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# Corporate Monitorships and New Governance Regulation: In Theory, in Practice, and in Context

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CORPORATE MONITORSHIPS AND NEW GOVERNANCE REGULATION:  
IN THEORY, IN PRACTICE, AND IN CONTEXT

Cristie Ford and David Hess<sup>1</sup>

## **Introduction**

The global financial crisis that began in 2008 has had a profound impact on how we think about regulating corporations. This article contributes to this discussion through a focus on the potential role of settlement agreements in enforcement activity to change corporate behavior. Referred to as either deferred prosecution or non-prosecution agreements<sup>2</sup> in the criminal context and reform undertakings in the civil regulatory context,<sup>3</sup> this is an approach to regulation where the government takes a direct role in reforming corporations' cultures and considerations of risk. In exchange for leniency for alleged criminal or civil violations of the securities laws, a corporation agrees to end its wrongful practices, develop and implement an improved compliance program, and, in many cases (and most importantly for purposes of this article), hire an independent monitor to oversee those undertakings and make recommendations for improvement.<sup>4</sup>

In theory, we believe monitorships have significant potential as a form of new governance regulation focused on reforming corrupt corporate cultures (Ford 2005; Hess and Ford 2008). As described further below, monitorships operate in space separate from an adversarial, enforcement interaction, and therefore provide the opportunity to assist corporations in meaningfully changing what former SEC Chairman William Donaldson referred to as their "moral DNA." (Ford 2005: 773). However, with the increased use of these settlement agreements with monitorships, doubts have emerged about their effectiveness as currently implemented (Ford and Hess 2009).

In this paper, we focus on why corporations, monitors, and regulators, may deviate from expectations of monitorships as a new governance mechanism. That is, what factors influence actors' behavior in the monitorship context that may limit the potential effectiveness of monitorships? Although we believe that monitorships can be effective (and can be further improved through corrections to some of the potential problems we identify below), this

research, and the example of the recent financial crisis, pushes us to consider larger questions about how and to what degree new governance-style initiatives can consistently and reliably promote better corporate conduct. Focusing primarily on the US experience, the first part of the paper examines the history and context for the development of monitorships as prosecutorial or enforcement tools. The next section describes our own research into monitorships, beginning with an explanation of our normative commitment to new governance methods for dealing with difficult problems of corporate ethical culture, and ending by identifying the ways in which monitorship in practice fall substantially short of the ideal model we describe. The third major section identifies a set of micro-sociological characteristics of the prosecutorial and monitorship environment that push monitorships toward a status quo-favoring, under ambitious definition of their mandate. We close by raising some additional issues about the usefulness of an expertise-driven process, the effect of an enforcement-based one, and the possibilities for a much more radical, participatory, and open-ended process than we have yet seen.

## **Monitorships, Culture, and Compliance**

Monitorships are part of a broader regulatory trend that recognizes the limits of regulating corporations through external prescriptions and inspections, and therefore directs its energies toward encouraging corporations to engage in meaningful self-regulation through the adoption of effective internal compliance programs. In fact, efforts to ensure that corporations have in place compliance and ethics programs have been a feature of corporate regulation for some time. In the United States, the Organizational Sentencing Guidelines, first promulgated in 1992, seek to encourage corporations to take the steps necessary to prevent organizational members from breaking any laws. Those steps are to (1) adopt an “effective” compliance and ethics program; and (2) to “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law” (Lipman 2009). Until recently, however, corporations had significant freedom in how they chose to design and implement their compliance and ethics programs within the basic framework of the Sentencing Guidelines.

That approach began to change around 2003, in the wake of the Enron, WorldCom, and similar debacles. Previously, when a corporation committed a crime, the United States Department of Justice (DOJ) would prosecute the individuals that committed the wrongful acts

and sometimes also the corporation. The corporation would receive a significant fine. A similar strategy existed at the United States Securities and Exchange Commission (SEC), with increasingly heavy fines being the norm through the early 2000s. Sometime around 2003, the DOJ and SEC began to put greater emphasis on a controversial approach that intrudes more directly on corporate governance. Through the use of settlement agreements, the DOJ, SEC, FINRA, and some other American and Canadian securities regulators now may require corporations to develop and implement improved compliance programs, and, most controversially, to hire an independent monitor to oversee those undertakings and make recommendations on necessary changes. Not all such agreements require the use of corporate monitors (in our sample, described below, approximately 40 percent used monitors), but it appears to be a growing trend. For example, during the US bank bailout in late 2008 and early 2009, former US Attorney General John Ashcroft noted the likelihood of significant wrongdoing with respect to the use of bailout funds from the US government. He suggested that monitorships be used for corporations caught engaging in such economic crime (Ashcroft 2009).

Monitorships have been imposed on some very well-known corporations, such as America Online, Boeing, Daimler AG, and Monsanto, and one of the most notorious players in the recent financial crisis, AIG (though for reasons unrelated to credit default swaps or executive bonuses (Lattman 2009)). Monitorships are not without controversy. The controversies around corporate monitorships are typically based on anecdotal evidence and focus on the significant costs to corporations of hiring monitors, monitors' potential to function as unaccountable "czars" over the corporation (Khanna and Dickinson 2007), and conflicts of interest in the selection of monitors, such as the selection of John Ashcroft by the DOJ (Lichtblau 2008).

The focus of our research is on whether or not monitorships, as implemented, are actually likely to achieve the goal of forcing corporations to implement effective compliance and ethics programs and improve the ethics aspects of their organizational cultures. By "corporate ethical culture," we are referring to the *informal* control system within the organization. The formal control systems include the company policies, structures, and operational processes that play an indispensable role in keeping firms law-abiding. Culture goes beyond those easily visible organizational features, and includes the basic assumptions, values, and expectations that influence employees' behavior (see Schein 2004; O'Rielly 1989).

Firm cultures are not monolithic, easily described, or completely determinative of individual behavior. Nevertheless, understanding and managing corporate culture is necessary because individual ethical behavior is deeply affected by situational factors. That is, not all organizational wrongdoing can be blamed on a few individuals that act on their own initiative to break the rules to further their own interests. In many cases, the root cause of the wrongdoing is found in conditions existing at the organizational level. For example, a recent survey of over 5,000 employees across several industries asked what they viewed as the “root cause” of misconduct within their organizations, and over half of employees cited organizational factors, such as “pressure to do whatever it takes to meet business targets” and a belief that “their code of conduct is not taken seriously.” Only one-third attributed the wrongdoing to employees bending the rules for their own personal gain (KPMG 2008, 6). Numerous social scientific studies also support the relationship between personal ethical behavior and organizational culture (see Treviño et al. 2006; Treviño and Weaver 2003). Thus, if the response to wrongdoing is simply to terminate the employment of the individual wrongdoers without changing the context in which those individuals operated, then wrongdoing may well continue to occur in the future.

According to the Ethics Resource Center, “[e]thical culture is the single biggest factor determining the amount of misconduct in [an] organization” (Ethics Resource Center 2007, 26). The most recently revised Organizational Sentencing Guidelines, from 2004, recognize that a compliance program will not be effective if the organization has a culture that does not support the compliance program or perhaps even runs counter to the goals of the compliance program. Kaptein provides a list of certain “organizational virtues” that can be a part of an organization’s culture, which work to encourage ethical behavior and discourage unethical behavior (Kaptein 2009). This list includes such matters as the extent to which ethical expectations are understood by employees, the organizational support for ethical behavior, an environment that supports the open discussion of ethical issues, and transparency with respect to the consequences of ethical and unethical behavior. Importantly, each of these elements of an organization’s culture can be influenced by management (Kaptein 2009).<sup>5</sup> In other words, although an organization’s culture develops slowly over time and is difficult to change, certain aspects—including those that relate to ethical behavior—can prove responsive to appropriate effort and attention. Managing these aspects of culture is an important part of implementing an effective compliance program.

What we draw from this is that, to achieve the goal of reforming corporate behavior, corporate monitorships must also engage with organizational culture. This is not uncontroversial. Corporate culture, broadly defined, also relates to the corporation's strategy, for example, and therefore can have a direct impact on long-term shareholder value. Not everyone would agree that these are appropriate concerns for a monitor. On the other hand, there is evidence that the failure to look at culture results in less effective compliance programs (Tyler et al. 2008), and in some cases can result in counterproductive compliance programs (if the employees perceive the program is designed simply to protect upper management from blame for any wrongdoing that occurs) (Treviño et al. 1999). Because corporate culture is important, we argue that settlement agreements involving corrupt corporations must ensure that monitors focus on culture in two ways (Ford and Hess 2008). First, monitors must determine what aspects of the corporation's culture contributed to the wrongdoing, including whether the culture encouraged wrongdoing or discouraged the reporting of wrongdoing by other employees. Second, the monitor must ensure that management is actively concerning itself with the organization's culture going forward as part of its implementation of a revised compliance program. A new governance approach, discussed below, provides insights into how a monitorship can be structured to best achieve these goals and encapsulates our normative stance with regard to making possible sustainable, endogenous reform to corporate ethical culture.

## **Monitorships as New Governance Regulation**

The corporate monitorship is an enforcement innovation that is compatible with the larger new governance regulatory frame. The notion that monitorships should, in fact, be seen in ambitious new governance terms was catalyzed by claims by DOJ officials and SEC enforcement staffers to the effect that enforcement action can “effect change [to internal controls, supervisory procedures, and compliance functions] on an enormous scale” (Ford 2005). As such, our work on monitorships draws on a broader body of new governance scholarship around structural reform litigation (Sturm 1979; Sabel and Simon 2004; Sturm 2006).

Our attraction to new governance derives from its potential, in theory, to catalyze a more meaningful process of corporate cultural reform than more traditional enforcement techniques, based on fines and other sanctions, can do. A new governance approach imagines regulation that

is informed and underpinned by a decentered, horizontal experimental process. The process uses pragmatic problem solving techniques, including especially highly participatory and structured dialogue. As a matter of institutional design, it relies on information-forcing techniques such as reason-giving, transparent and explicit dialogic and analytical processes, benchmarking, and outcome analysis. It employs an incrementalist approach that seeks to incorporate situational learning into subsequent practice, and also to promote the mutual and ongoing revision of both means and ends by way of a flexible, “best practices”-driven process. New governance also has ramifications for the regulator’s role, in that these experiences are then rolled into a public/private matrix (Freeman 2000) within which the regulator oversees the coordination and sharing of information from localized experiments and pushes localities to improve by comparison to experience of others. The relationship between new governance and other contemporary regulatory forms, including responsive regulation, outcome-oriented regulation, or risk-based regulation, is beyond this paper’s scope (but see Gilad 2010, Ford 2011). However, new governance has an affinity with management-based regulation (Coglianese and Lazer 2003) and meta-regulation (Parker 2002; Gilad 2010) in particular, which focus on the analytical processes that organizations use to reach their conclusions and the establishment of a learning-by-doing regulatory architecture.

As applied to settlement agreements imposing corporate monitors, a new governance style endeavor would involve a broadly participatory, dialogic, and transparent process emphasizing root cause analysis rather than a superficial compliance audit. The monitor would be closely engaged in facilitating dialogue and problem solving at all levels of the corporate hierarchy. The monitorship would take place after the enforcement action had been provisionally settled, and continue for a period of time long enough to permit a careful, less instrumental investigation. It would be structured to be flexible, open-ended, and capable of learning from its own experience. On this model, the monitor is stationed in the organization not as an agent of the government, but as a quasi-independent third party that assists the corporation in developing a compliance program that works best for that organization. Of course, the monitor is there to provide assurances to the government that the corporation is actually doing what it has committed itself to doing in the settlement agreement, but as we envision it the monitor is also making a unique contribution. The monitor is in a position to go beyond basic verification activities that may only further the isomorphic imitation of industry-standard

compliance protocols (DiMaggio and Powell 1983) and to provide an element of clear-eyed, impartial, and experienced human judgment that would otherwise be lacking. An adequate degree of cognitive and structural independence from both the corporation and government is critical.<sup>6</sup>

Seeing the monitor's role in these broader terms shifts the frame of reference. To fulfill this mandate, the ideal monitor needs a range of attributes in addition to independence, including credibility with both regulator and firm; a wide range of skills including background knowledge of compliance and corporate governance, enough comprehension of fairness and due process to be able to identify scapegoating and other potential justice issues; strategic planning and communication skills; and management skills including understanding organizational culture (e.g., incentives, social norms) and the ability to generate useful (and ideally generalizable) information.<sup>7</sup>

We talk further below about the challenge involved in actually creating such high-functioning, demanding, broadly-skilled monitorships. With these attributes, though, monitorships could offer meaningful benefits in the enforcement context and, relative to one-off fines, provide significant advantages to both corporations and regulators. (Without these attributes – that is, if the monitor's function is only to verify the corporation's adoption of a generic compliance protocol – we are somewhat sympathetic to critiques of the significant cost and marginal benefit that monitorships bring.) In particular, a new governance monitorship would be different and more effective than a fine as a mechanism for catalyzing cultural reform because it is forward-looking and forces participation and creation of information. Such monitorships would use the organization's own language and norms to foster a dialogic process of endogenous learning. This permits buy-in – which is especially essential when dealing with problems of culture. Unlike *in terrorem* fines, credit-for-compliance, or credit-for-cooperation schemes—which mainly set up incentives for corporations to avoid sanctions and signal to regulators that they care about compliance—monitorships in their ideal form could be geared toward a deeper project of actually investigating and embedding compliance values within the corporation (Ford 2005). Moreover, the findings made through such a monitorship process have the potential to be more “valid”, because they are based on sources of information that were



drawn upon in a less high-pressure environment (relative to the acute enforcement stage). This makes scapegoating and cosmetic compliance potentially both less of a risk and easier to detect.

Reminiscent of the “benign big gun” argument developed by Ian Ayres and John Braithwaite almost two decades ago (Ayres and Braithwaite, 1992), we argue that there is real value in embedding a new governance monitorship within the enforcement environment. We make this claim, notwithstanding the recognized challenge that an enforcement context presents for an approach that requires a degree of trust (Ford 2005), because the enforcement environment is a crucial medium for forcing change within recalcitrant organizations. Meaningful corporate reform that impacts the culture of the organization is something that is unlikely to occur within the organization without external prompting, and unlikely to be done effectively without an independent observer being involved. For many corporations—especially among those that have been accused of significant wrongdoing—the compliance and ethics program may be viewed as a cost to be minimized (Laufer 1999). Monitorships have the potential to create a space for meaningful dialogue and introspection because, although they are situated within the enforcement context, they are managed post-settlement and conducted by an independent third party monitor. The presence of the monitor in the organization sends a strong signal to the organization that reform must be taken seriously. It forces the company to direct resources to its compliance and ethics functions. This is reflected in the comments of one of the interviewees in our study (which we describe below):

*The greatest problem to effect change is the inevitable loss of momentum that occurs inside an entity once the crisis has passed. Just the everyday pressures that exist to do whatever business it is, to deal with whatever crisis there is, gets in the way of actually completing whatever it is people agree is the right thing to do. So having an independent consultant involved in the process puts a framework around it, just like program management does to cause ordinary change to take place. You need the discipline of someone outside the organization who's got a timeline, who's got to report to somebody. You have to have an end date. When you have those things, then you've managed to meet all the milestones and get it done.*

The ultimate goal, of course, would be to ensure that the corporation continues to manage its corporate culture and update its compliance program once the monitorship ends. For this to occur, the corporation must “buy in” to the process. Again, consistent with the new governance approach, the monitor and the corporation would have to work together to creatively solve problems, as opposed to the government taking a command-and-control type approach to

company's compliance and ethics program. This requires a level of mutual trust between the monitor and corporate officers. Absolute trust is neither required nor feasible, but the corporation should trust that the monitor is basically working in the corporation's interest even while ensuring that it is doing everything it can to prevent future violations of law. It also requires the corporation to have trust in the process: trust that the government is imposing a monitorship for the right reasons, and is not appointing a monitor that will, as one of our interviewees described it, "run amok" over the corporation.

## **Monitorships in Practice: Can They Meet the Expectations of New Governance Regulation?**

### *Research Approach*

Our investigation took a qualitative research approach to examining whether, and to what extent, monitorships in practice align with the new governance model in theory. We see this approach as appropriate because corporate monitorships are still at a relatively early stage in their development as an enforcement technique, and ours is one of the first empirical research projects on this issue. Although we reach some tentative conclusions in this paper, we are equally interested in raising questions and pointing out potential problems that should be investigated by researchers in the future.

Our analysis is based on interviews and secondary data. Our interviews were primarily with individuals that were insiders to the monitorship process. We supplemented that information with interviews with informants that were outside the monitorship process, but whose expertise in corporate compliance gives us a valuable external perspective. We conducted telephone interviews with 20 different individuals in Canada and the United States—whose identities we agreed to keep confidential—in the summer of 2008. During the interviews, we asked the individuals about their own direct experiences, as well as for their broader views on monitorships. These were semi-structured interviews with questions covering all five stages of the monitorship process shown in figure 1 below.

Nine of our interviews were with individuals that served as corporate monitors for the DOJ and/or the SEC. We contacted 32 individuals identified as having served as monitors, based on publicly available information as of spring 2008. We interviewed all nine individuals that

agreed to speak with us. For a broader perspective, we interviewed one individual who served as a monitor in multiple and varied institutional contexts over a long career dating back to some of the earliest uses of monitorships. Six interviews were conducted with individuals that (currently or in the recent past) served as prosecutors or regulators imposing monitorships. These interviews were obtained by contacting relevant government agencies and by a snowballing technique of asking interviewees to nominate other potential interviewees. The remaining interviews were with well-established compliance consultants. These individuals were selected for their ability to provide an outsider's perspective on corporate compliance programs, which are at the heart of corporate monitorships. They provided more general, experience-based accounts of what is necessary for a compliance program to be successful, and provided a perspective from the company side. This was necessary because although we contacted all corporations that we identified as being involved in monitorships, we received no response from those companies.

The interview data is supplemented with secondary data. This includes public statements made by monitors, compliance officers at companies that went through monitorships, government officials, and corporate attorneys involved in the negotiation of settlement agreements. Public statements were in the form of presentations at conferences, presentations over the internet in "webinars," published articles, and interviews published in trade journals. Our secondary data also includes the actual settlement agreements establishing the monitorships, government press releases announcing the settlements, and any monitorship reports that had been made publicly available (which is very rare).

This study has several limitations. First, those monitors and regulators that agreed to be interviewed may be unrepresentative of the broader group. This concern is somewhat alleviated by the fact that our interviewees described a wide range of experiences and opinions—both positive and negative—which suggests that we may have captured a representative range of views, even if we cannot draw robust conclusions about the distribution of those opinions among monitors and others. Second, we do not have data on the success or failure of the monitorship meaning, for example, how satisfactory were the changes to internal compliance processes, or whether the monitorship succeeded in identifying root causes of wrongdoing or preventing subsequent misconduct. Our analysis is based on our evaluation of what the monitors did or did not do during the monitorship, as compared to expectations about what they should be doing

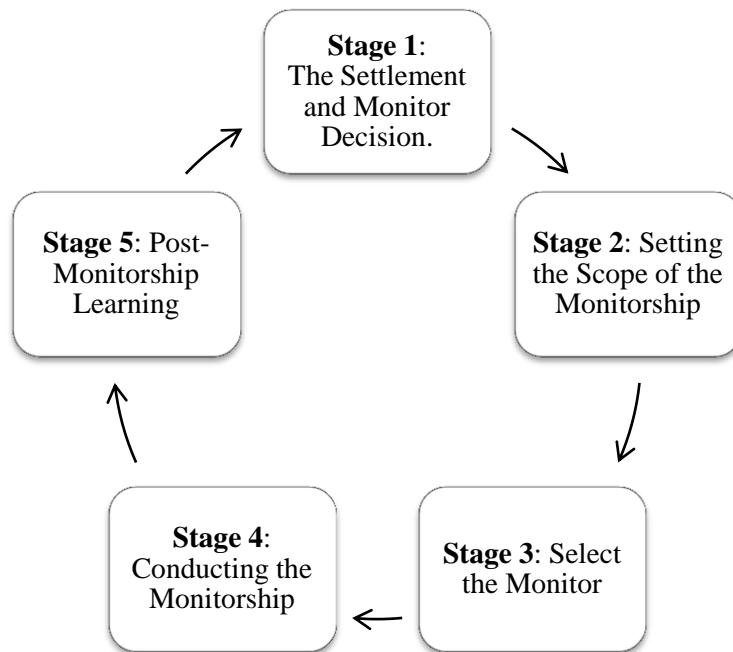
based on the opinions of other monitors, compliance consultants, regulators, and the written documents establishing the monitorships. Despite this limitation, our research approach allows us to point out potential areas where practice may deviate from theory, and lay the groundwork for future research in the monitorship context and other areas of new governance regulation.

Finally, we should note one secondary information source that we encountered after our own interviews were completed, and that gives us greater confidence in our findings. Professor Jayne Barnard investigated the SEC's use of monitorships by conducting eight interviews with SEC enforcement staff and defense attorneys (who were typically former enforcement attorneys) (Barnard 2008). Although she did not interview any monitors and focused only on SEC monitorships, her findings support most of our findings, and her recommendations are generally consistent with ours. Some of those findings are discussed below.

#### *Understanding the Monitorship Process*

To better understand monitorships, we divided the process into five stages: the decision to settle and establish a monitorship, setting the scope of the monitorship, selecting the monitor, conducting the monitorship, and post-monitorship learning (see figure 1). Based on our interviews and our review of the underlying documents available, we found that at each stage of negotiation or implementation of a monitorship, there is the potential for a breakdown in the process. This is especially problematic when problems at early stages of the process place the monitorship on a downward spiral that effectively eliminates any prospect of achieving meaningful reform at the corporation. Although our analysis of each stage (set out next) focuses on the problematic areas, we are not saying that successful monitorships cannot and have not occurred. Our research design does not permit us to make objective, definitive conclusions on the success or failure of monitorships (either individually or as a whole). However, a hypothesis based on our research would be that any positive results are due more to self-motivated individual efforts of monitors and corporate officials, than to a system that can consistently produce positive results over time. Thus, while recognizing the success stories (albeit self-reported by insiders), we focus on the potential problems which give some insight into the difficulties of implementing new governance regulation in practice. This approach provides lessons both for monitorships specifically and for new governance regulation more generally.

Figure 1 below sets out the five stages of the monitorship process.

**Figure 1.****Figure 1. Stages of the Monitorship Process.**

*The Settlement Decision.* The first decision a regulator must make is whether to indict/charge the corporation, agree to a settlement (with or without a monitor), or prosecute only the individuals and not seek punishment for the corporation. Different strategies will be appropriate in different contexts, with monitorships and compliance undertakings being appropriate when the government concludes that the wrongful conduct is due at least in part to the corporation’s culture and/or to a faulty compliance program. The cost of a monitorship is also easier to justify where more pervasive, serious, persistent corporate-level problems are identified.

Although our interviewees consistently agreed on when monitorships should be used, they had mixed opinions on whether or not monitorships were being used appropriately in practice. One of our former prosecutor interviewees explained the decision in terms of the nature and severity of the wrongdoing in question. If the company was, in that interviewee’s words, “rotten to the core”, then it should be criminally indicted or subject to severe regulatory sanctions. If the company’s legal troubles were the result of a few rogue employees or an easily fixed problem with company policies or procedures, then imposing a monitorship (and the costs associated with it) would be unfair and unjustified. Although a settlement agreement may still be

appropriate in these situations, the imposition of a monitor would not. In between these two poles are those corporations that are not “rotten to the core,” but do have significant cultural problems that cannot be fixed by simple technical fixes to compliance programs. These are the cases where a monitor is necessary to assist the corporation in reforming its compliance program and culture, and to provide an independent determination as to whether the company has implemented the changes in the settlement agreement effectively. A former prosecutor interviewee stated, “When the company has committed to all these reforms, it’s just a promise, you can’t change culture overnight. The monitor’s role is to see that there is follow through, the company has committed, the monitor is there to see that it is completed.” Likewise, a monitor interviewee stated:

*So even in a situation in which you have rogue employees or companies or individuals that got the company in trouble, under circumstances by which it didn’t go all the way to the top but there’s a concern that maybe the company was looking the other way because people were more profitable and maybe didn’t pay too close attention or something else. That’s a situation in which it seems to me that the government can say “We just don’t feel comfortable letting this company go. We don’t think their compliance programs are mature enough, we don’t think the management necessarily gets it.”*

That monitor went on to describe a monitorship as a way for the Department of Justice “to get the level of comfort that the corporation had learned its lesson, had implemented vigorous compliance programs, sort of gotten the message and the message was learned all the way throughout the corporation.” Overall, as another monitor stated, the goal is “not to penalize the shareholders for what happened in the past, but to prevent violations in the future.”

Some of our interviewees, however, had concerns that the government’s decision to impose a monitorship on a corporation was becoming a default policy choice. The fear was that government officials were not always considering whether the case at hand was one that could significantly benefit from a monitorship, but instead were seeking to impose a monitorship as a matter of routine. For example, one monitor stated, “I have a little concern that . . . the SEC may be using this tool in cases where it’s not appropriate, where the problem is so narrow, and the company already taken steps, or doesn’t really require monitoring.” Another monitor stated, “I think there has been a tendency for [monitorships] to be the fall back position on many of these cases.” Likewise, Barnard has found that the first draft of a settlement agreement is often prepared by the most junior member of the enforcement team and that attorney typically includes

a “full-service compliance monitor” as a matter of routine (Barnard 2008: 817 ). A third monitor we interviewed pointed out that even when a corporation agrees that the monitorship is inappropriate, the corporation would not strongly challenge the government, because going to trial would not be a “responsible business decision.” Ultimately, this can contribute to complaints that the company had been “coerced” into the monitorship.

To the extent that the corporation perceives the monitor as being unnecessary and simply pushed upon it by the government, the perceived legitimacy of monitorship can be severely damaged. In such a situation, the corporation is less likely to enter the monitorship with the cooperative mindset needed for it to be successful. Oppositely, for those interviewees that thought the monitorship worked well, they attributed that success to buy-in to the monitorship process and trust in the process. For example, one monitor believed he had a productive working relationship with the company because “the government and the company felt that the process was fair and that they benefited from it.” This monitor believed that process was already off to a productive start before he arrived because “the parties concluded that this monitorship was a good solution and my sense is that at the end of the day everybody seemed satisfied that the objectives of aborting criminal prosecution and having a monitorship that helped ensure that the implementation of compliance procedures.”

*The Scope of the Monitorship.* Once the decision to impose a monitorship has been made, the parties must set the terms of the monitorship. In many cases, it seems, the government starts with a very demanding, generic version of a settlement agreement, whose terms are then modified based on the strength of the corporation’s negotiating position (see Barnard 2008). Often, the government begins with a settlement agreement that includes all of the most stringent terms used in other monitorships to date, after which the defense attorneys work to negotiate away some of these terms by emphasizing the changes the company has already made and the amount of money it has already spent on investigations and reforms (Barnard 2008). This can, however, vary significantly based on the government attorney involved. Barnard (2008) found that different attorneys have very different views on the importance of requiring monitors or mandated compliance program changes, and those views are reflected in the final agreement. In addition, Barnard (2008) found that some staff attorneys cared significantly less about the company’s remedial efforts when negotiating the final agreement than they did about what individuals the company had terminated (including individuals the SEC was not planning on

bringing legal action against). Thus, rather than a centralized, consistent policy applied to the facts of the case at hand, the individual government attorney that is assigned to the case can be a strong determinant of the scope of the monitorship. This is important, because all the monitors we interviewed stated that they tried to strictly follow their duties as set out in the agreement. However, as stated below, how they interpreted those duties also varied.

*Selecting the Monitor.* Monitors can be selected in a variety of ways. The government may appoint the monitor, the corporation may select a monitor subject to the government's veto power, or they may develop a system to jointly select a monitor. Regardless of the process used, with striking frequency (especially at the DOJ), the end result was that the monitor chosen was a former prosecutor or other government employee possessing little to no prior experience as a monitor, and no formal training or experience in managing a corporate compliance program. According to the majority of our interviewees, the reason for the significant use of former prosecutors was not conflicts of interest (that is, current prosecutors selecting ex-prosecutors based on personal ties), but perceptions of credibility. The government wants someone it can identify with and believes it can trust, and the corporation wants to ensure its monitor has credibility with the government. Likewise, Barnard (2008: 820-821) found that "well-advised companies know to turn to former SEC or DOJ staffers as their candidates – 'somebody [the staff lawyers] trust.'"

This raises a difficult question about the appropriate qualifications for being a monitor. The monitors and regulators we interviewed thought it was appropriate that monitors should typically be ex-prosecutors now acting as defense attorneys in private practice. Multiple monitors said their role relied heavily on their ability to see things from both the prosecutorial and defense perspectives, and to communicate with both types of audiences. After asserting the intrinsic value of both of these perspectives, one monitor went on to state,

*[y]ou have to mediate between those competing interests and also advocate - that is, to say, persuade - the various interested parties of the wisdom of a given solution. Those are all talents that a lawyer brings to the table, I think, more often than not in a more effective way than a non-lawyer. Those are things lawyers learn, those are things lawyers do.*

By contrast, all of the compliance consultants we interviewed perceived significant potential problems with the current profile of monitors. Overall, they felt that former-prosecutor monitors were unlikely to have the experience or knowledge base necessary to analyze a



corporation's culture or provide advice on how to manage that culture as it relates to the corporation's compliance program. For example, these types of monitors are more inclined to believe that the root causes of wrongdoing within the organization are employee ignorance of laws and corporate policies, as opposed to management pressure to meet performance expectations (see Edwards and Reid 2007). Thus, such monitors may be more likely to focus on auditing internal controls and the content and breadth of training programs, while downplaying cultural issues. Monitors we interviewed generally downplayed these concerns and stated that non-lawyers or those without prosecutorial experience did not have the necessary "legal expertise" or mediating skills. We return to this issue in the following section.

*Conducting the Monitorship.* Overall, we found wide variation in how monitors conducted their work – even where the language of the monitors' settlement agreements was essentially identical (as is likely to occur when enforcement attorneys frequently borrow language, if not the entire agreement, from prior settlement agreements (see Barnard 2008)). Some monitors stated that, regardless of the precise text of their assignment, they had no choice but to consider issues of corporate culture based on what the settlement agreement tasked them with accomplishing. For example, one monitor described his job in the following terms:

*You have to do enough work, interview enough people, sit in on enough of the meetings where [corporate culture] can be observed, talk to people about how they feel about the culture, look at the compliance activities that have occurred and you ultimately form a judgment based upon that data, reviewing that data and come to a conclusion and in this instance.*

Another monitor focused on "tone from the top" as the key part of corporate culture that he was investigating. He stated,

*You need systematic controls that make it difficult for people to violate the law and you also need a very strong tone from the top. . . . If you don't have tone from the top, then all your controls, people will just bypass them and work around them. And if you have tone on the top but you don't have control, then there's always going to be some people that take that tone from the top less seriously and you've got to have ways of deterring them from doing bad things.*

To examine these issues, that particular monitor interviewed people "from the very top to the very bottom" of the organization. Likewise, another monitor described the requirements of his job as follows:

*[The monitor needs] enough of an understanding of the business of the entity to have a sense for where the vulnerabilities are in the system and then obviously to spend enough time with the compliance people and the auditors and the others who are doing risk assessments to get a real sense of how seriously these folks are taking their jobs and to try to also test it out in the field by getting a sense of how comfortable do employees feel that if they have something they've observed and they follow whatever hotline procedures or whatever other procedures at the company that they're going to get a favorable response without retaliation and with the ability for anonymity if they feel the need to have anonymity and that sort of thing.*

Other monitors indicated that, although looking at corporate culture might have been part of the job, it was not the monitor's job to direct the change in corporate culture. One monitor stated that "[I'm] not sure it's the job of the monitor [to change corporate culture]. The job of the monitor is to warn, you know where there's – where there's still a problem in culture, that is what the monitor has to do." He also stated, "I would think it would be arrogant, maybe a little arrogant or presumptuous if I monitored – think you're really going to transform corporate culture." Similarly, another monitors stated,

*I wasn't appointed to change the corporate culture at [the company]. That said, the broad topics that I was there to examine and report on went deeply into the culture and required me to sort of make observations about the culture and about how it influenced the compliance, you know, of the company, and as a consequence, at least, my perception was dealing on almost a daily basis with questions of corporate culture.*

Some monitors did not explicitly consider issues of corporate culture at all. One monitor told us that he focused only on the technical details of the compliance program and internal controls. He did not focus on matters of culture, because he did not believe that culture could be measured or audited, and further, that the phrase had no real meaning. He also stated that evaluating it was beyond his assigned duties. Interestingly, the settlement agreement he was operating under contained very similar language to the monitorship agreements described above, and the press releases announcing that company's settlement agreements specifically attributed the company's problems to a corrupt corporate culture.

Another aspect of the monitor's job is ongoing interaction with company and government officials. With respect to interactions with the government, we saw significant variety in practices. In one case, the settlement agreement required quarterly meetings between the government, the company, and monitor. In other cases, the monitor's only interaction with the

government after the monitorship started was through the filing of reports. In some cases, the monitor stated that the reports were closely read and discussed with the monitor, but in other cases the monitor received little to no feedback on the report.

Other monitors reported levels of interaction between the two extremes of regular, formal meetings versus interaction only through the monitor's report. One monitor stated that he regularly updated the government on what he was doing, but he did not have substantive discussions on the progress of the company. He stated:

*I think at least in our case it was a matter of keeping the government advised about what kinds of activities the monitor was engaged in, how much involvement, how much time and effort was being expended. We did detailed billings which set out our activities, what we were doing, how we were doing it, why we were doing it. They were given both to the company and the government so that the government had a very clear road map of exactly what was being done and how much effort was being put in to the process. But mostly I think that they were observing that for purposes of determining whether or not they thought the monitor was expending sufficient energy and effort at the task to give them the comfort that an effective job is being done and the recommendations would be well informed by the facts.*

Barnard (2008) found that interactions between monitors and SEC was relatively common, but it depended on the prior relationship between the monitor and SEC staff attorneys; that is, "close personal friends" (Barnard 2008: 822) communicated significantly more often than those without a prior relationship.

Likewise, monitor interactions with company officials varied significantly. Although some monitors described their role as being in part "teacher," no monitor described assuming an authoritarian role. For example, one monitor had the impression that the monitor in the WorldCom case (based on public reports filed by the monitor) directed the entire process based on preconceived notions of what the company needed. The monitor we interviewed decided to actively work against that model in developing his own approach, and was very open to the input of those in the company. He qualified his comments by stating,

*But I hasten to add ...that there are times when you've got to say, this is the way it's going to be. When there's a serious problem, or something that really requires immediate attention, or raises very clear ethical issues. Plainly, under those circumstances, you don't wait around or allow the company to take anything less than the completely ethical position on a given issue.*

Other monitors made similar comments about the need to let the company work through its own problems and to step in only to provide comments, not orders, unless the company was not acknowledging or was clearly mismanaging particularly serious problems. A couple of monitors mentioned actively working with the company's Chief Compliance Officer (or similar role) to support that officer's positions within the organization, whether it was attempting to change the minds of the general counsel's office or the board of directors.

*Post-Monitorship.* Figure 1 above describes a continual monitorship process, within which Stage 5 (Post-Monitorship Learning) feeds back to Stage 1 (the Settlement and Monitorship Decision) with respect to a subsequent monitorship. In practice, though, our research suggests that Stage 5 learning may be sparse, and its relationship to a subsequent Stage 1 decision quite tenuous. What happens after a monitorship ends is summarized by the comments of one of our interviewees:

*Maybe it turned out okay, maybe it didn't, maybe nobody knows, because there's nobody out there evaluating these things. And unless a company gets caught doing something improper again nobody may find out whether the deferred prosecution agreement worked or didn't work.*

Our research indicates that once a monitorship ends, essentially no attempt is made to understand its successes and failures as a process, or to shape future monitorships based on that information. Although settlement agreement terms are replicated, the lessons of actual practice are not being captured, particularly among criminal prosecutors. In addition, monitors' reports are rarely made public so that others can attempt to use the information. We hasten to add that our interviewees presented some strong arguments for not making these reports public. Primarily, they believed that confidentiality could help to create a more open environment for communication at the corporation during the monitorship, as individuals would not have to worry about their statements being made public.

#### *Concerns about Monitorships as New Governance Regulation*

Our research was not designed to allow us to draw direct conclusions about what factors support or impede a successful monitorship. Rather, we examine how monitorships operate in practice compared to how new governance theory would propose that monitorships should operate. The deviations between practice and theory seem to be many. Regardless of whatever other purposes monitorships may serve, as implemented so-far in practice, they are ill-equipped

to promote the kind of rich, deliberative, context-specific investigation that new governance suggests can generate meaningful endogenous reform to corporate ethical culture.

Under a new governance approach, monitorships should be carefully crafted to fit the case at hand, monitors should work closely with corporations to not only improve the technical aspects of compliance programs and training exercises but also provide an outsider's independent perspective on all important cultural issues that affect the implementation of compliance programs, and lessons (both positive and negative) should be captured and used to continually improve the design and implementation of monitorships. The above evidence shows a significant potential for breakdowns in this system. For example, in the absence of systematic, explicit, and context-specific methods for designing monitorships, form may trump function. That is, new monitorships could be established based on boilerplate from prior monitorships, with little to no attention to "fit." Alternatively, the same absence of adequate and justifiable specificity could lead to excessive discretion on the part of prosecutors or monitors. Monitorships could be imposed and structured based on the particular beliefs of the government official that happens to be leading the investigation at hand. Setting the scope of the monitorship and defining the monitor's assignment may then be the product of an adversarial negotiation within which prosecutors reflexively seek the harshest terms possible, and the corporation seeks to negotiate away those terms. When it comes to choosing a monitor, one is selected based on credibility with the government rather than a matching of skills with the demands of the situation, which impacts how the monitor carries out the process. Finally, information on specific monitorship outcomes and strategies is not aggregated or analyzed, so cannot be used to improve the process going forward.

The US federal government has taken some steps to improve monitorships, which are consistent with solving some of the potential problems we have identified. In 2009, the Government Accountability Office (GAO) conducted a study of deferred and non-prosecution agreements, including both those with and without monitors, and found evidence of process improvements at the DOJ during that year (GAO 2009). For example, the DOJ implemented a system to centrally track the use of settlement agreements, the terms of the agreements, and the variation between agreements based on the facts of the case. Prior to 2009, the DOJ did not collect any data on the use of DPAs. The GAO observed that data collection would allow the DOJ to accurately report on the number and terms of DPAs to Congress and the public, to

identify best practices, and to ensure consistency across agreements. The GAO also strongly encouraged the DOJ to develop performance measures, which it had not done, in order to gauge the effectiveness of settlement agreements and to support the continuous improvement of DPAs over time. The GAO's suggested performance measures included whether the company continued engaging in the wrongful behavior and how well the company had implemented the terms of the agreement.

The GAO also noted that the DOJ had implemented a more centralized process for selecting monitors. The primary goal of this change was to decrease perceptions of favoritism in monitor selection. However, a more centralized process does not significantly advance our recommendation that monitors be selected based on having a broad and appropriate skill set and not just for their "credibility" with prosecutors. We could make other reform recommendations directed toward fine-tuning the existing system (see Ford and Hess 2009). Here, though, we want to explore the possibility that there may be deeper issues at play that will ultimately influence the success of monitorships, and these are issues that do not have easy fixes. In the next section, by considering subtle sociological characteristics of monitorships-as-implemented, we ask whether these internal reforms will be sufficient for monitorships to reach their full potential in light of the institutional environment in which they operate.

## **Remaining Challenges**

### *The Status Quo Bias*

In a recent article, Professor Miriam Baer challenged the assumptions underlying monitorships, the depiction of monitorships as new governance mechanisms, and the usefulness of corporate compliance programs in general (Baer 2009). In her view, it is not actually possible to embed a new governance style monitorship within the prosecutorial or enforcement context. She argues that because compliance is regulated through a profoundly adversarial, "quasi-adjudicative" system that pits prosecutors against defense counsel, there is no opportunity for the experimental, information-based, collaborative structure that monitorships envision. Moreover, there is little possibility that a new governance regulatory style will ever take hold in that environment.

Although Professor Baer's work does not engage directly with the empirical results we describe here, her argument and our observations about how many monitorships are functioning well in practice are not necessarily at odds. Like her, we recognize the torque that the adversarial environment puts on monitorships (though unlike her, we do not see the problem as insurmountable, and we see the motivating effect of enforcement action as potentially positive.) We probably put more stock in the fact that some monitorships do produce good outcomes, at least according to self-reports of the monitors we interviewed, if for no other reason than that this shows it is possible for individual monitors to transcend the adversarial background relationship that appointed them.

Along with us, Baer is concerned about the relationships between the prosecutor, the corporation, and the monitor. Interestingly, however, our largest worry about the impact of this relationship on the success of monitorships is almost the mirror image of hers. In her view, irreducible adversarialism makes the prospects for new governance monitorships dim. These concerns are supported by the comments of one monitor we interviewed who thought that giving the government too much power in a monitorship to bring additional charges, for example, based on what a monitor had learned, could harm the process by reducing trust. According to that interviewee, a monitorship needed to operate in a space outside of direct enforcement involvement because that is required to allow the company and the monitor to communicate frankly and work through problematic issues. The specter of renewed enforcement staff presence jeopardizes the trust that is essential to that process.

Our primary concern, however, is not with excessive prosecutorial/enforcement overhang, but with not enough ambition in the process to induce real change in corporations. Rather than sharing too little ground, we are concerned that monitors, prosecutors, and subject corporations' executives share too much. We are concerned that monitorships are embedded in a regulatory environment that is not actually designed to significantly destabilize the status quo. Enforcement actions against corporations that have compromised ethical cultures should be designed to be destabilizing. Yet, there is a real risk that monitorships can become "closed shops." That is, the participants share a fundamental unity of interest around keeping the monitorship project and the corporation's rehabilitation moving ahead smoothly, without the fundamental reform of a corporation envisioned by monitorships in theory. In many cases, it seems that none of the parties involved—the corporation, the government agency, or the

monitor— has an incentive to drive the monitorship beyond technical fixes and good optics for the sake of external stakeholders, and toward something more profound, uncertain, and unpredictable (in the way that real, open-ended dialogue and root analysis can be).

Note that we are not making an explicit capture argument here (though there may be some of that). We are making a microsociological, implementation-level claim. Although there will be exceptions, our concern is that the parties may share interests that lead to the creation of an underambitious system of monitorships. The corporation naturally wants to retain as much freedom as possible and it will push the government and the monitor to devise and implement as limited a monitorship as possible. It is helped in its case by the argument that unaccountable monitors should not be permitted to “run amok” through a public company’s internal operations at shareholders’ expense. Within the existing monitorship paradigm, monitors may not provide significant push-back against the corporation’s limited interpretation of their monitorship mandate, because they may be disposed to view the corporation as their “client.” This view may arise from the close working relationship that develops over time, the corporation’s role in selecting that monitor in certain cases, and the monitor’s background as a corporate defense attorney in private practice (which is a common career move for former prosecutors). Finally, government enforcers – especially on the criminal side – may be more focused on closing their file and moving on to the next case, rather than pushing the monitor to dig deeper into the workings of the corporation. Thus, there is a significant difference between reaching (and then publicizing) the settlement agreement, and actually ensuring the monitorship as implemented is capable of having a lasting positive effect on corporate ethical culture. Prosecutors may not even be the right people to oversee monitorships, as prosecutors hire monitors precisely because they do not have the skills or bandwidth to do it themselves. They may not even know the right questions to ask to verify performance. The end result is the strong likelihood of low ambition monitorships focused on technical compliance with policy and procedure requirements.

We discussed monitors’ skill sets, above, and the compliance consultants’ complaint that former prosecutors are ill-equipped to act as effective monitors. We recognize that professional competition may play a role in the compliance consultants’ assessment (Siporin 1978). Yet we are inclined to take the critique seriously given the long experience of the particular consultants we spoke with, and the general high regard in which these individuals are held. We are also



concerned about a separate way in which former prosecutors' relationships and affinity exert effects on monitors' capacity to act as meaningful change agents.

As discussed further below, former prosecutors tend to be chosen to be monitors not primarily because of intrinsic conflicts of interest, or regulatory/prosecutorial capture. Instead, they are chosen because of the perception that credibility with agency staff attorneys – which includes trust and a background in the same professional culture – is an essential job requirement. Virtually by definition, this puts something of a conformist spin on the monitorship's trajectory.

It is noteworthy that monitors describe themselves as meaningfully straddling boundaries and bridging divides because they can speak from within both the prosecutorial and defense bar perspectives. These can be significantly different perspectives, but both are legal perspectives. An additional job requirement, but one that further narrows the pool of candidates, is the ability to speak the language of business. This includes having credibility with business people (something that monitors may find themselves anxious to demonstrate) and sharing a value system that supports the social good that corporations generate. It also includes a desire to maintain control over the cost of the monitorship and “add value” to that corporation. As an end result, the monitorships are not open to new perspectives and destabilizing change.

Other factors also impact this bias towards the status quo. We were struck by one interviewee's confidence, almost insistence, in telling us about how a certain agency develops its monitorships based directly on prior monitorship templates. Like most, this monitor was a former prosecutor now engaged in corporate defense work at a large firm. In interviewing him, we had the sense that his understanding of the internal workings of that agency – including his personal acquaintance with key individuals and his stated knowledge of their intentions – was a source of professional pride for him, and that it had some currency in his present work environment. This makes sense: talented former prosecutors are often hired by large firms precisely because they possess this knowledge.

The potential consequence, though, is that individuals like the one we interviewed, once they have left the prosecutor's office, may develop a vested interest in preserving the value of their inside knowledge (Crano 1995; Giacalone and Paul Rosenfield 1989), even as their firsthand experience of it recedes into the past. They may become more likely to resist change,

more inclined to downplay change they see, and even inclined to rhetorically overstate how certain and entrenched practices were in their prosecutorial office when they were there, in order to ratchet up the significance of their insider knowledge. An individual in this position may perceive that he or she has more to gain from knowing how that office works, than in interrogating the merits of its approach. In concrete terms, in the monitorship situation, this could translate into a resistance to helping to tailor monitorships to suit particular contexts, if that would undermine the force of one's inside knowledge about prosecutorial process. (It also reminds us that what we learn about institutional process through interviews is necessarily filtered through the lens of our interviewees.) The result may be that, as a function of their very interpositioning between prosecutorial and defense bar, the individuals most likely to be chosen as monitors may also be among the least likely to push the boundaries of the structure's potential. What this suggests is a potentially wicked tension between credibility or perceived expertise, and thoroughgoing reform.

The problems of deep affinity, and a substantial shared preference for the status quo on the part of all the parties to a monitorship, also shows in the two further areas discussed below. The first we have already touched upon and is the selection of monitors based above all on their credibility with a particular in-group set of prosecutors, and their possession of a particular, narrow set of background experiences and skills. The second way in which the ultimately conservative nature of monitorships manifests itself is in the surprising failure of prosecutors to gather meaningful data about monitorships, analyze them, develop performance measures, or otherwise try to build a regulatory structure outward from the monitorship environment. Monitorships have become a central part of a prosecutor's tool kit, but they are still at an ad hoc and under-analyzed stage of development. This suggests, at best, considerable regulatory distraction. These specific problems may also help to shed light on the stress points for the effective implementation of new governance regulatory approaches generally. Understanding the parties' deep incentives is essential to understanding how and whether any new governance monitorship structure could actually be operationalized.

*Monitor Selection: Credibility, Insularity, and Expertise*

One of our monitors told us that ultimately, successful monitorships were a function of a monitor's hard-to-duplicate personal characteristics. We were told that it may be "impossible for

monitorships to be institutionalized” because “[t]he kind of self-restraint, the kind of self-critical analysis, the kind of self-discipline that you need to be a monitor is very, very, very unusual and there’s nothing that really prepares you for it.” We do not dispute that an exceptionally talented person can, and probably often does, make the difference. Unfortunately, it is difficult to predict in advance whether a particular person will have the qualities that will make him or her effective as a monitor. Moreover, from a regulatory design perspective, this personal perspective is unsatisfactory because it suggests that successes may not be replicable and that learning cannot be transferred.

We are inclined toward a skills-based, rather than personal, account of the successful monitor. We believe that we can identify attributes, experiences, and training that are helpful for the monitorship role. As an initial step for reform, the monitor selection criteria should focus more on the appropriate skills that a monitor brings to the monitorship, and less on notions of credibility. In this area, there are significant insights to be derived from Susan Sturm’s work on institutional intermediaries (Sturm 2006). Sturm emphasizes the need to identify those individuals that have credibility within multiple fields (in her case, in science and gender equity) yet that still have sufficient counterweight allegiances to resist being pulled in by the organization’s worldview. In one sense, measuring skills in purely legal experience terms, the monitors that are being chosen by the DOJ and SEC are the ones that ought to have these dual-world attributes already. They have prosecutorial and defense experience and therefore have credibility with both regulators and firms. The problem is that they may lack the broader skill set that a compliance expert would bring, and that a particular monitorship may call for.

The open issue is whether our proposal to re-examine monitor selection criteria could ever gain traction, or whether this tendency for credibility to trump competency is an inevitable byproduct of the enforcement environment – or perhaps the white collar and financial regulatory environment. As some of our interviewees stated in response to questions about why so many monitors are former prosecutors:

*... [I]f you are the company looking to retain somebody, you want to have somebody that the regulator is going to view as a credible force. ... [Y]ou sort of only have one shot at it and you want a household name about whose integrity no one is going to call to question ...*

Similarly, another interviewee stated:

*I think the comfort level that the government might have in the monitor is important not only to the government but the more credibility the monitor has with the government the better off the company can be too because if the company has a monitor who has done an effective job and has made recommendations that are going to be received and accepted by the government, that's good for all concerned.*

Identifying a structural fix – ensuring that monitors with appropriate skills are selected – does not respond to the problem that, in the enforcement environment, the overriding priority is that the monitor has sufficient credibility and gravitas, as those terms are understood within that milieu. This is the priority for both the firm (which, as our interviewee noted above, has only “one shot” at it), and the regulator (which is not in a position to conduct a substantive review of the monitor’s work). When we think about what a truly effective institutional intermediary might look like in this enforcement environment, then, we find it difficult to move past some precarious combination of the existing monitors’ background, *plus* expertise in corporate compliance, root cause analysis and dialogue facilitation, *plus* maybe even the kind of bedrock personal characteristics that our monitor interviewee referred to above.

Even if we could find such people, this pushes us to an expertise-based, in-group oriented approach. The problem is exacerbated by embeddedness within an enforcement environment. Our interviewees told us that in order to be effective, monitors had to be credible with prosecutors and firms. This required that they have the background qualifications and expertise in business and law (and sometimes even specific to the relevant industry). While this makes sense, it significantly narrows the range of experiences and perspectives that are introduced into the process. Being lawyers, these monitors may be less likely to recognize organizational cultural issues and be less well equipped to respond to them. Our view, by contrast, is that organizational culture is a prime determinant of organizational misconduct. Being former prosecutors, they are members of a particular professional culture, and a professional community that intersects and overlaps in multiple ways (including through “revolving door” employment relationships) with the lawyers that represent the firms they prosecute.

Some of the monitorships we looked at seemed based on the assumption that public companies and financial firms were key contributors to social welfare who, ultimately, did not need not be scrutinized to the degree that racketeer-influenced unions (an earlier subject of monitorships and a precursor to current corporate monitorships) did. It is relevant that we

conducted our interviews in summer 2008, before the financial crisis reached its zenith. Viewing monitorships in the wake of what the financial crisis has taught us about the pathologies in financial and banking regulation internationally, however, makes us somewhat more sympathetic to the view that DPAs and analogous regulatory settlements are (at least somewhat unconsciously, in our view) “soft landings” for a privileged set of large corporations and financial firms. Interestingly, one lesson that we may ultimately draw from the global financial crisis is how catastrophic the effects of this kind of insular regulatory method can be when operating on an industry-wide, or even economies-wide, scale. The financial crisis has multiple direct and indirect causes. Without signing onto the angry populism characterizing some current perspectives, it does seem that industry’s confidence in self-regulation, combined with the failure of regulators to approach industry’s self-account with the requisite degree of skepticism and independent-mindedness, is part of the story of the financial crisis. Similar cultural patterns – monitors’ adoption of the value-oriented language of business, regulators’ and prosecutors’ failure to build adequate accountability and verification mechanisms into their responsibilities – seem to underlie monitorships’ structural shortcomings as catalysts of reform.

What monitorships and the recent financial crisis both demonstrate is that one should not underestimate the tendency of systems to perpetuate themselves. Disentrenchment is difficult, and contingent. Even with the architecture of reform that a monitorship puts around a change process, monitorships can fall victim to subtle, even unconscious, undermining by precisely those actors who might otherwise be in a position to force real destabilization. There is more to creating deep systemic change than building a system that has the potential to do so. No matter how promising that system in theory, resistant subcultures can thwart effective change (Gunningham and Sinclair 2009). This is as true of regulators, and of monitorships, as it is of corporate ethical cultures. It is potentially as true of new governance and its sister forms of regulation as it is of monitorships in particular.

#### *Lack of a System of Learning-Based Monitorships*

The tendency of monitorships to favor the status quo is also manifest in what regulators do with the information being generated by them. Theoretically, the specter of a renewed prosecution or other enforcement action remains in the background when a settlement-based monitorship is imposed, and it keeps the monitorship credible. As we discuss above, this will

not be a real threat where monitors' reports are not subject to meaningful scrutiny and corporations do not "fail" their monitorships at the end of the agreement's term. It is not wrong to suggest that regulators need to wield a credible "big stick" to ensure that monitorships are more than a cosmetic exercise. Regulators are the ones with the ultimate responsibility for ensuring that these projects are effective. Moreover, even if they do not have the ideal expertise for performing this role, their capacity to scrutinize monitorships would be significantly augmented if they engaged in the kinds of comparative information analytics that new governance theory argues for.

The lessons of monitorships' successes and failures must be collected and reflected back to other monitors if anything more than ad hoc improvement over time is to be expected. Monitors' forensic work on failed compliance programs could also help improve compliance practice at corporations across the board. This is valuable information that should be used by the government in structuring and operating monitorships in the future, but should also be available to monitors, who currently have to develop their monitorship approach from scratch.

Learning from monitorships also calls for a new regulatory and prosecutorial orientation, around information as a central driver of enforcement policy. Compared to the risk regulation of structured financial products, for example, analyzing monitorships is not especially difficult or complex. However, it does require a capacity and attention that – as the GAO pointed out – the DOJ in particular has not given to monitorships until recently. Monitorships will not amount to new governance learning-by-doing methods if the regulator has not developed the structures necessary to draw information out of the discrete monitorship situations and into its larger analytical and regulatory processes (Ford 2010). The fact that monitorships appoint an independent third party to conduct the monitorship itself does not automatically mean that fewer regulatory resources are needed. On the contrary, substantially more and more sophisticated analytical resources may be called for. Currently, neither prosecutors/enforcement staffers nor judges possess the skill set to make the kinds of assessments required.

However, this leaves unanswered some difficult questions about regulatory expertise and the "soft" judgments that have to be made around compliance in the first place. Corporate culture in particular (as opposed to structural compliance) is difficult to measure and often significantly organization-specific. Without discounting the value of expertise in corporate

compliance and governance in appointed monitors, the fact remains that problems of corporate ethical culture are internal problems, and changing them requires an endogenous shift. A monitorship is an expertise-based intervention aimed at promoting more lasting, internal change. Given how slippery culture can be, and how circumscribed monitorships currently seem to be, we should perhaps be considering whether monitorships need to be *broadened*, in terms of concept and participation, in order to be effective.

Specifically, what we originally envisioned as a prosecutorial decision to delegate “soft” and difficult assessments of corporate cultural factors to a monitor, on the basis that the prosecutor did not possess the necessary skills, mindset, or capacity, has turned out to be a prosecutorial decision to delegate this kind of work to other people that are very much like the prosecutors themselves. This may partially explain the lack of post-monitorship follow up and learning. A prosecutor that has delegated an assignment to someone very much like herself will not feel compelled, or even necessarily comfortable about, second guessing that work product once finished. Softer questions of corporate culture, which might require more careful and more long term analysis, are beyond both the scope of the monitor’s report and to some degree the prosecutor’s own analytical frame. The fact that the monitor’s report then predictably focuses on concrete and legalistic outputs, such as new training programs, amounts to a form of “trained incapacity” (Veblen 1914) that reinforces the shared legal culture and makes it even more difficult than before to talk about hard notions of culture.

We may be able to ratchet up the capacity of current players in the monitorship process by establishing monitorship oversight mechanisms that involve a larger group of stakeholders. One promising option, proposed by Christine Parker during the workshop that catalyzed this volume, would be to involve something along the lines of Michael Dorf’s and Jeff Fagan’s “problem-solving courts” in monitorship oversight (Parker 2009, Dorf and Fagan 2003). In Parker’s view, at the heart of negotiated settlements like monitorships (as well as at the broader heart of what Jacint Jordana and David Levi-Faur have described as “regulatory capitalism”: Jordana and Levi-Faur 2004<sup>8</sup>) is a tension between the individualized, flexible and often private negotiation of solutions to business wrongdoing, and the legitimate public interest in what solutions are negotiated and how effectively they bring policy goals and values into business. Consistent with our findings, Parker identifies a disjunction between the kinds of institutions and practices currently available, and what regulatory capitalism demands as measured against its

own theoretical ideal. Like new governance, what regulatory capitalism demands are public institutions that can engage business firms in true negotiated settlement processes with their communities. She proposes that, rather than relying on traditional courts to oversee negotiated settlements, what the theory demands are more participatory ‘problem-solving courts’. This represents a move away from a controlled, expertise-based model and toward a more participatory one. It is a process – starkly different from the status quo – that puts the participatory, dialogic elements of new governance at the center of its method. For firms with the worst organizational culture problems, in light of the DOJ’s failure to make monitorships deeply effective, we should consider the possibility that opening the process up to this form of oversight will spur reform and accountability that is currently somewhat wobbly.

Using problem-solving courts to assess monitorships is a well-reasoned response to a problem that we recognize in very similar terms, but we want to suggest that increased public participation and a more dialogic method in monitorship oversight could take any number of forms. Another possibility, put forward by Rosabeth Moss Kanter and Rakesh Khurana of Harvard Business School, would be for a South African style truth and reconciliation commission (Kanter and Khurana 2009). Kanter and Khurana proposed a Financial Truth and Reconciliation Commission be established to deal with the aftereffects of the financial crisis, including populist rage and its negative side effects for market and consumer confidence. They see a Truth and Reconciliation Commission model as a process based on sharing narratives, local level reconciliation efforts, and public financial education “that can engage a large portion of the population in the search for truth and a basis for trust”.

Given the serious risks associated with the truth and reconciliation commission proposal in particular, however, and its certain unpopularity with corporations, we would be chary about endorsing it except as a deterrent “penalty default” (Karkkainen 2003) that firms and monitors would work hard to avoid. However, the benefits of introducing a more participatory, dialogic process might include that it has the potential to be profoundly destabilizing and to activate endogenous self-examination and change; it meaningfully recognizes who the stakeholders are in the modern firm; and it broadens the range of perspectives and amount of information available, to create better decisions and greater perceived legitimacy. Especially if the in-groupness of the worlds of white collar and securities law is a primary concern—and this world will include



judges, as well as the prosecutors and defense counsel from whose ranks they are elevated — problem-solving courts and truth and reconciliation commissions hold considerable appeal.

Clearly, proposals to bridge the gap between the participatory, open-ended processes envisioned by new governance theory and the exigencies of practical regulatory settlements face considerable challenges. We are not suggesting that monitorships are beyond fixing, or that more participatory oversight processes of any stripe would necessarily be more accountable than monitorships in their current iterations; only that we should not automatically rule out more participatory measures as “backstops”. In general, public process would be more logistically difficult than closed ones. Even if we see the public process as a deterrent penalty default to be used in only the most desperate circumstances, the public process would have to be insulated enough from civil liability that a dialogic process was possible. Otherwise, it could become just another forum for adversarialism, opportunism, and cosmetic compliance. Prosecutors, companies, and monitors may find themselves even more unwilling to make the monitorship process a challenging one if civil liability loomed to this degree. In the context of principles-based securities regulation, one commentator suggested that open, principles-based regulatory structures would not function well in American securities regulation because of that national system’s heavy reliance on *ex post* enforcement and civil liability (Wallison 2007). To the extent that monitorships also try to create an open-ended process in the context of an enforcement-oriented environment, they may be subject to the same limits. More public processes, whether they look like problem-solving courts or truth and reconciliation commissions, would not be immune from contagion from the effects of sweeping civil liability. In other words, we should be mindful that, just like monitorships, more open-ended and dialogic processes generally may risk being downgraded to less ambitious models because of underlying cultural factors, including the fear of liability, that are external to their regulatory design.

## **Conclusion**

Our research shows how monitorships in practice are at serious risk of amounting to less ambitious interventions than was hoped for by many proponents and feared by many critics. As compared to the theoretical ideal of a new governance process, many monitorships were not primarily directed toward ongoing problem-solving, or built around highly participatory and

carefully structured dialogue. Regulators and prosecutors did not employ reason-giving, transparent processes, benchmarking and outcome analysis, or structured processes for sharing information. These learning mechanisms did not appear to be sufficiently built into the regulatory structures around monitorships. These monitorships did not push individual corporations to improve their outcomes by comparison to the (aggregated and confidentiality-protecting) experience of others. Prosecutors typically maintained the most minimal oversight role. They failed to develop adequate data analytical capacity, to generate useful information, or to follow up. This essay tries to identify some of the significant, if subtle, microsociological forces contributing to the basic conservatism of the monitorship model as practiced.

An initial reaction may be that monitorships have turned out not to actually be new governance structures at all. Certainly, as implemented, they are not perfect examples of new governance methods. To portray the results of our research as a game-ending conceptual challenge to new governance itself would be to mischaracterize it. Yet, in spite of the distance between theory and effective implementation, is still useful to discuss monitorships through a new governance lens. The concerns listed above do not lead us to completely abandon the monitorship project, for the same reason that we do not abandon imperfect new governance efforts: the lack of alternatives. We continue to see a place for (and the possibility of) an improved monitorship structure in white collar and financial regulation. The existing alternatives—blunt sanctions and credit-for-cooperation schemes—were not previously and are still not satisfactory responses to the challenges of corporate ethical culture that, we believe, was a strong argument for the use of monitorships in the first place.

This paper tries to shed light on the sociological and institutional forces that contributed to the underambitious nature of corporate monitorships. Improving real-life regulation requires engaging with and learning from the half measures, near misses, and failures (especially recurring or similar ones) that hint at the aspects of the model that are hardest to implement in light of any particular context. In order to make new governance an effective approach, we must continue to learn about which elements are indispensable and, just as importantly, how to ensure they are in place given the particular conditions in a specific regulatory environment.

The fact that incremental decisions taken at every stage (see figure 1) of many monitorships degraded their ability to destabilize the status quo sheds light on deeper problems

related to the insularity of the group that administers the white collar and financial regulation regime in the United States in particular. Under these conditions – the absence of a diverse set of voices, the centrality of esoteric knowledge and membership in a small professional community, an underlying desire to avoid significantly destabilizing public companies – we cannot be confident that meaningful monitorships, or meaningful new governance initiatives of any sort, will result on their own. The relative absence of alternative, challenging perspectives within the regulatory conversation also compromises the quality of decisions. Compensatory strategies, including perhaps problem-solving courts or other more public mechanisms for overseeing monitorships, need to be developed to address those conditions directly. But problems of power and access are not unique to new governance, and they do not go away if new governance goes away. Understanding how new governance initiatives will play out within the dynamics and institutional processes of particular regulatory regimes is an essential step in making new governance an effective tool for regulatory design.

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<sup>2</sup> For the purposes of this article, our reference to DPAs refers to both deferred prosecution agreements and non-prosecution agreements.

<sup>3</sup> Or, in Australia, “enforceable undertakings” (Parker 2003).

<sup>4</sup> For an overview, see generally, (Greenblum 2005); (Orland 2006); (O’Hare 2006); and (Garrett 2007).

<sup>5</sup> For a discussion of similar factors, see (Treviño, *et al.* 1999); see also ETHICS RESOURCE CENTER (2007) (stating that “four elements shape ethical culture: ethical leadership, supervisor reinforcement, peer commitment to ethics, and embedded ethical values”).

<sup>6</sup> Thus, use of the term “monitor” is perhaps misleading. A monitor is not an extension of the government, but should function as a team member. Likewise, the use of the term “independent consultant” (a term often used by the SEC), may also be misleading, as the monitor is a team member with real powers, as not simply a provider of recommendations that the corporation may or may not use at its discretion.

<sup>7</sup> Having monitors with information collection skills is important because to make monitorships effective as a broader regulatory strategy, the regulator also needs the ability to centrally aggregate the data coming from discrete monitorships in order to make risk assessment and outcome evaluation possible.

<sup>8</sup> Regulatory capitalism is a separate concept from new governance, but the two share commitments to collaborative, problem-solving, broadly participatory and non-hierarchical governance methods; transparency, accountability, and reason-giving as policy priorities at the regulatory level, endogenous learning and firm responsibility for its own reform, though underpinned by public consequences; and the establishment of learning mechanisms in place at both firm and regulator. (See Parker, 2010.)