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# Numerical Half Truths, Human Lies, and Other Distortions of Truth

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## Tabor Lecture

### NUMERICAL HALF TRUTHS, HUMAN LIES, AND OTHER DISTORTIONS OF TRUTH

Richard W. Painter\*

#### I. INTRODUCTION

The Glenn J. Tabor Lecture has been an opportunity for me to explore with the faculty, staff, and students of Valparaiso Law School an issue at the juncture of professional responsibility and business ethics: whether our society's obsession with rankings and other numerical measures of success has undermined our honesty and commitment to the values that matter most. I believe it has, and in this Paper I briefly explain some of the reasons why.

Before I met Glenn Tabor at this lecture, I knew that his professional life was an extraordinary success.<sup>1</sup> One could attempt to quantify Glenn Tabor's professional accomplishments, perhaps by tallying his win-loss record at trial, or measuring the mean amount of his jury awards (or should it be the median?). Perhaps the number of lawyers in his law firm is relevant, or the average profits per partner (if we are interested in "equity" among partners, perhaps the median is more important). Perhaps we should consider the amount of money Mr. Tabor himself has made practicing law.

Or perhaps not.

When I met Mr. Tabor, I learned that he was not only a great lawyer but a sincere and passionate human being. Although this lecture is named for him, achieving recognition is not his objective; neither is the acquisition of money or material goods. I have learned about his commitment to social justice, his concern for his community, and his desire to make the world a better place. Mr. Tabor's career confirms that the most important things in life—including that part of us commonly referred to as "character"<sup>2</sup>—cannot be quantified.

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<sup>1</sup> The Indiana General Assembly passed a resolution congratulating Mr. Tabor for his selection as the recipient of the 1999 Indiana Trial Lawyers Lifetime Achievement Award. See S.J. Res. 0044, 110th Gen. Assem., 1st Reg. Sess. (Ind. 1999), <http://www.in.gov/legislative/bills/1999/PDF/SRESF/SC0044.pdf>.

<sup>2</sup> Cognitive psychology sometimes attempts to quantify and explain attributes, such as trust, empathy, and honesty, and I have found some of these studies useful in my own analysis of business lawyers. See Richard W. Painter, *Lawyers' Rules, Auditors' Rules and the Psychology of Concealment*, 84 MINN. L. REV. 1399, 1413-14 (2000) (discussing Daniel

480 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 47

In this Article, I discuss a few examples of how obsession with quantitative measures of success undermines ethics in education, law, and business. There are other areas of civic life, such as government, where quantitative measures of success have also had their toll. For example, politics is shaped by our obsession with quantitative ratings by liberal and conservative interest groups, campaign dollars raised and spent, numbers of electoral votes, and numbers of members needed for control of a legislative body. These concerns, however, are topics for discussion at another time.

II. QUANTITATIVE MEASURES OF ACCOMPLISHMENT IN EDUCATION, LAW,  
AND BUSINESS

Education was transformed by standardized testing in the mid-twentieth century. Scholastic Aptitude Tests ("SAT") were introduced into college admissions in the 1930s.<sup>3</sup> At the time, President Conant of Harvard used the SAT's presumably objective measure of academic ability to increase the fairness of an admissions process, which had previously drawn students principally from well-known boarding schools and other private academies.<sup>4</sup> The SAT soon spread to other colleges after the beginning of World War II, and admissions for many top colleges became increasingly selective. By the 1960s, R. Insee

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Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263 (1979)). These basic human traits, along with others, such as love and regret, however, are impossible to describe exclusively or even principally with quantitative measures.

<sup>3</sup> See Geoffrey Kabaservice, *The Birth of a New Institution: How Two Yale Presidents and Their Admissions Directors Tore up the "Old Blueprint" to Create a Modern Yale*, *YALE ALUMNI MAG.* (Dec. 1999), available at [http://www.yalealumnimagazine.com/issues/99\\_12/admissions.html](http://www.yalealumnimagazine.com/issues/99_12/admissions.html) (noting that in the 1930s Harvard President James Conant envisioned a reconstruction of the education system).

<sup>4</sup> Princeton psychology professor Carl Brigham had helped the Army set up its IQ testing program during World War I and adjusted the methodology of that test to create the SAT. *Americans Instrumental in Establishing Standardized Tests*, PBS: FRONTLINE (Oct. 1999), available at <http://www.pbs.org/wgbh/pages/frontline/shows/sats/where/three.html>. Conant and his admissions directors then used it beginning in the early 1940s. *Id.* See generally James Bryant Conant, *Education for a Classless Society*, 165 *THE ATLANTIC MONTHLY* 593, 602 (May 1940), available at <http://www.theatlantic.com/past/docs/issues/95sep/ets/edcla.htm> ("Extreme differentiation of school programs seems essential—differentiation of instruction, but not necessarily a division into separate schools. From this it follows that rapid improvement in our testing methods must be forthcoming; a much more conscientious and discriminating form of educational guidance must be developed soon if we are not to fail.").

(“Inky”) Clark, as Yale’s Admissions Director, was transforming Yale’s process to match much of what had already been done at Harvard.<sup>5</sup>

Overall, this resulted in many colleges having a student body that was more diverse and more academically focused than ever before. Wrinkles in the system—such as the fact that standardized tests may discriminate against some minority groups through built-in cultural assumptions in test questions<sup>6</sup>—were ignored or believed to be counteracted by robust affirmative action programs (these programs provided another set of numerical targets for admissions officers to meet). There were many motivating factors behind these changes in Ivy League colleges and elsewhere, but administrators relied upon the SAT and other standardized tests to make these changes happen.<sup>7</sup>

Elementary and secondary schools later followed suit by also relying on standardized tests, first to prepare students for the SAT and American College Testing Exam (“ACT”)—for example, the Secondary School Admission Test (“SSAT”) is given for admission to private secondary schools, and the Preliminary SAT (“PSAT”) is given in the junior year as a “trial run” before the SAT; these two tests have been used for decades. Then, with increased public concern about the quality of public primary and secondary education, states developed their own proficiency exams. Finally, in 2002, the No Child Left Behind Act federally mandated testing and tied both school funding and teacher and administrator careers to test results.<sup>8</sup> If the current year’s numbers looked good—or at least comparatively good relative to other years—

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<sup>5</sup> Kabaservice, *supra* note 3 (“The Class of 1970 entered with the highest SAT scores in Yale’s history . . .”).

<sup>6</sup> See Roy O. Freedle, *Correcting the SAT’s Ethnic and Social-Class Bias: A Method for Reestimating SAT Scores*, 73 HARV. EDU. REV. 1, 1 (2003) (“The SAT has been shown to be both culturally and statistically biased against African Americans, Hispanic Americans, and Asian Americans.”). Freedle’s study was replicated later by researchers who found similar results. See Maria Veronica Santelices & Mark Wilson, *Unfair Treatment? The Case of Freedle, the SAT, and the Standardization Approach to Differential Item Functioning*, 80 HARV. EDU. REV. 106, 126 (2010) (“[T]he SAT, a high-stakes test with significant consequences for the educational opportunities available to young people in the United States, favors one ethnic group over another.”).

<sup>7</sup> Reliance on testing to assess potential for future success extends in some areas of the country to as early as age three or four when private schools give intelligence tests for admission to pre-K and kindergarten programs where, in some cases, the programs run through 12th grade. See Jennifer Senior, *The Junior Meritocracy*, N.Y. MAG. (Jan. 31, 2010), available at <http://nymag.com/news/features/63427/> (explaining that most private and public schools in New York require standardized exams for kindergarten admission). News coverage of this admissions process almost invariably mentions the fact that many parents assume that their child’s entry into these schools will assure a smooth path to admission to high-ranking colleges and universities. *Id.*

<sup>8</sup> No Child Left Behind Act, Pub. L. No. 107-110, 115 Stat. 1425, 1439–40 (2002).

schools would likely get more money, administrators could justify high salaries, and teachers would keep their jobs. If not, everyone would be in trouble. Law school admissions have moved in the same direction. The quantitative measure of academic merit has been the Law School Admission Test ("LSAT"), which is heavily weighted in law school admissions along with an applicant's grade point average ("GPA").

Then, beginning in the 1980s, another quantitative measure moved to the fore—the colleges and universities that rank students along a quantitative scale for admissions would also be evaluated themselves in like manner.<sup>9</sup> Media companies made money advising prospective students as to where to apply and admitted students as to which institution they should attend based on a ranking system. The criteria used by U.S. News and other media outlets for ranking educational institutions were narrow and educators complained loudly.<sup>10</sup> But it would be hard to claim that the ranking criteria were any narrower than the factors the educators themselves used in admissions, principally the SAT, other standardized tests, and GPAs. If educational institutions could rank applicants and proclaim that their rankings were accurate, or relatively accurate, compared with what had been done before, then the applicants had reason to believe that media outlets could also provide accurate numerical rankings of the institutions.

Rankings based on quantitative measures of achievement inform and sometimes dictate decisions, and sometimes the results appear to be absurd. For example, I recently asked a law dean which of two hypothetical students he would admit to a top 20 law school. Student A has a 3.3 GPA from the University of Illinois Urbana-Champaign in engineering (Illinois has one of the top engineering programs in the world). Student B has a 3.9 GPA from Northern Illinois University with a major in leisure studies or perhaps physical education. The two students have the same LSAT score. The law dean told me that he might feel compelled to choose student B over student A. The reason: U.S. News looks almost exclusively at GPA and LSAT scores in assessing the quality of a law school's student body,<sup>11</sup> and choosing student A could lower the overall GPA for the law school, leading to a decline in ranking,

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<sup>9</sup> See, e.g., Robert Morse & Sam Flanigan, *Methodology: Law School Rankings*, U.S. NEWS AND WORLD REP. (Mar. 12, 2012), <http://www.usnews.com/education/best-graduate-schools/top-law-schools/articles/2012/03/12/methodology-law-school-rankings> (providing the different criteria used by U.S. News to rank law schools, including median LSAT scores, median undergrad GPA, employment rates for graduates, and assessment scores of lawyers and judges).

<sup>10</sup> See *id.* (noting the factors analyzed by U.S. News and World Report to determine a law school's ranking).

<sup>11</sup> *Id.*

so that the next year neither student A nor student B would want to enroll in the law school. Although many graduate programs, including medical schools, interview applicants, law schools almost never do; thus, the law dean or his colleagues would probably never meet either student until he or she enrolled.<sup>12</sup>

Reliance on quantitative measures of achievement has extended to law practice as well. Narrow hiring criteria have been entrenched for a long time, with some law firms only hiring from the top of the class at a handful of law schools and the very top of the class at a few other law schools. As law firms became larger and hired more associates, however, reliance on rankings became more complex.<sup>13</sup> While there was a somewhat broader range of law schools under consideration, class rank within law school became extremely important, particularly for students at more modestly ranked law schools. With more associates being hired, there would be less time, particularly lawyer time, spent interviewing and checking references on each applicant.<sup>14</sup> Law firm partners would be very unlikely to know most of the applicants in other contexts, because the days had long since past when lawyers practiced in their hometowns and law firms hired most of their associates locally.

Law firms rely heavily on quantitative measures of an applicant's potential for future success; for most applicants, this boils down to the ranking of the law school they attend, which is determined in large part by one's LSAT score and law school GPA. In robust economic times, law firms have relied on summer associate programs for recruiting associates; meaning that first year law school grades count the most, while third year grades hardly count at all.<sup>15</sup>

I will not here enter the debate over whether the particular law school a student attends and law school GPA accurately predict future success in the practice of law. I also will not address "efficiency" based arguments that if there were better criteria for hiring associates, then profit-maximizing law firms would use them. Perhaps it does not matter much anyway, because at large law firms very few of the associates hired

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<sup>12</sup> This may be changing as a few of the most highly ranked law schools recognize the importance of qualitative as well as quantitative criteria in the admissions process; for example, Harvard Law School offers interviews to a number of applicants and in 2012 announced that it would expand that number, lengthen the interview to fifteen minutes, and use video conferencing over Skype instead of just the telephone. See Juliet R. Bailin, *Harvard Law School to Conduct Interviews over Skype*, THE HARV. CRIMSON, Oct. 16, 2012, <http://www.thecrimson.com/article/2012/10/16/Harvard-Law-School-Skype/>.

<sup>13</sup> See generally MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS (1991) (discussing the transformation of the big law firm).

<sup>14</sup> *Id.*

<sup>15</sup> It is not certain, in view of present economic difficulties and contraction of some large law firms, that this practice will resume even when the economy recovers.

make partner or even remain more than a few years. The law firm has ample opportunity to apply its own measures of assessment once associates arrive, and the low retention rate is perhaps an indicator that the two dimensional hiring criteria of law school rank and class rank are not accurate predictors of which associates will be the best fit for the firm's practice. The law firm only uses these criteria to determine who can enter its "tournament of lawyers" and does its real assessment of the contestants later.<sup>16</sup>

Quantitative measures of achievement, however, continue to be important in the firm after a lawyer is hired. In many firms, billable hours are a critical measure used for associate compensation and decisions about promotion to partner. Clients may complain that this system emphasizes quantity rather than quality of legal work and that it may even encourage overbilling, but most law firms address this problem by writing off time on client bills and making other adjustments.

For partners in law firms, there is yet another critically important ranking: profits per partner for the firm. The American Lawyer and other publications rank law firms according to many criteria, including some attempts to poll clients and other lawyers on the quality of their work, but in the sea of law firm rankings, profits per partner is the primary evaluative criteria. Partners watch this ranking and so does the media—a drop in profits per partner is assumed to spell trouble for a firm, encouraging its more productive partners to consider jumping ship.

And here again is an illustration of how rankings at various junctures in the system reinforce each other. Law students considering associate positions are aware of profit per partner numbers, and law students lucky enough to have multiple employment offers consider these rankings. Many of the most successful law students have lived and thrived in a quantitative ranking system for all of their lives. Against a background of substantial uncertainty about their future in the practice of law, they feel comfortable relying on law firm rankings as they had used law school rankings three years earlier.<sup>17</sup> The fact that the law firm

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<sup>16</sup> See GALANTER & PALAY, *supra* note 13, at 100 (referencing "promotion-to-partner tournament" as the practice in which associates at large firms fight for a position as partner).

<sup>17</sup> I recall that during my second year of law school in 1986, law students, with encouragement from some partners in the same firms, discussed Cravath, Swaine & Moore, Davis Polk & Wardwell, and Sullivan & Cromwell as the "Harvard," "Princeton," and "Yale" of law firms, respectively. In those days Wachtel, Lipton, Rosen & Katz had only recently shot up the rankings toward the very top in profits per partner, a reality that may have been disconcerting for lawyers and law students used to thinking of law firms, and perhaps other things as well, in terms of there being a "top three." And, of course, other

is for most associates likely to be yet another line on a resume—and perhaps another educational experience—makes it more likely that law students will heavily weigh a firm’s ranking when making their employment decisions.

Other quantitative measures of success are important to the largest law firm clients, most of which are publicly-held companies. For them, the holy-grail is stock price, which is closely followed by annual and quarterly earnings. Senior officers’ compensation is routinely tied to the present year’s stock price and earnings. Using stock options as compensation, instead of the stock itself, puts even more emphasis on short-term fluctuations in stock price. Robust earnings projections can help boost stock price, unless of course the company does not meet them.

Federal law has reinforced the use of quantitative measures of corporate achievement, since the Securities Act of 1933 and the Securities Exchange Act of 1934 required audited financial statements for public companies and assured investors of financial statement accuracy by making both companies and their auditors liable if audited financial statements were incorrect.<sup>18</sup> These laws require many other disclosures that are not quantitative, such as discussion in registration statements of business operations and officers’ background and experience, but the laws are designed to assure that the numbers a company reports are accurate.<sup>19</sup>

Academic economists often assume that these numbers public companies report are correct, or at least that securities markets are good at using these numbers and other factors to assess the overall value of a company. By the mid-twentieth century, the “efficient capital market hypothesis” replaced the skepticism about stock prices that had dominated the thinking of John Maynard Keynes and other earlier

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New York law firms have been financially successful, in some years more successful than the aforementioned firms. The American Lawyer’s profits per partner rankings substituted more objective criteria—albeit one-dimensional criteria—for the old prejudices that some firms were more prestigious because they always had been more prestigious. In some respects, the function of these rankings is similar to that of using SAT scores in college admissions—as an objective measure of preparedness, instead of recruiting students mostly from well-known preparatory schools. And perhaps these rankings also have analogous drawbacks.

<sup>18</sup> See, e.g., Securities Act of 1933, 15 U.S.C. § 77k(a) (2006) (imposing liability on auditors as well as issuers for misleading financial statements and other material misrepresentations in a financial statement); Security Exchange Act of 1934, 15 U.S.C. § 78j-1 (2006) (requiring an audit of financial statements and setting out the guidelines of such audits).

<sup>19</sup> See Securities Act of 1933, 15 U.S.C. § 77d-1(a)(5) (requiring a background check on each officer holding a certain amount of outstanding equity).



economists.<sup>20</sup> The law and economics movement has reinforced among some lawyers and judges this same view that the numbers—particularly market prices—tell an accurate story. Investors, the media, and other observers in turn assume that corporate executives—like college applicants, law students, and lawyers—should be evaluated according to these numbers.

Finally, a round of hostile tender offers in the 1980s, reinforced by academic acceptance of a “market for corporate control,”<sup>21</sup> shook up entrenched elites in corporate boardrooms in much the same way that Conant’s use of the SAT shook up entrenched elites in top universities. Directors and officers, like college applicants and football coaches, would be judged by the numbers—specifically, earnings and stock price. Meritocracy in corporate governance meant immediate realization of shareholder value according to the numerical metrics widely accepted as a measure of that value. If managers’ numbers were not as good as they could be, privileged positions in the corporate boardroom and executive suite would be lost when dissatisfied shareholders tendered their shares to a hostile bidder.

### III. THE ETHICAL CONSEQUENCES OF NUMERICAL ASSESSMENT OF PERFORMANCE

There are many consequences of modern society’s reliance on numerical measures of achievement. For example, schools teaching for state proficiency exams or the SAT/ACT will probably spend less time teaching material that is not on the test, even if that material is important for other educational objectives. Universities that emphasize football

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<sup>20</sup> Compare 1 CHARLES MACKAY, MEMOIRS OF EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS 1-97 (London, L.C. Page & Co. 1932) (1841) (describing historically irrational economic bubbles and providing a humorous commentary on them), and JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 156 (London, MacMillan & Co. 1960) (1936) (likening equity markets to a beauty contest because investors are concerned principally with what other investors think), with William T. Allen, *Securities Markets as Social Products: The Pretty Efficient Capital Market Hypothesis*, 28 J. CORP. L. 551, 562-63 (2003) (supporting the use of the efficient capital market hypothesis).

<sup>21</sup> See generally Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target’s Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1196 (1981) (arguing that market for corporate control provides an incentive to management to efficiently operate); Gregg A. Jarrell, James A. Brickley & Jeffrey M. Netter, *The Market for Corporate Control: The Empirical Evidence Since 1980*, J. ECON. PERSP., Winter 1988, at 49, 51 (noting that market for corporate control serves a beneficial function for the economy); Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 47 (1983) (arguing that corporate takeovers generate positive gain for the shareholder’s benefit).

scores may give insufficient attention to their academic mission and to admitting students qualified to fulfill that mission. Companies that emphasize only annual and quarterly performance may give insufficient attention to research and development, client and employee relations, environmental sustainability, and other aspects of their businesses that are not reflected in current profits or stock price. Hostile takeovers and the so-called “market for corporate control” may make this problem worse. Admittedly, many of these claims are controversial—for example, one can argue that a well-rounded education combined with innate intelligence improves SAT scores, or that U.S. News rankings reflect the quality of a law school, or that market prices anticipate and reward well-managed companies, even if their current earnings are not impressive.

The focus of this Paper, however, is on the ethical consequences of our obsession with the numbers. And those consequences, I believe, are worrisome.<sup>22</sup>

#### A. *Cheating*

For ages, some students have cheated on tests. The SAT and ACT are no exception. In 2012, a large cheating scandal was uncovered in Long Island.<sup>23</sup> Similar cheating has likely taken place elsewhere. State proficiency exams are also vulnerable to cheating, with the added complication that school administrators, who are supposed to prevent cheating and are required to report it when it does occur, are themselves interested in the test scores. In education, as in corporate governance, monitors probably should not have interests too closely aligned with the persons they are supposed to monitor. In 2012, Stuyvesant High School, one of the top public schools in the country, had to void seventy student test scores on the New York State Regents Exam because students cheated using cell phones and texting devices.<sup>24</sup> Stuyvesant’s own student newspaper had two years earlier reported a culture of academic dishonesty, “whose roots derived from an emphasis on numerical

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<sup>22</sup> See *infra* Part III.A (exploring the rise of cheating in educational and business institutions).

<sup>23</sup> See Jenny Anderson, *SAT and ACT to Tighten Rules After Cheating Scandal*, N.Y. TIMES, Mar. 27, 2012, [http://www.nytimes.com/2012/03/28/education/after-cheating-scandal-sat-and-act-will-tighten-security.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/03/28/education/after-cheating-scandal-sat-and-act-will-tighten-security.html?pagewanted=all&_r=0) (reporting on the reaction to a large cheating scandal in Long Island in which the Nassau County district attorney’s office charged twenty teenagers for participating in a scheme where high scoring students used fake IDs and were paid \$500 to \$3600 to take the SAT for other students).

<sup>24</sup> Al Baker, *At Top School, Cheating Voids 70 Pupils’ Tests*, N.Y. TIMES, July 9, 2012, <http://www.nytimes.com/2012/07/10/nyregion/70-students-at-stuyvesant-to-retake-exams-after-cheating-case.html?pagewanted=all>.

488 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 47

success, like high test scores, rather than on valuing learning that is not as easy to measure."<sup>25</sup>

Cheating in college is apparently widespread.<sup>26</sup> Law Schools are prone to cheating as well, with tolerance by some faculty members who do not want to incur the burdens associated with accusing a student of cheating.<sup>27</sup>

Corporate executives also sometimes cheat in their businesses in order to increase earnings, whether by making unsafe products, violating environmental laws, or, according to allegations made in 2012 against Wal-Mart, violating the Foreign Corrupt Practices Act.<sup>28</sup>

Another form of cheating is dishonest reporting of numerical results. Some school districts inaccurately report test scores in order to comply with numerical goals set under the No Child Left Behind Act. Some law schools report inaccurate information to the ABA. Those that have been caught include: Villanova, which reported inflated LSAT and GPA data to the ABA apparently in order to enhance its U.S. News ranking; and the University of Illinois College of Law, which was fined \$250,000 by the ABA in 2012 for doing the same thing.<sup>29</sup> In the case of Illinois, the admissions director, whose job it was to report the data, was also compensated based on his success in recruiting students with high LSAT and GPA—an obvious conflict of interest that a subsequent investigation by an outside law firm pointed out needed to be corrected.<sup>30</sup>

Cheating in reporting results is a sin the corporate world knows all too well. Enron and WorldCom were the most prominent recent

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<sup>25</sup> *Id.*

<sup>26</sup> See Donald L. McCabe, *It Takes a Village: Academic Dishonesty and Educational Opportunity*, LIBERAL EDUC., Summer/Fall 2005, at 26, 28 (reporting that up to fifty percent of undergraduates admit to having cheated on tests or other forms of academic dishonesty).

<sup>27</sup> See generally Sue D. Naim, *Student Cheats and Those Who Harbor Them*, 60 J. LEGAL EDUC. 664 (2011) (discussing the hesitation to turn in law students who cheat).

<sup>28</sup> See David Barstow, *Vast Mexico Bribery Case Hushed up by Wal-Mart After Top-Level Struggle*, N.Y. TIMES, Apr. 21, 2012, <http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html?pagewanted=all> (reporting on how illegal payments to government officials fueled Wal-Mart's growth in Mexico).

<sup>29</sup> *Villanova Censured for Inflating GPAs, LSAT Scores*, FOXNEWS.COM (Aug. 16, 2011), available at <http://www.foxnews.com/us/2011/08/16/villanova-censured-for-inflating-gpas-lsat-scores/>.

<sup>30</sup> See *University of Illinois College of Law: Censure*, COUNCIL OF THE SECTION OF LEGAL EDUCATION AND ADMISSIONS TO THE BAR OF THE AMERICAN BAR ASSOCIATION, at 1-2 (June 2012), [http://www.americanbar.org/content/dam/aba/administrative/legal\\_education\\_and\\_admissions\\_to\\_the\\_bar/council\\_reports\\_and\\_resolutions/2012\\_june\\_u\\_illinois\\_public\\_censure.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/legal_education_and_admissions_to_the_bar/council_reports_and_resolutions/2012_june_u_illinois_public_censure.authcheckdam.pdf) (imposing \$250,000 in monetary sanctions and other penalties for intentionally reporting inaccurate data on LSAT scores and GPAs of entering classes in 2005 and 2007-2011).

examples of executives manipulating numerical data to lie about their companies. These incidents led to the enactment of the Sarbanes-Oxley Act in 2002, which, among other things, tightened accounting controls and the auditing process.<sup>31</sup> As some of the events leading up to the financial collapse of 2008 illustrated, however, this legislation did not entirely solve the problem.

In Repo 105, Lehman Brothers concealed 50 billion dollars in debt on its quarterly balance sheets up through 2008 by selling low-quality assets, mostly mortgage-backed derivatives, to other banks for cash and using the cash to pay down debt at the end of each quarter.<sup>32</sup> These “sales” and the “repayments” would be unwound, and the junk assets and debt would be added back to the balance sheet a few days later.<sup>33</sup> English law apparently allowed the transaction to be treated as a “sale” if the assets were valued at 105% or more of the cash paid for them.<sup>34</sup> It did not matter that substantially equivalent assets would be given back to Lehman and the cash returned a few days later.<sup>35</sup> Linklaters, a law firm in London, opined that the sale, coupled with a repurchase agreement, was a true sale under English law, a conclusion that might or might not have been technically correct.<sup>36</sup> Lehman transferred the securities to London, where the transaction was executed through its London branch.<sup>37</sup> It was reported to Lehman’s auditors in the United States as a true sale and recorded as such on Lehman’s consolidated balance sheet for its quarterly report.<sup>38</sup> After the transaction was unwound, it could be repeated at the end of the next quarter and the next quarter and so on.

Repo 105 may have complied with U.K. law governing sales, but the failure to disclose such a large amount of assets and liabilities failed to

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<sup>31</sup> See Sarbanes Oxley Act of 2002, 15 U.S.C. § 7202 *et seq.* (2006) (controlling accounting and auditing procedures).

<sup>32</sup> See Report of Anton R. Valukas, Examiner at 1-14, *In re Lehman Bros. Holdings Inc.*, No. 08-13555 (JMP) (Bankr. S.D.N.Y. Mar. 11, 2010) (explaining the circumstances surrounding Lehman’s eventual bankruptcy).

<sup>33</sup> See *id.* at 782-93 (discussing Lehman’s use of a Repo 105 transaction to adjust its balance sheet).

<sup>34</sup> *Id.* at 783-86.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at app. 17, at 31 (Linklaters Letter to Lehman Brothers International (Europe) on May 31, 2006) (“Subject to the qualifications set out in this opinion, in respect of each Transaction, following the transfer by Seller to Buyer of the Purchased Securities, in our opinion, Seller will have disposed of its entire proprietary interest in the Purchased Securities by way of sale.”).

<sup>37</sup> *Id.* at 784-93 (discussing the Repo 105 transaction facilitated through Linklaters law firm in London).

<sup>38</sup> See *id.* at 1-14 (explaining the circumstances surrounding Lehman’s eventual bankruptcy).

comply with basic disclosure requirements for a public company in the United States. If Lehman Brothers had been a private company, as it was up through the 1980s, this transaction would have been pointless, because the partners would have been lying to themselves about the value of their business. The numbers reported to Lehman's public investors lied about the firm's debt levels and the quality of its assets. The people who ran Lehman—and arguably their lawyers and accountants—lied as well. When Lehman Brothers finally acknowledged its insolvency and filed for bankruptcy in September 2008, it brought much of the financial system down with it.

*B. Crowding Out*

Yet another problem with the ascendancy of numerical measures of success is that criteria that cannot be measured numerically are crowded out. Standardized testing, for example, may crowd out other educational priorities, including classroom discussion of ethics and civic responsibility. Using test scores for college or law school admission crowds out other factors, such as the character of the applicant. Quantitative criteria for measuring performance on the job (for example, billable hours of law firm associates) may crowd out other criteria, such as the ethical practice of one's profession or trade. Finally, management's emphasis on reported earnings and stock price crowds out attention to business ethics, as well as other priorities.

One indicator of sound ethics is a business person's relationship with longstanding customers. Such relationships, however, are difficult to measure quantitatively. Accounting methods used to calculate corporate earnings do not, and probably cannot, include changes in the value of a company's reputation. If senior managers' bonuses, and even continued employment, are based principally on the current year's bottom line, and the bottom line does not reflect reputation, reputation will be less important to these managers. Directors and officers of public companies who are driven by the numbers (principally stock price and earnings) have little incentive to assign a high value to a factor that cannot be easily quantified.

Henry Kaufman, formerly the head economist for Salomon Brothers, recalls how taking advantage of clients was viewed when the firm was a partnership instead of a public company and when the firm's annual profits were a closely-held secret:

During one of our executive committee meetings back in the 1970s, a young trader interrupted the meeting that was then being held by Bill Salomon, the managing

2013]

*Numerical Half-Truths*

491

partner, and he gave him a slip informing him of a very large bond trade we had just completed with one of our institutional clients.

Bill asked, "How much did we take out of the trade?"

The young trader replied, "A point," meaning one percentage point.

Bill then called in the partner in charge of transactions, who reaffirmed that the firm had made one point.

Bill Salomon's admonition was brief and to the point. He said, "Salomon Brothers does not take such a profit." The bonds purchased were highly marketable, of high quality, and they were sold by an institution that was a valued client.

He ordered the trading partner to return part of the profit to the institution. In addition, he told the trading partner that the participation in the profits of the firm for him was going to be reduced.

The question then is: What prompted Bill Salomon to take this action in the 1970s? It was, among other things, to protect the relationship with an important institutional client. But it was also to ensure that this wouldn't happen in other transactions of this kind by the firm.<sup>39</sup>

William Salomon's dispute with this trading partner was about the relative importance of a quantitative value (the size of the profit Salomon took on a trade) and a qualitative value (Salomon's relationship with a client). The client relationship could generate additional profits in the future, but those could not be assessed quantitatively in the present.

Imagine Salomon's reaction if he had been told that the trader did something illegal to cheat a client. We don't know how often that happened, if at all, when Salomon was head of the firm, but we do know

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<sup>39</sup> Henry Kaufman & Joanne J. Myers, *Henry Kaufman on Civility in the Financial Sector*, Address at the Carnegie Council (June 20, 2011), available at <http://www.carnegiecouncil.org/studio/multimedia/20110620/index.html#section-21657>. "Civility" itself is another value that is difficult to measure quantitatively.

492 VALPARAISO UNIVERSITY LAW REVIEW [Vol. 47

that it happened years after he had left the firm and after it became a publicly-held company in 1981. Probably the most valuable business relationship Salomon Brothers had as a major bond dealer was with the U.S. Treasury, a relationship that was shattered when a trader illegally attempted to corner the market in Treasury securities in 1991.<sup>40</sup> Senior management, when told what had happened, ignored the violation.<sup>41</sup> When they were caught later, the Treasury Department almost shut the entire firm down.

In 2012, Greg Smith, a senior Goldman Sachs executive, published a New York Times op-ed titled, *Why I am Leaving Goldman Sachs*.<sup>42</sup> He described Goldman's proud history of serving clients for over one hundred years and then the recent deterioration of its client relationships:

To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. . . .

. . . .

What are three quick ways to become a leader [at Goldman Sachs]? a) Execute on the firm's "axes," which is Goldman-speak for persuading your clients to invest in the stocks or other products that we are trying to get rid of because they are not seen as having a lot of potential profit. b) "Hunt Elephants." In English: get your clients—some of whom are sophisticated, and some of whom aren't—to trade whatever will bring the biggest profit to Goldman. Call me old-fashioned, but I don't like selling my clients a product that is wrong for them. c) Find yourself sitting in a seat where your job is to trade any illiquid, opaque product with a three-letter acronym.

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<sup>40</sup> See *In re Gutfreund*, Exchange Act Release No. 3-7930, 1992 WL 362753, at \*11-12 (Dec. 3, 1992) (finding violations by top officers of Salomon Brothers Inc., who knew of a bond trader's illegal efforts to corner the market in Treasury securities but failed to report it as required by law).

<sup>41</sup> *Id.* at \*12.

<sup>42</sup> Greg Smith, *Why I Am Leaving Goldman Sachs*, N.Y. TIMES, Mar. 14, 2012, <http://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html?pagewanted=all&r=0>.

Today, many of these leaders display a Goldman Sachs culture quotient of exactly zero percent. I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them. If you were an alien from Mars and sat in on one of these meetings, you would believe that a client's success or progress was not part of the thought process at all.

It makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as "muppets," sometimes over internal e-mail. . . .

. . . .

It astounds me how little senior management gets a basic truth: If clients don't trust you they will eventually stop doing business with you. It doesn't matter how smart you are.<sup>43</sup>

There are many factors underlying this shift in culture in investment banks.<sup>44</sup> The point I make here is that a large part of the problem is emphasis on factors that can be quantified—present earnings and stock price—at the expense of factors such as reputation and customer relationships, which are not easy to quantify. In the days when Salomon Brothers and Goldman Sachs were "elite" investment banks because of a longstanding reputation in the business community, these qualitative factors may have been important, but not so in a world where quantitative factors are preeminent, and managers of even the best banks are repeatedly required to "prove themselves" according to the numbers. A lot of priorities are crowded out in such an environment, and, as Smith pointed out in his editorial, business ethics is one of them.<sup>45</sup>

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<sup>43</sup> *Id.*

<sup>44</sup> See Claire Hill & Richard Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE U. L. REV. 1173, 1183–84 (2010) (arguing that the factors that lead to a shift in culture involved investment banks shifting from a partnership structure to corporations, which coincided with directors shifting their focus to short-term gains and receiving larger bonuses).

<sup>45</sup> Smith, *supra* note 42.



C. Cover-Ups

Perhaps the worst form of “crowding out” occurs when decision-makers confront wrongdoing, and, because of their single-minded obsession with meeting numerical targets, they don’t do anything about the wrongdoing or even cover it up.

Horace Mann School in New York City has been one of the most successful private schools in the country in meeting numerical targets—its SAT scores and Ivy League admissions statistics are among the best in the country.<sup>46</sup> The fact that Horace Mann does statistically better than many of the boarding schools that dominated Ivy League admissions up through the 1950s is an indicator of how James Conant’s vision of meritocratic ascendancy in the 1930s finally became a reality.<sup>47</sup> Horace Mann was led for several decades up through the late 1990s by Inslee Clark, the man who had brought a similar approach to Yale’s admissions in the 1960s.<sup>48</sup>

In 2012, the *New York Times* published a lengthy essay by a Horace Mann alumnus who reported something drastically wrong beneath this veneer of extraordinary success. Several teachers were sexually abusing students on multiple occasions: Inslee Clark and other administrators knew about the abuse, and they did nothing about it.<sup>49</sup> The administrators had priorities and addressing this problem was not one of them. The same thing has of course happened at other schools without as accomplished an academic record, so one cannot blame it only on the pursuit of high SAT scores. Nonetheless, it is also true that reporting the abuse and telling parents about it would have, temporarily at least, made it more difficult for Horace Mann to compete with other New York private schools in attracting academically talented students—a critical factor in generating numerical statistics that put Horace Mann at the top. Now that the abuse has been exposed years later by an alumnus and not by the school, the current crop of administrators can claim that it is part of the school’s history and has nothing to do with the experiences that

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<sup>46</sup> See David Chung, *Top High Schools Find Admission Success*, THE BROWN DAILY HERALD, Apr. 27, 2011, [http://www.browndailyherald.com/top-high-schools-find-admissions-success-1.2553620#.UJU9r45Z\\_ww](http://www.browndailyherald.com/top-high-schools-find-admissions-success-1.2553620#.UJU9r45Z_ww) (noting that Horace Mann was ranked second in the nation by Forbes).

<sup>47</sup> See *supra* notes 3–7 and accompanying text (discussing the evolution of the SAT and the changes in Ivy League school admissions).

<sup>48</sup> See Amos Kamil, *Prep School Predators: The Horace Mann School’s Secret History of Sexual Abuse*, N.Y. TIMES MAG., June 6, 2012, <http://www.nytimes.com/2012/06/10/magazine/the-horace-mann-schools-secret-history-of-sexual-abuse.html> (describing R. Inslee Clark as a legendary reformer).

<sup>49</sup> See *id.* (describing stories of sexual assault at Horace Mann by a variety of different teachers and the failure of the administration to address these concerns).

students have there today. After dealing with the bad publicity and unpleasant alumni relations from the scandal, they can get back to the pursuit of academic excellence according to the metrics they and many other educators believe to be most important.

Penn State University has been extraordinarily successful for several decades in meeting a different type of numerical target: football wins and bowl championships.<sup>50</sup> In a country obsessed with sports as much as academic achievement, these numbers mean a lot. Penn State's football metrics also translated into something that all colleges and universities care about: money. Proud alumni gave enormous amounts of money to Penn State in honor of its football program and Joe Paterno, its coach for several decades.

In late 2011, the world learned the shocking news about what had been going on for decades underneath this veneer of success. Paterno's assistant coach, Gerald Sandusky, had used the lure of privileged access to Penn State football to attract young boys and then molested and raped the boys in the locker rooms and elsewhere on the Penn State campus, as well as at his own home.<sup>51</sup> Paterno knew about this and told his superiors at Penn State.<sup>52</sup> His superiors, including the athletic director and the president of the university, did nothing about it.<sup>53</sup> They did not inform the police or even ban Sandusky from the Penn State campus; Paterno also failed to take any additional action.<sup>54</sup> Penn State covered-up the abuse, while Sandusky continued to molest and rape young boys with impunity.<sup>55</sup>

I and other authors have written about the litany of corporate cover ups—Enron and many others—that have dominated our business landscape for decades. Wal-Mart's apparent bribery cover-up in Mexico is a more recent episode of the same phenomenon.<sup>56</sup> Generally, once people know there is a problem, they do not act to correct it but instead

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<sup>50</sup> See generally *Penn State Football History Database*, NATIONALCHAMPS.NET, [http://www.nationalchamps.net/NCAA/database/pennstate\\_database.htm](http://www.nationalchamps.net/NCAA/database/pennstate_database.htm) (last visited Nov. 3, 2012).

<sup>51</sup> See Freeh Sporkin & Sullivan, LLP, *Report of the Special Investigative Counsel Regarding the Actions of the Pennsylvania State University Related to the Child Sexual Abuse Committed by Gerald A. Sandusky* 19–30 (2012), [http://www.thefreehreportonpsu.com/REPORT\\_FINAL\\_071212.pdf](http://www.thefreehreportonpsu.com/REPORT_FINAL_071212.pdf) (providing a timeline of the assaults and the locations of the assaults, beginning in 1998).

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> See generally *id.* (giving an extensive overview of the sexual allegations against Jerry Sandusky and the purported cover-up by University of Penn State officials).

<sup>56</sup> See *supra* note 28 and accompanying text (discussing the allegations of corruption against Wal-Mart).

cover it up, postponing but not avoiding the pain. One common denominator is that many of these decision-makers are obsessed with meeting numerical targets, namely stock price and reported earnings. Dealing with a crisis earlier rather than later may mean a temporary hit to numerical performance.

In these public companies—as at Horace Mann and Penn State—obsession with numerical targets intensifies what I have elsewhere called the “psychology of the cover-up.” A cognitive bias underlying the cover-up phenomenon is the tendency to take risks, including ethical risks, in a “loss frame,” where the decision-maker has to choose among two types of potential losses. The decision is between accepting a loss (for example, acknowledging a missed earnings target, having to fire a football coach who has had a string of victories, or firing high school teachers who have mentored some students toward the Ivy League while molesting others) and the alternative of trying to avoid the loss by risking a potentially much greater loss (being caught committing securities fraud or a scandal over child sex abuse in an educational institution).

Decision-makers in such a loss frame often choose the riskier course of action, even if it is not logical because it is unlikely to work in the long run. Cognitive psychologists have studied this phenomenon and have described this framing effect as part of what they call “prospect theory.”<sup>57</sup> Even casinos know about this theory and profit when gamblers in a loss frame dig themselves deeper into a hole, thinking they can climb out of it—this psychological bias, like many others, is probably exacerbated by alcohol, perhaps explaining the availability of free drinks in many gambling establishments. In a July 2012 op-ed, former White House counsel John Dean acknowledged that this “psychology of the cover-up” in a loss frame explained much of his own conduct in Watergate, as well as the cover-up that had occurred more recently at Penn State.<sup>58</sup>

Numerical targets—earning projections, stock prices, test scores, college admissions statistics, and football scores—provide the frame of

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<sup>57</sup> See generally Kahneman & Tversky, *supra* note 2 (analyzing how an individual’s ability to make decisions is affected by both the risk of losing and the potential overall gain).

<sup>58</sup> John Dean, *How Lawyers Can Minimize Professional Mistakes During a Scandal Like that at Penn State: Part Two in a Two-Part Series of Columns*, VERDICT (Aug. 10, 2012), <http://verdict.justia.com/2012/08/10/how-lawyers-can-minimize-professional-mistakes-during-a-scandal-like-that-at-penn-state> (referencing a prior discussion in RICHARD W. PAINTER, GETTING THE GOVERNMENT AMERICA DESERVES: HOW ETHICS REFORM CAN MAKE A DIFFERENCE 282–85 (2011)). See generally Kahneman & Tversky, *supra* note 2 (studying the choices individuals make after assessing the associated risk); Painter, *supra* note 2, at 1413–14 (discussing the psychology behind a cover-up).

reference that can easily put decision-makers in a loss frame. These targets often escalate over time, and, as the targets get more ambitious, there is greater risk that something will get in the way of meeting them. Covering-up the obstacle to success is sometimes the preferred choice, even if it is not the ethically responsible choice.

#### IV. CONCLUSION

College students, law students, academic administrators, coaches, lawyers, and corporate executives all live in a world that values a form of “merit” measured by numbers. Sometimes, the numbers tell the truth about selected dimensions of achievement: Penn State probably did score all of the touchdowns they are reported to have scored over the past two decades; SAT scores accurately reflect the number of correct and incorrect answers to specified questions, unless students cheat; law schools have the mean LSAT and GPA they report, unless they lie; corporations’ reported earnings correlate with their actual earnings, according to generally accepted accounting principles (“GAAP”), unless the financials do not comply with GAAP. Sometimes people lie about the numbers. At other times, the numbers themselves do not tell the entire truth; for example, when stock price and earnings do not reflect the true value of a company. People who know this sometimes use the numbers to tell half-truths.

Numbers sometimes tell part of a story but tell nothing about something else that is drastically wrong with a school, a college sports program, or a company. Decision-makers obsessed with the pursuit of a one or two-dimensional numerical metric do not want to be bothered with dealing with a different problem, which may in fact be much more important than whatever the numbers are supposed to represent.

In this Paper, I have not suggested particular solutions to this dilemma. I have suggested that living a personal and professional life according to a metric that cannot easily be measured may ultimately be more satisfying than continuously striving to meet numerical goals. Finding that metric is up to each individual and institution. I am honored to have given this lecture in honor of a man who has found a meaningful metric to guide his life, and I wish the same for the students, faculty, and staff of this law school, as well as other members of our profession.