

The farmer was Wilbur Tennant. Wilbur made this video of his cows dying by a creek, and he suspected the chemical company DuPont was responsible. DuPont had this gigantic factory nearby making Teflon, that non-stick material for pots and pans.

DuPont was disposing of its waste next door to Wilbur, and the creek had been carrying green water to his farm.

That water shouldn't look like that. There is something really wrong with this water.

His cows drank it and soon developed a terrible illness and started foaming at the mouth.

It soon emerged that this green water was contaminated with an extremely toxic chemical called PFOA. PFOA was used to make Teflon. And it hadn't just been contaminating Wilbur's farm but also the entire town's water supply.

DuPont had known about how toxic PFOA was since the 1960s, but it kept that information secret because dumping toxic chemicals was in its best financial interests. And one school of legal and economic thought is, yeah, that's exactly what it should have done. This is THE INDICATOR FROM PLANET MONEY. I'm Mary Childs.

And I'm Darian Woods. Today on the show, breaking the law as a cost of doing business. We talk to a business law professor about DuPont's secret math, and we ask whether a company's duty is to the law or to its shareholders.

DuPont and its spinoff companies have now settled numerous lawsuits relating to PFOA, and that includes Wilbur, the cattle farmer. A big one came in 2017 with a huge $670 million settlement. Poisoning people and cows - bad behavior, clearly. But was it bad for business?

Roy Shapira is a law professor at Reichman University in Israel who wanted to answer this question. He and his co-author got access to internal documents revealed by the lawsuits.

And so we got a rare peek into corporate decision-making. Who knows what when? What kind of cost-benefit analysis are they conducting?

And this is rare because recently, companies have gotten a bit wise to writing that cost-benefit analysis down.

So we weren't sure that we will have documents, or we could make reasonable inferences based on the documents that would lead us to this clear conclusion in the numbers. That was the part that was surprising.

It was so clear. There are minutes from a specific meeting of executives in 1984. There they reviewed a detailed cost-benefit analysis of the options they had with PFOA. Do they invest in abatement? Do they stop using this chemical altogether? Or do they continue despite the possible risks to their bottom line? They opted to continue using PFOA.

If you're a director in DuPont in, let's say, 1984, and you got all this information about the chemical being extremely toxic and you anticipate that you end up paying hefty legal fines down the road, it's still rational for you to make the decision to double down and keep producing and not investing in abatement.

Roy and his co-author found crime pays.

And actually, this is a real thing that people say in economics and its sociopath sibling, business law.

There are a couple of very influential law professors who said that if Mary is a manager of a company, it's not only that you may violate the law if you think that it's profitable. You should violate the law because, as a manager, your duty is to maximize profits for your shareholders. We call this approach law as price.

Law as price. The law breaking it, violating regulations, paying future fines and settlements - that's just the cost of doing business. And lots of companies behave in ways that could suggest this approach. Automakers regularly face lawsuits and fines for improperly disposing of toxic waste. And delivery companies like FedEx and UPS rack up so many parking fines that they even get bulk discounts in some cities.

Now, from the DuPont executives' perspective in 1984, it was by no means guaranteed that DuPont would be negligent and sloppy with its waste disposal and get caught. And then, even if they got caught, it wasn't guaranteed that the company would then need to settle or pay giant fines.

And beyond that, even if you went on to settle for loads of money like that big $670 million, that settlement could be worth it. DuPont, after all, made a lot of money on Teflon.

They started paying only in 2017, which is decades after they took the decision. By then, it's simply a question of the value of time.

Time makes future money less valuable. So take the $670 million settlement that DuPont had to pay in 2017 and add all the other previous lawsuits and fines that DuPont had to pay before that. That totals about $1 billion. Roy's paper calculated that this was worth only $100 million in 1984. In other words, DuPont could set aside $100 million in profits in 1984, invest it, and that would be enough to pay the $1 billion in 2017.

We reached out to DuPont about this. They said, we are not that old company officially known as E.I. du Pont de Nemours and Company. That company no longer exists. We are a very different company, DuPont de Nemours, Inc.

Very different indeed.

So the new DuPont said the chemical part of the original business was spun off into a new company, Chemours. We reached out to Chemours, but it said that it was inappropriate to comment on events that happened before it was formed.

In any case, Roy and his co-author's calculations showed that the settlements up to 2017 were not deterrence.

If that's what they were thinking, that from an economics kind of perspective, from a cost-benefit analysis, they were right. It was rational.

I can see your skin crawling trying to tell me this. You're like, it was rational.

Yeah. Right. So, I mean, there's nothing inherent about economics that will make you take bad choices, but also, it zeroes in on efficiency. And when you zero in on efficiency, it might lead you to behavior that have anti-social consequences.

Now, after Roy's paper came out, DuPont and its spinoff companies got hit by even more penalties. In 2023, for example, they agreed to pay more than $1 billion for water contamination with chemicals like PFOA.

Pretty big consequences. But Roy says you can't just increase the fines if companies are still doing these cost-benefit analyses about whether or not to break the law.

There are neat solutions like that, but they usually don't work. What you're doing is that you're just increasing the incentives for me to engage in these delay tactics and these distorting of information tactics and everything like that.

Big corporations have a lot of tools at their disposal for this. They can hide the information. They can set up PR campaigns. They can muddy the waters with confusing studies.

The more effective way to combat it is to mitigate information asymmetries, to make sure that information from inside the company goes outside.

He says that could be through more whistleblowing, investigative journalism or even short-selling those stock traders who dig into companies, find something rotten and then bet against those companies.

Roy also thinks that corporate norms should change. Teach more ethics at business schools, for example.

I mean, morals - fine. But let's say I don't have those.

There are solutions that are heavier, like corporate governance solutions - for example, individual accountability. You can say that if something so bad happening on your watch, on something that was so central to what the company is doing, then you're personally liable for it, meaning it will come with a personal cost to you.

Even if you are long retired, you would still face consequences personally because at least in Roy's book, there has to be some way to correct for the economic lesson that crime can pay.