2007

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Citation Details

David Hess & Cristie Ford, "Corporate Corruption and Reform Undertakings: A New Approach to an Old Problem" ([forthcoming in 2007]) 41 Cornell Int'l LJ 307.

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Forthcoming: *Cornell International Law Journal*

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CORPORATE CORRUPTION AND REFORM UNDERTAKINGS: A NEW APPROACH TO AN OLD PROBLEM

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I. Introduction

In 2007 the Foreign Corrupt Practices Act (FCPA) saw its thirtieth anniversary.[1] Although its first twenty-five years were relatively quiet, the same cannot be said for its last five years. In the current post-Enron, Sarbanes-Oxley Act (SOX) era, [2] the Securities Exchange Commission (SEC) and the Department of Justice (DOJ) have dramatically increased civil and criminal enforcement of the FCPA.[3] Not only is the number of cases being bought by these agencies increasing, the DOJ is starting to utilize novel theories of liability to prevent corrupt corporations from avoiding prosecution.[4] The increase in enforcement actions has been accompanied by record fines and intrusive settlement agreements.[5] For example, in 2007, Baker Hughes Incorporated—a supplier of oil field equipment—signed agreements with the DOJ and SEC in which the company admitted paying over $4 million in bribes to officials of a state-owned oil company in

[1]Foreign Corrupt Practices Act of 1977 (codified as amended at 15 U.S.C. § 78).

[2] For a review of the corporate scandals of 2001—including Enron, WorldCom, and others—and the legislative response of the Sarbanes-Oxley Act, *see generally* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work),* 35 CONN. L. REV. 915 (2003).

[3] *See* Justin F. Marceau, *A Little Less Conversation, A Little More Action: Evaluating and Forecasting the Trend of More Frequent and Severe Prosecutions Under the Foreign Corrupt Practices Act*, 12 FORDHAM J. CORP. & FIN. L. 285, 285 (2007) (noting that "the Department of Justice has initiated four times more prosecutions over the last five years than over the previous five years"); Danforth Newcomb*, FCPA Digest of Cases and Review Releases Relating to Bribes to Foreign Officials under the Foreign Corrupt Practices Act of 1977 (as of June 26, 2007)* 2 (2007) available at http://www.shearman.com/publications (stating that "One of the most important recent trends in FCPA enforcement is the increased aggressiveness of government enforcement of the FCPA. Both the DOJ and the SEC have become increasingly aggressive in pursuing potential FCPA violations. ")

[4] *See* Marceau, *supra* note 3, at 296-309 (describing ways the DOJ has expanded the reach of the FCPA through theories of liability applicable to parent companies, franchisors, successor companies, and others); John P. Giraudo, *Charitable Contributions and the FCPA: Schering Plough and the Increasing Scope of SEC Enforcement*, 61 BUS. LAWYER 135, 135-36 (2005) (discussing Schering Plough's 2004 settlement with the SEC, which is the first time that an FCPA violation was based on charitable donations and demonstrates the SEC willingness to bring actions against parent companies for actions committed by a subsidiary without the knowledge of the parent).

[5] Newcomb, *supra* note 3, at 3.

Kazakhstan.[6] As part of the agreements, Baker Hughes was required to pay over $44 million in fines and penalties—the largest monetary sum to date with respect to FCPA violations—and retain an independent monitor to oversee its implementation of a compliance program.[7] Similar settlements with independent monitor requirements were reached with other companies, such as Monsanto for bribing an Indonesian official to ease environmental regulatory requirements on its genetically modified agricultural products,[8] Schnitzer Steel for its wholly-owned subsidiary paying bribes in China and Korea to induce purchases of scrap steel,[9] and Micrus Corporation for paying bribes to doctors in Germany, Spain, France, and Turkey, to sell medical devices.[10]

These enforcement developments are not without controversy. Some commentators question the harsh punishments imposed on corporations that have self-disclosed violations of the FCPA and taken remedial actions. [11] Schnitzer Steel Industries, for example, discovered possible corrupt payments by its subsidiaries and then engaged in what the DOJ referred to as "exceptional cooperation" by disclosing the payments and

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[6] Department of Justice Press Release, *Baker Hughes Subsidiary Pleads Guilty to Bribing Kazakh Official and Agrees to Pay $11 Million Criminal Fine as Part of Largest Combined Sanction Ever Imposed in FCPA Case*, April 7, 2007, available at http://www.usdoj.gov/opa/pr/2007/April/07_crm_296.html. In addition, the SEC complaint alleged that Baker Hughes violated provisions of the FCPA with its actions in Nigeria, Angola, Indonesia, Russia, Uzbekistan, and Kazakhstan. *SEC v. Baker Hughes Incorporated and Roy Fearnley*, Civil Action No. H-07-1408, Litigation Release No. 20094, April 26, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20094.htm.

[7] Department of Justice Press Release, *Baker Hughes*, *supra* note 6.

[8] Department of Justice Press Release, *Monsanto Company Charged With Bribing Indonesian Government Official: Prosecution Deferred For Three Years*, January 6, 2005, available at http://www.usdoj.gov/opa/pr/2005/January/05_crm_008.htm.

[9] Department of Justice Press Release, *Schnitzer Steel Industries Inc.'s Subsidiary Pleads Guilty to Foreign Bribes and Agrees to Pay a $7.5 million fine*, October 16, 2006, available at http://www.usdoj.gov/criminal/pr/press_releases/2006/10/2006_4809_10-16-06schnitzerfraud.pdf.

[10] Department of Justice Press Release, *Micrus Corporation Enters Into Agreement to Resolve Potential Foreign Corrupt Practices Act Liability*, March 2, 2005, available at http://www.usdoj.gov/opa/pr/2005/March/05_crm_090.htm.

[11] Michael Freedman, *Trust Us: U.S. authorities say American and U.S.-listed companies that turn themselves in for overseas corruption will get leniency. If you believe that ...,* Forbes, Dec. 25, 2006, at 132.

then taking actions to improve its compliance program.[12] Despite these efforts, commentators complained that Schnitzer Steel received no real benefit from cooperation as the company was still required to pay large fines and had to enter a deferred prosecution agreement (DPA) with an independent monitor requirement.[13]

In FCPA actions, as well as other criminal and regulatory matters,[14] it is the growing use of DPAs that are creating the most controversy.[15] In general, there are concerns of prosecutors abusing their powerful bargaining position to extract overly-intrusive—and in some cases what are perceived as arbitrary—terms. [16] In addition, commentators bemoan the costs of implementing a compliance program that meets government demands and the required use of corporate monitors without clearly defined

[12] Department of Justice Press Release, *Schnitzer Steel, supra* note 9.

[13] Freedman, *supra* 11, at 132. *See generally* Joan McPhee, *Deferred Prosecution Agreements: Ray of Hope or Guilty Plea by Another Name*, 30 CHAMPION 12, 13-14 (2006) (arguing that DPAs are not always much of an improvement over a guilty plea, as the company may still be required to admit wrongdoing, the size of the fine may be the same, and the company often has to agree to highly intrusive government terms regarding compliance programs and corporate monitors).

[14] For our purposes, because FCPA violations are enforced by both the DOJ and the SEC, our discussion of DPAs also includes settlements with the SEC, which often contain similar terms with respect to the implementation of compliance programs and the use of corporate monitors. For an overview of SEC actions in this area, *see generally* Jennifer O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, 1 BROOK. J. CORP. FIN. & COM. L. 89 (2006). Although there are differences between the civil and criminal contexts, for purposes of this paper they are considered together.

[15] Under a deferred prosecution agreement, the prosecutor files an indictment against the corporation but agrees to defer prosecuting the charges if the corporation agrees to certain undertakings, such as admission of wrongdoing and rehabilitating itself through the implementation of a compliance program. Benjamin M. Greenblum, *Note: What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1864 (2005). If at the end of the term of the agreement the prosecutor determines that the company has not breach the agreement, then the prosecutor will dismiss the indictment. Id. Nonprosecution agreements (NPAs) are very similar, with the main difference being that an indictment is not actually filed. Id. at 1872 n.60. For overviews of the use of DPAs and NPAs and their development over time, *see generally*, Leonard Orland, *The Transformation of Corporate Criminal Law*, 1 BROOK. J. CORP. FIN. & COM. L. 45 (2006). For an in-depth case study of Bristol-Myers Squibb's DPA from the prosecutor's perspective, see Christopher J. Christie & Robert M. Hanna, *A Push Down The Road Of Good Corporate Citizenship: The Deferred Prosecution Agreement Between The U.S. Attorney For The District Of New Jersey And Bristol-Myers Squibb Co.*, 43 AM. CRIM. L. REV. 1043(2006).

[16] McPhee, *supra* note 13, at 14 (providing examples of DPA terms "requiring Bristol-Myers Squibb to endow a chair in business ethics at the law school from which the federal prosecutor received his law degree or requiring MCI WorldCom to "use good faith and reasonable commercial efforts" to add 1,600 employees to its workforce in Oklahoma").

powers that can potentially take actions that harm shareholder interests.[17] Others, however, claim that DPAs are too lenient on corporations and result in "crime without conviction."[18]

This article takes a closer looker at the use of DPAs, and in particular, the use of corporate monitors in combating corruption. To understand the usefulness of this approach and suggest reforms to the process, this article situates the use of DPAs within the emerging category of regulation referred to as "New Governance" regulation. A key feature of this form of regulation is that the government agency sets policy goals, but then relies on the regulated entity to develop implementation techniques.[19] The foundation of this approach is based on the recognition that effective regulation often requires the utilization of local knowledge to determine what works in that context.[20]

The New Governance approach is necessary for combating corrupt payments by corporations because the root cause of the wrongful conduct is the corporation's culture. One of the main problems in the FCPA context is the fit between the challenge presented, and the solutions available to prosecutors and enforcers. Prosecutors and enforcers acting on their own have neither the resources nor the mandate to engage in the kind of large-scale, ongoing interventions into corporations' corporate governance, culture, policies, and procedures, that would be required to really address deep-seated corporate cultural

[17] O'Hare, *supra* note 14, at 102-106; Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 Mich. L. Rev. 1713, 1735-37 (2007).

[18] CORPORATE CRIME REPORTER, CRIME WITHOUT CONVICTION: THE RISE OF DEFERRED AND NON-PROSECUTION AGREEMENTS, December 28, 2005, available at: http://www.corporatecrimereporter.com/deferredreport.htm; see also Brandon Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 856 (2007) (quoting Ralph Nader's comments that through the use of DPAs the DOJ is derogating their duty to seek justice).

[19] Edward Rubin, *The Myth of Accountability and the Anti-administrative Impulse*, 103 MICH. L. REV. 2073, 2108 (2005)

[20] Id. at 2107-2108. See *infra* Part III.A.

pathologies. Yet the prosecutor's most available and common recourse, deterrence through monetary fines, has considerable limitations as a tool for effecting corporate cultural change. Even if prosecuting the hard FCPA cases were easier and more common than it is, deterrence in the form of monetary fines can only be a partial response. Monetary penalties do not address intractable problems of institutional culture except in the most accidental way. Although monetary penalties may deter companies from engaging in open and obviously law-violating conduct, such penalties are unpredictable as tools for effecting large scale reform of organizational culture. Encouraging firms to *appear* law-abiding, such as through the use of "cosmetic" compliance programs or "calculated" cooperation with the government, is not the same as encouraging firms to *actually* be law-abiding, particularly in the face of collective action problems and the perceived "business necessity" of engaging in bribery in certain countries.

Fostering responsible self-regulation is another important response to the challenge of curbing corrupt practices. Broader societal pressures and the so-called "license to operate" may even be more important than regulatory action in encouraging corporate compliance with law.[21] The majority of corporations tend to be law-abiding not only because the law requires it, but because they believe that the underlying legal requirements are legitimate and that compliance carries rewards within their broader communities. However, voluntary self-regulation is insufficient on its own. There is the obvious problem that many corporate managers believe that they "need" to pay bribes to remain competitive or even to conduct business at all in some countries. In addition,

[21] *See* Neil Gunningham et al., *Social License and Environmental Protection: Why Businesses Go Beyond Compliance*, 29 LAW & SOCIAL INQUIRY 307, 329-39 (2004) (developing the idea of a "license to operate" which consists of social, economic, and legal demands on the firm).

many shareholders may put little pressure on corporations to end corruption, especially since the negative externalities associated with corruption are not primarily borne within the United States.[22]

This article develops a New Governance approach to combating corporate corruption that straddles the divide between self-regulation and traditional, command-and-control regulation. This approach involves the use of Reform Undertakings in settlement agreements with the SEC or DPAs with the DOJ. The Reform Undertaking is a novel remedial form that has emerged in securities law enforcement over the last few years.[23] A primary feature of this approach is the corporation's agreement to retain an independent monitor that has direct obligations to the government agency. This article argues that when implemented in a transparent and participatory manner by a suitably qualified Third Party, and when augmented by centralized learning, the Reform Undertaking is the best available mechanism for grappling with difficult problems of organizational culture. Reform Undertakings, and the use of DPAs in general, are a growing and controversial practice, but they have not yet received significant scrutiny by legal scholars. Although the particular focus of this article in on combating corruption, the insights gained from this article's use of a New Governance perspective are applicable to the use of DPAs generally, and to the use of corporate monitors by the DOJ and SEC in other settings.

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[22] However, investors taking a longer-term should realize that both grand and petty corruption "reduce profits and skew competition." David Hess & Thomas W. Dunfee, *Taking Responsibility for Bribery: The Multinational Corporation's Role in Combating Corruption*, in BUSINESS AND HUMAN RIGHTS: DILEMMAS AND SOLUTIONS 260, 268 (Rory Sullivan ed., 2003) [hereinafter Hess & Dunfee, *Taking Responsibility*]. In addition, public awareness of a firm's payment of bribes may have a negative impact on a corporation's reputation (Id. at 268-69) and relatedly, as mentioned earlier, its broader, socially-constructed "license to operate." *See generally* Gunningham et al., *supra* note 21.

[23] *See* Cristie L. Ford, *Toward a New Model for Securities Law Enforcement*, 57 ADMIN. L. REV. 757, 797-802 (2005)

This article proceeds by Part II reviewing the extent and nature of corruption that continues to exist in international business. This Part also explains how corrupt practices can be rooted in a corporation's culture, and thus persist despite external regulatory efforts to end bribery. Part III provides an overview of New Governance regulation and then assesses the use of compliance programs under the organizational sentencing guidelines as a form of New Governance regulation and finds some significant shortfalls. Next, Part IV further develops the idea of a Reform Undertaking and identifies the necessary requirements for this approach to be an effective tool in combating corporate corruption. Part V concludes.

II. The Continuing Problem of Corruption

A. The Paradox of Corruption

Corruption is universally disapproved yet universally prevalent.[24] This paradox of corruption is as true today as it has ever been. Although international efforts to combat corruption continue to evolve and draw strong public support, the payment of bribes by corporations continues as a common business practice. For example, a KPMG survey conducted in 2005 and 2006 found that eleven percent of employees working in regulatory affairs functions for their organizations observed others "making improper payments or bribes to foreign officials."[25] A survey by Control Risks Group Limited

[24] David Hess & Thomas W. Dunfee**,** *Fighting Corruption: A Principled Approach: The C² Principles (Combating Corruption)*, 33 CORNELL INT'L L.J. 593, 595 (2000) [hereinafter Hess & Dunfee, *Fighting Corruption*].

[25] KPMG FORENSIC, INTEGRITY SURVEY 2005–2006, at 5 (2006), available at http://www.kpmginsiders.com/pdf/050362_ForIntegritySurvNEW.pdf. The survey "asked employees whether they had 'personally seen' or had 'firsthand knowledge of' misconduct within their organizations

found that thirty-two percent of United States executive respondents believed that their competitors from the United States "regularly" or "nearly always" used local agents as a way to attempt to circumvent anti-bribery laws.[26]

There is even evidence to suggest that the prevalence of bribery is actually increasing in the post-SOX era of increasing attention to matters of corporate integrity and accountability. The Control Risks Group survey found that more United States-based corporations believed that they failed to win a contract due to a competitor paying a bribe in 2006 than they did four years earlier.[27] Overall, in 2006, forty-four percent of managers believed they lost a contract due to bribery in the last 5 years (twenty percent in the last 12 months).[28] These managers are not optimistic that these trends will reverse any time soon, as eighty-two percent of respondents believed that corruption would increase, or at least stay the same, over the next five years.[29]

B. The Limits of Deterring Corruption through Enforcement

The United States was the global leader in the fight against corruption in international business by passing the FCPA in 1977,[30] but United States-based

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over the prior 12-month period." Id. at 2. The survey results were based on 4,056 respondents from 11 different industries. Id.

[26] CONTROL RISKS GROUP LIMITED AND SIMMONS & SIMMONS, INTERNATIONAL BUSINESS ATTITUDES TO CORRUPTION - SURVEY 2006, at 12-13 (2006), available at www.crg.com/PDF/corruption_survey_2006_V3.pdf. An additional 44% indicated that they believed their competitors did so "occasionally." Id. at 13.

[27] Controls Risks, *supra* note 27, at 5.

[28] Id.

[29] Id. at 21 (finding that 28% of managers believed that corruption would increase, 54% believed it would stay the same, 12% predicted a decrease, and the remaining 6% were undecided).

[30] The FCPA provisions can be divided into two categories. First, corporations are prohibited from bribing foreign officials. Marika Maris & Erika Singer, *Foreign Corrupt Practices Act*, 43 AM. CRIM. L. REV. 575, 578 & 582-90(2006). Second, corporations must meet certain accounting practices requirements with respect to adequate internal controls and accurate record keeping. Id. at 579-81.

corporations continue to pay bribes at the same rate as corporations from other developed countries. Based on Transparency International's[31] 2006 *Bribe Payers Index*—which ranks countries based on the propensity of their corporations to pay bribes when conducting business abroad[32]—the United States tied for ninth amongst the thirty leading exporting countries.[33] Although a cluster analysis of the data that divided the countries into four groups placed the United States in top group,[34] Transparency International makes a point not to congratulate these countries, and states "companies from all countries in the survey show a considerable propensity to pay bribes."[35]

There are several factors contributing to the failure of the FCPA to significantly restrict the payment of bribes by United States companies. First, although the DOJ and SEC have increased enforcement of the FCPA in the past few years,[36] it may still be insufficient to create much of a deterrent effect. A recent review of all cases prosecuted under the FCPA concludes that the Act is significantly under-enforced and that a large share of the convictions consisted of "easy" cases that resulted from such actions as

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[31] Transparency International is one of the most well-known civil society organizations that are devoted to combating corruption in all its forms. Their website is located at: http://www.transparency.org.

[32] TRANSPARENCY INTERNATIONAL, BRIBE PAYERS INDEX (BPI): ANALYSIS 3 (2006), available at http://www.transparency.org/news_room/in_focus/2006/bpi_2006. The rankings are based on an anonymous survey of 11,232 executives from 125 countries. Id. After these executives select the nation of origin of the companies doing the most business in their country, they are asked to answer the following question by ranking the countries on a scale from "bribes are common" to "bribes never occur": "In your experience, to what extent do firms from the countries you have selected make undocumented extra payments or bribes?" Id.

[33] Id. at 4.

[34] The members of this group (in order from least likely to pay bribes to most likely) were: Switzerland, Sweden, Australia, Austria, Canada, UK, Germany, Netherlands, Belgium, US, and Japan. Id. at 5.

[35] Id. at 5. In fact, the press release accompanying the publication of the 2006 Bribe Payers Index is contains the subheading "Foreign bribery by emerging export powers 'disconcertingly high.'" *Transparency International, Press Release,* available at http://www.transparency.org/policy_research/surveys_indices/bpi/bpi_2006#pr.

[36] *See supra* notes 3-5 (noting the recent increase in FCPA enforcement actions and the record fines imposed).

corporations self-reporting the violations.[37] In addition, many convictions relied on actions that the corporation could have easily disguised to avoid detection, which suggests that more careful firms are able to make similar payments without significant fear of prosecution.[38] Overall, due to the DOJ's inability to demonstrate that it can obtain convictions on cases of corruption involving complex flows of money—the "hard" cases—corporations can continue to pay bribes with little fear of prosecution.[39]

Even though the FCPA may not provide much of a deterrent effect, it also serves an expressive function that tells managers that corrupt payments are immoral. In the face of strong economic pressures to either pay the bribe or lose business, however, moral suasion is not sufficient and many firms give in and pay the bribe out of a belief that it is a business necessity.[40] This problem is exacerbated by the fact that other major exporting countries are not enforcing their anti-corruption laws.[41] If other countries are not enforcing their anti-corruption laws against their home corporations, then United States corporations continue to feel that paying bribes is a business necessity in some situations. In other words, all major exporting countries must enforce their anti-bribery laws to ensure that all multinational corporations are competing on a level playing field and feel less pressure to pay bribes.

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[37] Philip Segal, *Coming Clean on Dirty Dealing: Time for a Fact-Based Evaluation of the Foreign Corrupt Practices Act*, 18 FLA. J. OF INT'L. L. 169, 171-75 (2006).

[38] Id. at 175, 189-95 (reviewing eleven convictions under the FCPA and showing how the corporation in each case could have easily avoided, or significantly reduced, the likelihood of detection).

[39] Id. at 195-96.

[40] *See* RONALD E. BERENBEIM, CONFERENCE BOARD RESEARCH REPORT, RESISTING CORRUPTION: HOW COMPANY PROGRAMS ARE CHANGING 9 (2006) (noting that of the 20 executives participating in a webcast conference, 85% believed that the FCPA failed to deter bribery in many cases due to a belief that there is a necessity of paying bribes in some countries).

[41] *See infra* notes 42-44 and accompanying text (providing data on international enforcement trends).

A recent review of enforcement of the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* by Transparency International presents some points of optimism that international enforcement is improving, but a closer look reveals that there are many reasons to believe that prosecution is not a significant deterrent. As for points of optimism, fourteen of thirty-four signatory countries show signs of enforcement as demonstrated by significant cases of prosecution or investigations.[42] However, eighteen countries have not prosecuted any companies or individuals for corruption,[43] and in both 2006 and 2007, the United States brought more prosecutions than the other thirty-three countries combined.[44] Furthermore, despite the increases in enforcement and international efforts to publicize new laws on corruption, many managers remain ignorant of their existence. One survey found that forty-two percent of executives of United States companies with international operations were "totally ignorant" on the laws covering bribery.[45] Executives of corporations from such major exporting nations as France, Germany, and the United Kingdom, were even more likely to claim total ignorance.[46]

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[42] FRITZ HEIMANN AND GILLIAN DELL, TRANSPARENCY INTERNATIONAL, PROGRESS REPORT 07: ENFORCEMENT OF THE OECD CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS 6 (2007), available at http://www.transparency.org/news_room/in_focus/2007/oecd.

[43] Id at 6.

[44] Id. at 5 (calculated from the data on prosecutions). To get a sense of the involvement of a country's corporations in international business, it is useful to note that the US accounts for 9.99% of world exports in 2006, compared to 56.87% for the other 33 countries. Id.

[45] Control Risks, *supra* note 27, at 10. This study was based on telephone interviews conducted in July 2006 of 50 high level executives (the respondents were described as "senior decision-makers at or near board level") from each Brazil, France, Germany, Hong Kong, the Netherlands, the United Kingdom, and the United States, for a total of 350 interviews. Id. at 22.

[46] Id. at 10.

C. Solving the Problem of Corruption

Solving the problem of corruption requires that it be attacked simultaneously with a variety of approaches addressing different causes of the problem.[47] These approaches must seek to reduce the demand for bribes (the public officials receiving the bribes) as well as restrict the supply (the corporations paying the bribes). This article focuses only on the supply-side. Though, it is important to remember that the anti-corruption efforts of multinational corporations can assist in deinstitutionalizing established norms of corruption in the host country and thereby also reduce the demand for bribes.[48]

There are multiple mechanisms available to reduce the supply of bribes. Increasing enforcement of existing criminal laws—in both the United States and internationally—can help provide a deterrent, as well as help level the playing field which also serves to reduce the pressure to pay a bribe to win business. As discussed above, enforcement has been limited and is not a complete solution to the problem.[49] Some commentators argue that the deterrent effect of criminal enforcement can be bolstered by encouraging corporations that lose contracts due to a corrupt payment to sue the bribe-paying corporation for civil damages.[50] In the past, there has been an

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[47] Thomas W. Dunfee & David Hess, *Getting from Salbu to the "Tipping Point": The Role of Corporate Action Within a Portfolio of Anti-Corruption Strategies*, 21 NW. J. INT"L L. & BUS. 471, 472-73 (2001).

[48] *See* Chuck C.Y. Kwok and Solomon Tadesse, *The MNC as an agent of change for host-country institutions: FDI and corruption*, 37 J. OF INT'L BUS. STUDIES 767 (2006) (providing an empirical analysis that supports the potential positive influence of multinational corporations).

[49] *See supra* notes 30-39 and accompanying text.

[50] Ethan S. Burger & Mary S. Holland, *Why the Private Sector is Likely to Lead the Next Stage in the Global Fight Against Corruption,* 30 FORDHAM INT'L L.J. 45, 63-68 (2006) (reviewing cases filed in US courts of corporations seeking damages against corporations alleged to have paid bribes to win contracts) and 72-73 (arguing in favor of a strong plaintiff's bar for bringing civil lawsuits on the basis of corrupt payments).

experiment with an international panel to hear complaints of competitors paying bribes, but this approach ultimately proved unsuccessful.[51]

Finding ways to encourage effective self-regulation is also a necessity. A voluntary corporate principles approach seeks, in part, to encourage multinational corporations to band together in their promise and efforts not to pay bribes.[52] Such initiatives are part of a larger focus on corporate social responsibility more generally. For example, the United Nation's Global Compact is a set of ten principles on core values that all corporations should support, including working against corruption in any form.[53] The FTSE4Good, a leading equity index of socially responsible firms,[54] has recently established anti-bribery criteria that firms must meet in order to stay in the index.[55]

As a necessary addition to these various approaches, this article develops the idea of self-regulation through the lens of New Governance regulation. For this purpose, it is

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[51] Stuart Marc Weiser, *Dealing with Corruption: Effectiveness of Existing Regimes on Doing Business*, 91 AM. SOC'Y INT'L L. PROC. 99, 99-101 (1997) (presenting the comments of Francois Vincke). The panel was established by the International Chamber of Commerce, but failed to have any impact on business behavior. Id. at 100-101.

[52] *See* Hess & Dunfee, *Fighting Corruption*, *supra* note 24 (outlining a corporate principles approach to combating corruption); Hess & Dunfee, *Taking Responsibility, supra* note 22, at 263-64 (Rory Sullivan ed., 2003) (reviewing corporate principles approaches supported by the Caux Round Table, Social Accountability International, and Transparency International).

[53] UNITED NATIONS GLOBAL COMPACT, TEN PRINCIPLES, available at http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html. The 10th principle states that "Businesses should work against corruption in all its forms, including extortion and bribery." Id. For a critique of the Global Compact and how it fits into discussions of corporate social responsibility, *see generally* Justine Nolan, *The United Nation's Compact with Business: Hindering or Helping the Protection of Human Rights*, 24 U. QUEENSLAND L. J. 445 (2005); Oliver F. Williams, *The UN Global Compact: The Challenge and the Promise*, 14 BUS. ETHICS Q. 755 (2004).

[54] *See* Oliver Balch, *Raising the Bar of Performance,* FIN. TIMES, Nov. 29, 2004, at 7.

[55] *Firms must meet bribery criteria for FTSE4Good*, SUPPLY CHAIN MGMT, March 16, 2006, at 9. The criteria went into effect in July 2006 for firms in industries that are at high risk for paying bribes, and January 2007 for all other firms. Id. Details on the criteria can be found at FTSE4Good, Countering Bribery Criteria (Feb. 2006) available at http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/FTSE4Good_Countering_Bribery_Criteria_Feb_06.pdf.

important to recognize that corruption is not unlike other problems of wrongdoing committed by organizations, such as fraud, discrimination, or violations of environmental regulations. In all cases, wrongdoing is not simply a matter of corporations being "rational profit maximizers" that make compliance decisions based on a cost-benefit calculation that takes into account the benefits of noncompliance versus the severity of potential penalties discounted by the chances of being caught.[56] Instead, wrongdoing can become embedded in organizational polices, practices, and perceptions. Thus, any regulatory approach that seeks to combat corruption must find ways to improve the ethical culture of corporations engaged in bribery. Reform Undertakings are a necessary tool in this endeavor. The goal, then, of Reform Undertakings is to encourage corporations to improve their cultures and to develop a better understanding of how those improvements are accomplished for purposes of developing best practices to be used throughout the industry. The next section shows why the issue of corporate culture must be addressed when attempting to combat corruption.

D. Why FCPA Enforcement Must Focus on Issues of Corporate Culture

Combating the supply-side of corruption will not be successful without taking steps to ensure that corporations are developing cultures that are supportive of the effort to end corrupt payments. To illustrate, consider again this article's opening case of Baker Hughes Inc. This company, headquartered in Houston, Texas, provides oil field services throughout the world. In 2001, the SEC issued a cease-and-desist order claiming that the company made improper payments to an Indonesian official and that the company made

[56] Timothy F. Malloy, *Regulation, Compliance and the Firm*¸76 TEMP. L. REV. 451, 453-55 (2003).

payments in Brazil and India without assuring itself that the payments would not ultimately be used for bribes. In addition, the SEC alleged that the company did not properly record the payments and instead listed them as ordinary business expenses.[57] As part of the cease-and-desist order, Baker Hughes was required to develop internal accounting controls to prevent improper payments in the future.[58] In 2007, however, the SEC filed a compliant against Baker Hughes alleging that for several years after the date of the cease-and-desist order the company continued to make payments in such countries as Nigeria, Angola, Indonesia, Russia, Uzbekistan, and Kazakhstan, without adequately assuring itself that these payments were not going to government officials.[59] As part of its deferred prosecution agreement with the DOJ, Baker Hughes admitted to paying bribes in Kazakhstan until at least November 2003.[60]

Can a few rouge employees be blamed for these numerous acts involving the payment of bribes and employees actively attempting to avoid direct knowledge of whether a payment will be used by an agent to pay a bribe? Will installing a better internal control system end these practices? Can the improper payments be explained simply by blaming leadership for not doing a better job of monitoring and supervising subordinates?[61] Business ethics researchers and other social scientists studying

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[57] *In the Matter of Baker Hughes Inc*., Exchange Act Release No. 44784 (Sept. 12, 2001), available at http://www.sec.gov/litigation/admin/34-44784.htm

[58] Id.

[59] *SEC v. Baker Hughes Incorporated and Roy Fearnley*, Civil Action No. H-07-1408, Litigation Release No. 20094, April 26, 2007, available at http://www.sec.gov/litigation/litreleases/2007/lr20094.htm

[60] *US v. Baker Hughes Incorporated, Deferred Prosecution Agreement* filed in the US District Court for the Southern District of Texas, April 11, 2007, at Attachment A, pp. 10-13 (copy on file with authors).

[61] *See* Susanne C. Monahan and Beth A. Quinn, *Beyond 'Bad Apples' and 'Weak Leaders': Toward a Neo-Institutional Explanation of Organizational Deviance*, 10 THEORETICAL CRIMINOLOGY 361, 361-62 (2006) (stating that commentators often attempt to explain deviant behavior within organizations by blaming

organizations know that the answer to all these questions is "no."[62] Corrupt practices can become so ingrained in how a corporation conducts its daily activities that simply adding more controls or increasing monitoring activity have only limited effectiveness because they do not address the root of the problem: the corporation's culture.

Encouragingly, the importance of addressing the problem of corporate culture is gaining greater recognition in the law. As discussed further below, the 2004 amendments to the Federal Sentencing Guidelines updated the requirements of an "effective" compliance program for organizations to receive a mitigated sentence. In addition to updating the structural characteristics requirements of the original 1991 Guidelines (e.g., anonymous reporting mechanisms, training programs), the amendments stated that corporations must also "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[63] Likewise, the DOJ views the decision to indict a corporation as a potential tool to improve corporate cultures,[64] and considers a corporation's existing culture when making the decision of whether or not to indict a corporation.[65]

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individual "bad apples," explicit orders from leadership for subordinates to commit the wrongful act, or the failure of leadership to monitor and supervise employees).

[62] Id. at 362 (stating that explanations that focus only on individual failure downplay the importance of the organizational environment); *see also* Trevino et al., *Behavior Ethics in Organizations: A Review*, 32 J. MGMT. 951, 966-68 (2006) (reviewing empirical studies on the influence of organizational culture on individuals' ethical behavior).

[63] § 8B2.1(a)(2)

[64] Paul J. McNulty, Deputy Attorney General, *Memorandum to Heads of Department Components & United States Attorney*, Dec. 12, 2006, at 2 (copy on file with author) (stating that "Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture. . . .")

[65] Id. at 6 (stating that a corporation's "history of similar conduct may be probative of a corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs.")

The following subsections take a closer look at how corporate culture can influence employees' use of improper payments. This discussion provides a foundation for understanding the role of the law in improving corporate culture.

1. Combating Corrupt Corporate Cultures: Understanding Individual Rationalizations

To understand how the law can help corporations develop cultures that do not condone, or unintentionally promote the use of, corrupt payments, it is useful to first look at the individuals, and then take a step back to see how the organization influences individual behavior. For individuals within corporations, the concern is that otherwise ethical employees pay bribes—or ignore obvious warning signs that the corporation's agents are paying bribes—by rationalizing their behavior. [66] There are several different ways that employees rationalize corrupt behavior. First, employees may take an action they know is wrong by denying any responsibility for those actions. They do this by claiming that they have no alternative but to pay a bribe.[67] Employees rationalize this behavior by claiming that they are trapped in a problem that is not of their creation (and

[66] Vikas Anand et al., *Business as Usual: The Acceptance and Perpetuation of Corruption in Organizations*, 19 ACAD. MGMT. EXEC. 9, 10-14 (2004). Rationalizations allow individuals "to neutralize their negative feelings or regrets about their behavior." Id. at 10. Although the authors use the word "corruption" in their article, they are using the word to refer to general wrongdoing and not simply the payment of bribes. Of course, it is important to recognize that the payment of bribes or the avoidance of conducting due diligence so that one can attempt to avoid direct knowledge that payments to an agent are being used for bribes are not unlike other types of corporate wrongdoings, whether it is price-fixing, securities fraud, or violations of environmental regulations.

[67] *See* Id. at 11-12. As reported in the SEC complaint against Baker Hughes Inc., once the company was informed that it must pay a bribe in order to win a contract, company managers complained that the payments were "distasteful" but agreed to pay anyway because they were necessary. *SEC v. Baker Hughes Incorporated and Ray Fearnley*, *Complain*t, US District Court for the Southern District of Texas, April 26, 2007, at 11-12, available at http://www.sec.gov/litigation/complaints/2007/comp20094.pdf. One subcontractor consented to making the payment and stated in an email "Our response to the question is do we have any option?" Id. at 11.

is perhaps a long-standing "tradition" in that country), thus they do not have to take moral responsibility for doing what they know is wrong.

Employees may also deny that anyone is being injured by their conduct.[68] Because there is a belief that no one is being harmed and the members of the organization are benefiting through the new business, employees do not feel bad about paying a bribe.[69] The harms caused by bribery involve long-term impacts on a country's economic development, the performance of vital functions by the government, and citizens' realization of essential human rights.[70] With their perceptions filtered by their short-term economic demands, employees may have a difficult time seeing how their actions make these problems worse in any appreciable way, or how their refusal to pay a bribe in this situation will make a difference for the better (especially considering that if they do not pay the bribe, a competitor likely will).

Moreover, euphemistic labeling[71] makes it easier for employees to avoid seeing the harm. Employees pay "facilitation payments"—which, because they are explicitly allowed by the FCPA, further muddies the moral problem of corruption—rather than bribes. Not gaining appropriate assurances that an agent is not using the corporation's payments for bribes is viewed as a "failure to conduct due diligence," which hides the moral nature of the problem. In addition, many view an omission to act that causes harm

[68] *See* Anand et al., *supra* note 66, at 12-13.

[69] *See* Id. at 13.

[70] Hess & Dunfee, *Taking Responsibility*, *supra* note 22, at 261-62; Hess & Dunfee, *Fighting Corruption, supra* note 24, at 596-97; Vito Tanzi, *Corruption Around the World: Causes, Consequences, Scope, and Cures*, 45 IMF STAFF PAPERS 559, 582-86 (1998).

[71] *See* Arthur P. Brief et al., *Collective corruption in the corporate world: Toward a process model*, in GROUPS AT WORK: THEORY AND Research 471, 485 (Marlene E. Turner, ed., 2001*); see also* Ann E. Tenbrunsel and David M. Messick, *Ethical Fading: The Role of Self-Deception in Unethical Behavior*, 17 SOCIAL JUSTICE RESEARCH 223, 226-228 (2004) (discussing language euphemisms and unethical behavior in organizations).

as less ethically wrong than an affirmative action that causes harm.[72] Thus, employees may view ignoring red flags and failing to conduct due diligence on an agent as morally unproblematic, even though they would have problems with affirmatively authorizing the payment of a bribe. This is compounded by the fact that employees will likely feel greater loyalties to their team within the organization than to society generally[73] and therefore pay bribes that provide a short-term benefit to the team at the expense of perpetuating a cycle of corruption.

Some employees may actually feel that they are doing the right thing for society by paying a bribe. Consider the ethical dilemma set out by Berenbeim:

> Suppose, for example, you were a project manager bidding on a local governmental contract to build a bridge. You know that a bribe is necessary for your proposal to even receive serious consideration. Other companies that you believe do inferior work will not hesitate to pay the bribe. Should you sacrifice the lives and safety of a country's innocent citizens because of your company's unwillingness to accede to deeply ingrained cultural and political practices? No act of yours will put an end to this practice; the only consequence will be death and injury to those who use the bridge.[74]

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[72] David M. Messick and Max H. Bazerman, *Ethical Leadership and the Psychology of Decision Making*, SLOAN MGMT. REV., Winter 1996, at 9, 15.

[73] *See* Anand et al., *supra* note 66, at 13.

[74] Ron Berenbeim, *Cutting off the supply side of bribes: being against corruption is more difficult than you think,* VITAL SPEECHES OF THE DAY, April 15, 1999, at 408, 409.

Many employees will rationalize their behavior through such a line of analysis.[75]

Finally, because FCPA violations are apparently rarely enforced compared to the actual number of violations (or at least perceived violations),[76] then individuals may begin to challenge the legitimacy of the law as it is being applied and therefore not see noncompliance as unethical.[77] Arbitrary and unfair (as perceived by employees) enforcement of the FCPA, and other countries' anti-corruption laws, raise issues of fairness. As established by Tom Tyler's work in social-psychology, individuals feel less of a moral obligation to follow a law that is applied unfairly.[78]

Overall, employees can easily find rationalizations to take actions that are against the company's code of conduct or the law. The fault, however, does not lie just with (or even primarily with) the individuals. Organizations with unethical cultures push employees to use these rationalizations where they otherwise would not. The

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[75] Berenbeim challenges a manager that believes paying a bribe in that situation is justified by asking: "How can the manager be certain that his company's bridge is sufficiently superior to justify the bribe? If we allow the justification for bridge bidding, what others must we also permit? Should those who believe themselves to be purveyors of other higher quality, lower cost products be allowed similar flexibility?" Id. at 409. Berenbeim hopes that those questions will cause a manager to doubt their practices, however, those questions also demonstrate how easy it is for a manager to fall prey to this rationalization. That is, any manager that rightly or wrongly believes that they have a higher quality product than their competitors may use this justification.

[76] *See supra* notes 36-39 and accompanying text (discussing enforcement trends).

[77] *See* Anand et al., *supra* note 66, at 13. The same would apply to a company's provisions on the payment of bribes in its code of conduct. Prohibiting the payment of bribes is not as simple as those unfamiliar to the area may believe. Two challenging areas are the use of facilitation payments and business courtesies, which includes small gifts, travel expenses, and entertainment expenses. Dunfee & Hess, *supra* note 47, at 476-80. These payments are allowed by the FCPA, but at some point they can cross the line and become bribes. Id. Attempting to distinguish when a manager or agent has crossed that line is extremely difficult and depends on local laws and customs. Id. Thus, what one manager's company considers an improper payment may be allowed by a competitor. Or, even within one company, similar payments but in different contexts may be treated differently by the company. To some employees, the distinctions may seem arbitrary and unfair. In addition, the allowance of facilitation payments and business courtesies can place managers on a slippery slope, where they continually push the boundaries of what is an acceptable payment until they have crossed the line without even being fully aware of the ethical and legal issues involved. Tenbrunsel and Messick, *supra* note 71, at 228-29.

[78] *See generally*, TOM R. TYLER, WHY PEOPLE OBEY THE LAW (1990).

organization's socialization process, social norms, and incentive systems, can all work to encourage employees to rationalize their actions and believe the corrupt practices are "business as usual."[79] Of course, organizational culture can also support the ethical values that make employees more likely to refuse to pay or authorize bribes and work to prevent those around them from engaging in corrupt acts. The next section takes a closer look at how corporate cultures can encourage wrongful conduct by employees.

2. Combating Corrupt Corporate Cultures: Understanding Organizations' Social Architecture

To understand how corporate cultures function and evolve over time, it is useful to distinguish between a corporation's "hardware" and its "software." [80] A corporation's hardware includes its formal structure, policies, and processes.[81] Software refers to the informal norms of behavior within the organization,[82] which includes the ethical culture and ethical climate of the firm.[83] With respect to combating corruption, the corporation's hardware includes its code of conduct, FCPA compliance program, and internal accounting controls. How those formal processes work in practice, however, depends on

[79] Anand et al., *supra* note 66, at 10-11.

[80] David Hess, *A Business Ethics Perspective on the Sarbanes-Oxley Act and the Organizational Sentencing Guidelines*, 105 MICH. L. REV. 1781, 1806 (2007).

[81] Id. at 1806.

[82] Id. at 1806.

[83] For purposes of this paper, we will use the term ethical culture to include the firm's ethical climate. A firm's ethical climate refers to employees' perceptions of organizational practices that have ethical content. Linda Klebe Treviño et al., *The Ethical Context in Organizations: Influences on Employee Attitudes and Behaviors*, 8 BUS. ETHICS Q. 447, 448-50 (1998). The firm's culture refers to the informal and formal systems of behavioral controls within the organization. Id. at 451-52. Ethical climate and ethical culture are viewed as being strongly related. Id. at 474; see also Daniel R. Denison, *What' the Difference Between Organizational Culture and Organizational Climate? A Native's Point of View on a Decade of Paradigm Wars*, 21 ACAD. MGMT. REV. 619, 645 (1996) (arguing that scholars studying organizational climate and organizational culture are not making clear distinctions between the two, and that climate versus culture is more a matter of "differences in *interpretation* rather than differences in the *phenomenon*" [emphasis in original]).

a firm's software. Thus, enforcement actions that simply require corporations to adopt a compliance program and adequate internal controls will often not be enough. Although these organizational hardware policies are necessary, they are not sufficient. Social norms within the organization can easily render compliance program requirements meaningless.

As one example, consider the use of employee hotlines. This is a tool to allow employees to anonymously report unethical or illegal behavior they have observed to upper management. These hotlines are considered a vital part of an effective anti-bribery compliance program.[84] To function as desired, however, hotlines must be supported by the organization's software, which requires leadership to actively manage the process. Employees will not use the hotlines if they believe that they will face some form of retaliation (a fear that exists even with anonymous reporting) or that the organizational will not take action to correct the problem they report.[85] To create an organizational culture that supports reporting wrongdoing, management must actually show employees that there is no retaliation for any reports filed and that all reports will be fully investigated and dealt with appropriately. DuPont, for example, does this by distributing "Business Ethics Bulletins" to its employees that describe wrongdoing within the organization, how the wrongdoer was punished, and how the transgression came to the attention of management.[86] Without these extra efforts, upper management should not

[84] Berenbeim, *supra* note 40, at 23.

[85] A recent survey by the Ethics Resource Center supports this. Of respondents witnessing misconduct of any form, almost one-half did not report the misconduct. ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY: HOW EMPLOYEE VIEW ETHICS IN THEIR ORGANIZATIONS 1994–2005, at 28 (2005) [hereinafter NBES]. When asked what factors influenced their decision not to report the acts, 59% stated that they did not believe the company would take corrective action, 46% stated a fear of retaliation, and 39% doubted that their report would really remain anonymous. Id.

[86] Andrew Singer, *DuPont's Daring Communications Formula*, ETHIKOS & CORPORATE CONDUCT Q., January/February 2004, at 1, 1-2.

have confidence that this piece of organizational hardware will have any impact on reducing the payment of bribes.

If management does not attend to the software of the organization, then other aspects of the organization's hardware can end up having unintended, negative consequences that contribute to the routinization of corruption within the corporation. Over a period of time, wrongdoing, including the payment of bribes and the failure of employees to heed warning signs that an agent of the corporation is paying bribes, can become institutionalized into the culture of the organization.[87] This occurs through a process where the leadership of the organization condones or encourages the wrongful behavior (either explicitly or implicitly), employees choose to engage in the behavior, and then, over a period of time, the wrongful actions become routine.[88] The starting point of this process can be the intentional as well as unintentional acts of leadership throughout the organization.

A useful starting point in seeing how this process works is the implementation of the organization's incentive system, which is a key part of the organization's hardware. An organization's promotion and compensation systems can have significant influence on employees' attitudes on corruption.[89] Rewarding employees for only the end result (e.g., winning the contract) and not considering the means (e.g., whether or not they paid a bribe), punishes employees for losing a contract because they refused to a pay a bribe or use a questionable agent. As employees see that their rewards are based only the ends, they receive an implicit message that the organization encourages employees to use

[87] *See* Brief et al., *supra* note 71, at 473.

[88] Id. at 473.

[89] Anand et al., *supra* note 66, at 14 (referring to the process of co-optation).

unethical means to reach those ends.[90] This message gets communicated to employees even if the organization has clear policies on bribery, as the actual implementation of the incentive system communicates what the organization "really values."[91] Moreover, poorly drafted anti-bribery policies can also send this message that the firm's true priorities are winning the contract. For example, one study found that less than one-half of firms involved in international business have a written policy stating that the company acknowledges that refusing to pay a bribe may result in lost business.[92] Such an incentive system in practice works to further an employee's rationalization that she has no responsibility for her wrongful actions, as she has no other alternative but to pay the bribe. In addition to the reward system, the authority structure inherent in organizations gives legitimacy to these implicit or explicit orders to engage in questionable acts.[93]

Over time, these actions that once raised doubt in employees' minds and forced them to rationalize their behavior become routine.[94] Employees no longer question, for example, failing to conduct appropriate due diligence on agents so they can avoid direct

[90] Brief et al., *supra* note 71, at 474. A recent survey by KPMG asked respondents what causes employees to engage in misconduct. The most common response—selected by 57% of respondents—was they employees "feel pressure to do 'whatever it takes' to meet business targets." KPMG, *supra* note 25, at 6. In addition, 47% of respondents pinned blame on a belief that they would be rewarded only for their results and not the means used, and 46% identified a fear of losing their jobs if they did not meet their targets. Id. Others have referred to this problem more generally as resulting from a "finance mode of control." *See* Monahan and Quinn, *supra* note 61, at 364-65 (reviewing the literature). Under this mode, upper management pushes down the hierarchy the problems of managing "conflicts between imperative for profit and for adherence to external regulations and norms" by setting "financial goals for subunits and set[ting] their workers loose to pursue those goals." Id.

[91] John M. Darley, *The Dynamics of Authority Influence in Organizations and the Unintended Action Consequences* in SOCIAL INFLUENCES ON ETHICAL BEHAVIOR IN ORGANIZATIONS 37, 40 (John M. Darley et al., eds, 2001) [hereinafter Darley, *Dynamics*]. Darley summarizes this point by stating that "talk is meaningful to the extent that it connects with the incentives eventually provided through the incentive system." Id.

[92] Berenbeim, *supra* note 40, at 18-19.

[93] Brief et al., *supra* note 71, at 477-79; Darley, *Dynamics, supra* note 91, at 38-39.

[94] Id. at 482-83

knowledge of the agents' acts, or listing questionable payments as ordinary business expenses. Acts that may appear so clearly wrong to an outsider become the banal, day-to-day functions of a member of the organization (or a sub-group within the organization).[95] As new members enter the organization, they are slowly socialized into the standard practices of the organization and the system perpetuates itself.[96] In addition, the system can strengthen over time, as those that dislike the practices leave the organization while those that participate stay and are promoted.[97]

Reinforcing this process is the strength of the expectation in the organization that employees must obey upper management without question. In some situations, management explicitly orders employees to commit questionable acts,[98] but in other situations employees can wrongfully assume they were ordered to commit the acts. Employees make incorrect assumptions because they seek to standout by taking the initiative and therefore act upon orders before they are given. They determine these orders by intuiting what management would want based on the objectives they were told to accomplish and without asking a lot of questions.[99] In either the case of explicit orders

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[95] Id. at 484.

[96] Id. at 488-90.

[97] John M. Darley, *How Organizations Socialize Individuals into Evildoing* in CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS 13, 37-38 (David M. Messick & Ann E. Tenbrunsel eds., 1996) [hereinafter Darley, *Socialize*].

[98] At KPMG, senior partners allegedly attempted to pressure to engage in potentially illegal acts related to tax shelters without questioning the appropriateness of the acts by sending out emails stating "you will do this now" in red font, or responding to questions that were asked by stating, "you're either on the team or off the team." Hess, *supra* note 80, at 1800-1801n.126.

[99] Darley, *Socialize*, *supra* note 91, at 24-25. Darley also provides an example of organizational cover-ups of wrongdoing that is instructive here. Once managers discover that their acts (or failures to act) have unintentionally caused the organization to commit a harmful act, social dynamics in the organization and psychological processes push those managers to deny that harm occurred or that the harm was caused by their actions. Id. at 26-27. Lower-level employees that are more directly aware of the harm and its cause, then interpret management's denial has a tacit order to lie about the harm and its organizational causes. Id. at 27. This dynamic is more likely to occur in an organizational culture with a strong obedience to authority

or assumed orders, the result is the same; employees are more likely to engage in unethical conduct, they do not deliver "bad" news to their superiors that could change those superiors' orders, and they do not report wrongdoing committed by others that they observe.[100] Overall, in a culture where employees are expected to have "unquestioned obedience" to their supervisors, employees rationalize their acts by believing that they are not the person morally responsible for their actions as they have no alternative but to follow their orders.

Other aspects of the organization's software that matter more for improving ethical behavior than its hardware[101] include leadership's demonstrated commitment to ethics, fair treatment of employees, and employees' confidence in being able to have an open discussion on the ethical issues related to any decision they must make.[102] When these factors are not present, wrongful behavior is more likely. All of these factors are involved in a complex process that top management likely does not fully understand and

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norm. Similarly, for corrupt payments, the same process can occur when an organization starts to see evidence that an agent who has been vital to the winning of new contracts in a country may be making improper payments.

[100] Linda Klebe Treviño et al., *Managing Ethics and Legal Compliance: What Works And What Hurts,* 41 CALIF. MGMT. REV. 131, 136-37 & 143-44 (1999 [hereinafter Treviño et al., *Managing Ethics*].

[101] *See* Id. at 136-40 (finding that formal characteristics of a compliance program were less important than informal aspects of implementation and the firm's culture for such outcomes as observed unethical/illegal behavior, awareness of ethical/legal issues, seeking advice on ethical issues, delivering bad news to management, reporting observed violations, and improved decision making).

[102] Id. at 141-44; see also Tom R. Tyler & Steven L. Bladder, *Can Businesses Effectively Regulate Employee Conduct? The Antecedents of Rule Following in Work Settings*, 48 ACAD. MGMT. J. 1143, 1153-54 (2005) (providing empirical evidence on the importance of fair treatment of employees over command-and-control type approaches for obtaining organizational rule-following behavior); ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY: HOW EMPLOYEE VIEW ETHICS IN THEIR ORGANIZATIONS 1994–2005, at 60, 89 (2005) (providing data showing the importance of demonstrated ethical commitment by top management for reducing unethical behavior within organizations and improving the conditions that make unethical behavior less likely (e.g., willingness to report misconduct, less pressure to compromise the organization's standards)).

probably has misperceived.[103] The development of a corrupt corporate culture is an insidious process that evolves over time. As Kim states, employees become "complicit in [wrongdoing], not through any overt or explicit calculation, but through a subtle and implicit reconfiguration of preferences, self-conception, and motivation."[104]

Of course, the key to preventing employees from rationalizing behavior or being socialized into unethical practices is prevention; establishing an ethical culture before wrongdoing occurs and becomes institutionalized as routine.[105] Part III reviews the current attempts by the law to encourage corporations to develop ethical cultures and discusses how these approaches fit into a New Governance approach to regulation. This sets the foundation for Part IV's development of the necessary next steps for the effective use of Reform Undertakings.

III. New Governance Regulation and Corporate Compliance Programs

A. Understanding New Governance Regulation

New Governance is an alternative approach to regulating business that is receiving greater attention lately by both regulators and legal scholars. This approach to regulation is based on the basic belief that effective implementation of any law or

[103] *See* Ethics Resource Center, *supra* note 85, at 75 (discussing empirical evidence showing that although top management may believe they are projecting a commitment to ethics, lower level managers and employees often have different perceptions); Linda Klebe Treviño, *Out of Touch: The CEO's Role in Corporate Misbehavior*, 70 BROOK. L. REV. 1195, 1208–1209 (2005) (stating that upper level management often has a significantly more positive view of the organization's ethical culture than do lower level employees).

[104] Sung Hui Kim, *Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983 , 997 (2005). Kim's article is a discussion of inside counsels' complicity in corporate fraud, but the social-psychology literature that she relies on directly applies to the corporate culture issues discussed here.

[105] Anand et al., *supra* note 66, at 17-18.

regulation requires "empathetic understanding" of the specific situation of the regulated entity and allowing that organization to have an active role in determining its strategies for compliance.[106] In addition, such an approach "will be most effective if the firm . . . absorbs [those compliance strategies] into its meaning structure so that they become part of its mode of operation or existence."[107] Thus, this approach is a move away from command-and-control regulation where the government's only role is to set definite rules and then punish noncompliance, and a move towards a more decentralized approach where the government sets basic goals and seeks direct involvement from corporations in developing individualized strategies to attain those goals.

Regulators are using this approach is in such diverse areas as environmental regulation,[108] food safety,[109] occupational health and safety,[110] and employment

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[106] Rubin, *supra* note 19, at 2107-2108. New Governance has emerged as a global term to refer to a broadly consistent, but not homogeneous, area of scholarship. Key works in the theoretical development of this approach include Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267 (1998), Susan Sturm, *A Normative Theory of Public Law Remedies,* 79 Geo. L.J. 1355 (1991), and Sturm, *Second Generation*, *supra* note 111; *see also* Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000). For a lively conversation on how to characterize the New Governance approach, see Lobel, id., at 348, 371-404 (identifying the basic organizing principles of the New Governance approach as "increased participation of nonstate actors, stakeholder collaboration, diversity and competition, decentralization and subsidiarity, integration of policy domains, flexibility and noncoerciveness, adaptability and dynamic learning, and legal orchestration among proliferated norm-generating entities"); see also Bradley C. Karkkainen, *"New Governance" in Legal Thought and In the World: Some Splitting as Antidote to Overzealous Lumping,* 89 Minn. L. Rev. 471 (2004) (providing a critique of Lobel's characterization of New Governance, and, *inter alia,* distinguishing between approaches based on Gunther Teubner's reflexive law and approaches grounded in John Dewey's philosophical pragmatism). For additional review, s*ee* Katherine R. Kruse, *Instituting Innocence Reform: Wisonsin's New Governance Experiment*, 2006 WIS. L. REV. 645, 676-83 (2006) (identifying the core elements of a democratic experimentalist approach to New Governance as "experimentation, provisional rules, benchmarking of best practices, and structures of accountability based on transparency.")

[107] Rubin, *supra* note 19, at 2108

[108] Robert F. Durant et al., *Introduction* in ENVIRONMENTAL GOVERNANCE RECONSIDERED: CHALLENGES, CHOICES, AND OPPORTUNITIES 1, 1 (Robert F. Durant et al. eds., 2004).

[109] Cary Coglianese & David Lazer, *Management-Based Regulation: Prescribing Private Management to Achieve Public Goals*, 37 L. & SOC'Y REV. 691, 696–98 (2003).

[110] Orly Lobel, *Interlocking Regulatory and Industrial Relations: The Governance of Workplace Safety*, 57 ADMIN. L. REV. 1071 (2005).

discrimination.[111] In each case, the organization plays a significant role in developing its own strategies for compliance with the law. This reflects basic New Governance principles of experimentation at the local level[112] but with the lessons from those experiments spread throughout the system through a process of dynamic learning that creates continual improvement.[113] The role of the law is to orchestrate this process by "facilitating innovation, standardizing good practices, and researching and replicating success stories from local or private levels."[114]

A primary example of this approach for organizations involves efforts to prevent employment discrimination. The challenge for the law in this area is to end what Sturm refers to as "second generation" discrimination.[115] Second generation discrimination has its causes rooted in the structural features of the organization and its culture, [116] as opposed to "first generation" discrimination which is based on overt and intentional actions.[117] Likewise, as discussed earlier, problems of corrupt practices within organizations are more complex than individuals making a rational decision to pay a bribe in full awareness of its wrongfulness and its potential consequences for themselves and their organizations. The observations that Strum makes about the problems and limits of a traditional rule-enforcement model of reducing discrimination equally apply to

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[111] Susan Sturm, *Second Generation Employment Discrimination: A Structural Approach*, 101 COLUM. L. REV. 458, 475–76 (2001) [hereinafter Sturm, *Second Generation*].

[112] Orly Lobel, *The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought*, 89 MINN. L. REV. 342, 379-82 (2004) (discussing the importance of learning through a diversity of approaches and encouraging continual improvement).

[113] Id. at 395-400.

[114] Id. at 395-401.

[115] Sturm, *Second Generation*, *supra* note 111, at 468.

[116] Id. at 468-69.

[117] Id. at 465-67.

combating corruption. In general, Sturm argues that a rule-enforcement model encourages lawyers and compliance officials to adopt strategies focused on reducing "the short-term risk of legal exposure rather than strategies that address the underlying problem."[118] In the area of corruption, this is evidenced by the fact that the growth in anti-corruption laws globally is causing more managers to state that legal risks are a more important factor in the development and monitoring of their anti-bribery compliance programs than are concerns related to ethics and the ethical culture of the organization.[119]

Instead of a rule-enforcement model, a New Governance model utilizes the law as a tool to encourage corporations to use a problem-solving approach towards combating corruption. Through "legal orchestration," firms should be encouraged to engage with their employees and outside consultants to identify the problems rooted in the organization's hardware and software, and then develop (and then continually improve) workable solutions.[120]

B. The Organizational Sentencing Guidelines

The Organizational Sentencing Guidelines (OSG) can be viewed as a form of New Governance regulation.[121] Under the OSG, if a firm adopts an effective compliance program (that is, one that meets seven basic hardware requirements set out in the guidelines), then it will receive a reduced sentence if it is later found guilty of a crime. The idea behind the guidelines is for the government to establish the goals and basic

[118] Id. at 476.

[119] Berenbeim, *supra* note 40, at 17.

[120] Sturm, *Second Generation*, *supra* note 111, at 522-23.

[121] *See* Rubin, *supra* note 19, at 2108.

parameters of a compliance program, and then let the firm utilize its knowledge to best implement such a program so that it is effective, as well as consistent with the firm's structure and strategy. In recognition of the importance of the firm's software for ensuring an effective program, the 2004 amendments to the OSG refer to "compliance and ethics programs"[122] and require that firms "promote an organizational culture that encourages 'ethical' conduct."[123] Thus, although the government cannot compel any organization to be "ethical," it can attempt to establish appropriate incentives for organizations to determine what it means to be ethical—under the OSG, being ethical simply means compliance with the law—and how to develop such an ethical culture for their organization.

Although many firms may attempt to meaningfully implement a compliance program—and, if done appropriately, there is empirical evidence to suggest they can be effective[124]—many other firms may seek the benefits of a mitigated sentence by adopting only the appearance of a compliance program. More importantly, under the McNulty Memo, the benefits are not just a reduced sentenced but allowing the corporation to avoid prosecution all together. Because prosecutors cannot easily determine which corporations have meaningfully implemented a compliance program and which have not, creating only the appearance of adopting without the cost and effort of actual adoption is an attractive

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[122] Paul Fiorelli and Ann Marie Tracey, *Why Comply? Organizational Guidelines Offer a Safer Harbor in the Storm*, 32 J. CORP. L. 467, 483 (noting that the revised guidelines make forty-five references to "compliance and ethics programs").

[123] U.S. Sentencing Guidelines Manual §8B2.1(a)(2) (2006).

[124] *See* Hess, *supra* note 80, at 1791-95 (providing a review of the empirical studies on the effectiveness of compliance programs).

strategy. This is commonly referred to as the problem of "cosmetic compliance."[125] At the extreme, cosmetic compliance creates a moral hazard problem where corporations with largely symbolic compliance programs actually take less care to prevent wrongdoing because they have protection against prosecution and end up committing more wrongful acts.[126]

A related problem may be referred to as "calculated cooperation." By cooperating with prosecutors, corporations are less likely to be prosecuted and instead the government will only file charges against individuals. This policy is contained in the McNulty memo and the Thompson memo before that.[127] Credit for cooperation[128] is not without controversy, however. Recently, the controversy has been over prosecutors requiring corporations to waive attorney-client privilege to be considered as "cooperating."[129] For this article's purposes, the main concern is that credit for cooperation leads to the corporation scapegoating certain employees to end the governmental inquiry without adequate examination of the organizational causes of the wrongful act, such as the corporate culture.[130]

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[125] William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 54 VAND. L. REV. 1343, 1407 (1999); Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491-92 (2003).

[126] Laufer, *supra* note 125, at 1415-18

[127] Preet Bharara, *Corporations Cry Uncle And Their Employees Cry Foul: Rethinking Prosecutorial Pressure On Corporate Defendants*, 44 AM. CRIM. L. REV. 53, 82-86 (2007).

[128] Ford, *supra* note 23, at 792-96.

[129] Id.

[130] Laufer refers to this problem as reverse whistle blowing. William S. Laufer, *Corporate Prosecution, Cooperation, and the Trading of Favors*, 87 IOWA L. REV. 643, 648-49, 657-63 (2002). Under reverse whistle blowing, it is possible for upper management to implicate lower-level management in the wrongdoing and thus end the government's investigation even though the corporation had a culture of encouraging the wrongful behavior. Id. at 657-63.

Due to problems of cosmetic compliance and calculated cooperation, the OSG does not adequately address the issue of requiring problematic firms to actually change their culture. Instead, bribe-paying firms can easily decouple these efforts from the actual culture of the organization. In addition, granting leniency to corporations for calculated cooperation does not provide an incentive for firms to meaningfully conduct a full analysis of their culture to determine why corrupt payments persist and then take the necessary steps to right that culture. Thus, for corporations that have demonstrated that corruption is rooted deep in their culture, some other approach is needed.

C. Beyond Carrots and Sticks: The Challenge of Reversing Corrupt Corporate Cultures

As stated earlier, corruption is not necessarily a problem of "rational profit maximizers" making calculated cost-benefit decisions on whether or not the firm should make improper payments. In many cases, the use of improper payments becomes an unquestioned organizational norm that no longer raises a moral question with employees. The initial cause of these norms can be either the intentional or intentional acts of upper management. Either way, once these practices become embedded in the firm's culture, they are not easily reversed. Thus, simply requiring bribe-paying firms to improve their compliance programs and internal controls will likely not be sufficient. The firm must find ways to reverse its corrupt culture and then maintain that improved culture going forward.

Drawing on social psychology research, Brief and colleagues suggest several ways that may work in reversing a culture of wrongdoing and allowing employees to

stand up for what is right rather than blindly following implicit and explicit orders.[131] In short, the organization must find ways to support "functional disobedience," which is the open challenge to the legitimacy of implicit or explicit orders to engage in unethical behaviors.[132] A primary way to do this is through social norms of open communication.[133] Such norms allow employees to state their ethical concerns with organizational practices and find others with similar misgivings.[134] With the support of others, that employee is more likely to respond with responsible behavior rather than simply follow orders or comply with existing routines.[135] To promote functional disobedience, Brief and colleagues state that "the goal of disobeying morally questionable orders must be emphasized by management, methods and procedures for accomplishing this goal must be visibly in place, employees must be rewarded for functional disobedience, support (e.g., training) for accomplishing this goal must be readily available, and employees generally must feel their personal welfare is protected by management."[136] Brief and colleagues emphasize that all of these factors must be present, and the absence of any one can result in a continued culture of wrongdoing.[137]

Not surprisingly, these factors that can reverse an unethical culture are the same factors identified by researchers as necessary to maintain an ethical corporate culture.[138] The way to put these factors into operation is not simply through the adoption of a

[131] *See* Brief et al., *supra* note 71, at 491-92.

[132] Id. at 492.

[133] Id. at 493.

[134] Id. at 493.

[135] Id. at 493.

[136] Id. at 494.

[137] Id. at 495.

[138] *See* Treviño et al., *Managing Ethics, supra* note 100, at 141-44.

compliance program consistent with the OSG requirements, but through the adoption of an integrity-based program. Integrity-based programs refer to compliance and ethics programs not based primarily on following the rules and punishment for violations, but primarily on the emphasis of shared organizational values.[139] Existing empirical evidence suggests that compliance programs with a stronger integrity-based foundation are more effective in attaining a positive ethical climate and reducing unethical behavior than programs based simply on rule enforcement.[140] External pressures to adopt a compliance program, however, can work against the adoption of an integrity-based program because to outsiders such programs may look less rigorous and merely symbolic.[141] In addition, for an organization already heavily engaged in wrongful conduct, an external change agent may be necessary to reverse embedded wrongdoing and install an integrity-based program, as insiders "may lack the ability, will, and credibility to effect the needed changes."[142]

Overall, two things are necessary to reverse the cultures of corrupt corporations. First, firms must adopt a problem-solving approach to determine what factors of the organization's culture are contributing to the continuation of corrupt payments. As indicated earlier, this is not an easy task, as corporate cultures related to ethical behavior involve complex interactions of multiple factors. Second, firms must reverse that culture and ensure that an ethical culture exists going forward. This requires finding the right

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[139] Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar.-Apr. 1994, at 106, 110–11; Gary R. Weaver & Linda Klebe Treviño, *Compliance and Values Oriented Ethics Programs: Influences on Employees' Attitudes and Behavior*, 9 BUS. ETHICS Q. 315, 315-16 (1999)

[140] For a review of the empirical literature, see Hess, *supra* note 80, at 1791-93 & 1802-3.

[141] Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance With Law*, 2002 COLUM. BUS. L. REV. 71, 105, 113 (2002).

[142] Anand et al., *supra* note 66, at 20-21.

balance of a rules-based approach to compliance programs and an integrity-based approach. Due to each corporation's unique history and situation, this balance will vary between firms. Reform Undertakings are the best mechanism available to prosecutors and enforcers to achieve these goals. Part IV further describes Reform Undertakings and their necessary requirements for success.

IV. Combating Corporate Corruption through Reform Undertakings

A. Reform Undertakings and New Governance Regulation

1. Reform Undertakings: What, Why, When

Reform Undertakings are agreements between the DOJ or SEC and corporations[143] (or other regulated entities[144]) that settle investigations related to

[143] The examples are many and they increase every month. Examples include Bristol-Myers Squibb Company for channel stuffing (described by prosecutors of the case at Christie & Hanna, *supra* note); Computer Associates for securities fraud (*US v Computer Associates International*, Deferred Prosecution Agreement, filed in US District Court, Eastern District of New York, Sept. 22, 2004) (copy on file with authors); Aspen Technologies for securities fraud (*In the Matter of Aspen Technology*, *Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934*, July 31, 2007, available at http://www.sec.gov/litigation/admin/2007/33-8827.pdf); Delta & Pine Land Company for violations of the FCPA (*In the Matter of Delta & Pine Land Company*, *Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934*, July 27, 2007, available at http://www.sec.gov/litigation/admin/2007/34-56138.pdf); Statoil for violations of the FCPA (*In the Matter of Statoil ASA*, *Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934*, October 13, 2006, available at http://www.sec.gov/litigation/admin/2006/34-54599.pdf).

[144] *Letter from David N. Kelley, U.S. Attorney, S.D.N.Y., to Robert S. Bennett, Attorney for KPMG LLP, Deferred Prosecution Agreement* (Aug. 26, 2005), available at http://www.usdoj.gov/usao/nys/pressreleases/August05/kpmgdpagmt.pdf; *In the Matter of General American Life Insurance Company,* Securities Act Release No. 8832, August 9, 2007, available at http://www.sec.gov/litigation/admin/2007/33-8832.pdf; *In re National Stock Exchange*, Exchange Act Release No. 51714, May 19, 2005, available at http://www.sec.gov/litigation/admin/34-51714.pdf.

violations of the securities law, including FCPA violations.[145] As a term of the settlement or agreement, the corporation agrees to improve its compliance programs and to retain, at its own expense, an independent third party monitor, consultant, or auditor (the "Third Party") to provide expert assistance with, and possibly to oversee, the corporation's implementation of that program.[146] The Third Party's role is to intervene in the firm over a period ranging anywhere from six months to three years and to identify compliance failures and reasons for the alleged law violation.[147] The Third Party then reports back to the regulator or prosecutor as to his findings, his recommendations for improvements to the compliance program, and the steps taken by the corporation in response to those recommendations.[148]

Reform Undertakings reflect a profound shift in prosecutorial and enforcement philosophy. In comparison to conventional sanctions such as monetary penalties or criminal prosecution of individuals, the Reform Undertaking is more open-ended, less deterministic, and significantly more interventionist. As such, they are most appropriate for the "worst actor" cases. [149] That is, those cases where the corrupt practices are the

[145] Ford, *supra* note 23, at 759-60. They may also be court-ordered, or administratively ordered. Id. at 797-98. Previously, the Reform Undertaking term was used to refer only to settlements with regulatory enforcement staffers, but for present purposes similarly-structured agreements reached with criminal prosecutors pursuant to deferred prosecution and non-prosecution agreements also qualify. *See generally*, Id . Garrett focuses only on DOJ deferred prosecution and non-prosecution agreements, and uses the term "structural reform prosecution." Garrett, *supra* note 18, at 854-55.

[146] Khanna and Dickenson, *supra* note 17, at 1721-26.

[147] Id. at 1721-26.

[148] *US v. Baker Hughes Incorporated*, *Deferred Prosecution Agreement*, *supra* note 60, at 15-17 (requiring the corporate monitor to provide three separate reports during the term of DPA, with each providing the monitor's assessment of the company's progress in establishing a compliance program and adequate internal controls, and making recommendations for improvements in the company's policies and procedures).

[149] Ford, *supra* note 23, at 772-73 & 805.

result of the insidious organizational culture issues discussed earlier[150] and where such practices have continued to, or are believed will, persist notwithstanding other sanctioning efforts. The clearest cases for the use of Reform Undertakings involve those corporations at the top of what Ian Ayres and John Braithwaite call the "enforcement pyramid."[151] When dealing with these actors, regulators should not assume that voluntary (post-enforcement) steps toward assuring the use of an effective compliance program are necessarily *bona fide*, rather than taken in an attempt to mitigate sanctions through external appearances only.[152] Nor should regulators automatically assume that corporate protestations are credible that claim their problems are the result of an insular group of "bad apples."[153] In both situations—cosmetic compliance and calculated cooperation—the enforcement environment has created a skewing effect and encouraged strategic action by corporations in trouble with criminal or regulatory authorities. The cases for which Reform Undertakings are most appropriate are precisely those in which voluntary self-regulation has demonstrably failed.

Based on the available public records, Schnitzer Steel appears to be one such "worst actor" case. According to the SEC's cease-and-desist order, two wholly-owned subsidiaries of Schnitzer Steal made improper payments in China and South Korea on their own behalf and as an agent for other customers from 1999 to 2004.[154] Although many of the payments were mostly in small increments ranging from $3,000 to $15,000,

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[150] *See supra* Part II.D.

[151] IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION 38-41 (1991).

[152] *See supra* notes 125-26 and accompanying text (discussing cosmetic compliance).

[153] *See supra* notes 127-30 and accompanying text (discussing calculated cooperation).

[154] *In the Matter of Schnitzer Steel Industries Inc., Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934*, Oct. 16, 2006, at 2-3, available at http://www.sec.gov/litigation/admin/2006/34-54606.pdf.

over the course of those five years those payments totaled over $1.8 million.[155] In an attempt to hide the improper payments, the subsidiaries used schemes to disguise the payments as "refunds" or recorded payments to government officials as "sales commissions," for example.[156] In some cases, the heads of the subsidiaries used secret bank accounts to make the payments.[157]

The involvement of two subsidiaries, the frequency of the payments, and the attempts to disguise them over an extended period of time, strongly suggest that these practices had become embedded as a routine practice within the corporate culture. Moreover, during this time, Schnitzer Steel did not implement a system of controls to monitor compliance with the FCPA, nor did it provide its employees or agents with even basic training on the requirements of the FCPA.[158] Even when company compliance officials notified executives of suspected improper payments in 2004, the company continued to pay bribes that were already promised and instructed employees to increase "entertainment expenses" to clients to make up for any reduction in direct cash payments.[159] Thus, although the company engaged in "exceptional cooperation" with the government,[160] Schnitzer Steal has demonstrated that it belongs in the "worst actor" category and needs significant assistance in reversing its corrupt corporate culture.

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[155] Id. at 2-3.

[156] Id. at 3.

[157] Id.

[158] Id. at 4.

[159] Id. at 4.

[160] *See supra* note 12 and accompanying text.

Likewise, Baker Hughes, discussed earler,[161] also appears to be a "worst actor" that suffers from an organizational culture where improper payments have become the norm and are not questioned. Despite the issuance of an SEC cease-and-desist order related to improper payments in 2001 that required the company to implement appropriate controls, the company continued to engage in the payment of bribes, falsifying those payments in company records,[162] and, according to the SEC complaint, exercised willful blindness[163] towards the use of possibly corrupt agents.[164] Overall, the use of corrupt payments continued from at least 1998 to 2005, and occurred with agents or employees in six different countries.[165] In addition, with respect to improper payments that Baker Hughes admitted to in its DPA, those payments (totaling over $4.1 million) were authorized by multiple heads of Baker Hughes operating divisions.[166] Although the legal department was allegedly made aware that the company planned to hire a new agent (whose commission was the improper payment), proper due diligence was not carried out by the managers involved and the legal department did nothing more than hand the necessary forms to the managers.[167]

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[161] *See supra* notes 6-7 and 57-60 and accompanying text.

[162] Baker Hughes Incorporated, Deferred Prosecution Agreement, *supra* note 60, at Attachment A, pp. 11-13. The company recorded bribes as "commissions," "fees," or payments for "legal services." Id. at 12.

[163] *See generally* William H. Simon, *Wrongs of Ignorance and Ambiguity: Lawyer Responsibility for Collective Misconduct,* 22 YALE J. REG. 1 (2005) (decrying institutional arrangements that permit "willful blindness" or "deliberate ignorance" under cover of professional responsibility or duty toward clients).

[164] *See supra* note 59 and accompanying text.

[165] Id. For listing of the alleged corrupt payments made after the Cease-and-Desist order, see *SEC v. Baker Hughes Incorporated and Ray Fearnley*, *Complain*t, *supra* note 67, at 31-32 (alleging that Baker Hughes made over 80 improper payments (including payments the company did adequate assure itself were not used for bribes) totaling over $9.5 million after the 2001 Cease-and-Desist order).

[166] *Baker Hughes Incorporated, Deferred Prosecution Agreement, supra* note 60, at Attachment A, pp.8-9 & 12.

[167] *SEC v. Baker Hughes Incorporated and Ray Fearnley*, *Complain*t, *supra* note 67, at 13-14.

For these "worst actor" corporations, the Reform Undertaking has several advantages relative to conventional regulatory mechanisms, such as stand-alone monetary sanctions or sanctions targeting only individuals within the organization. Most importantly, the Reform Undertaking responds to concerns about cosmetic compliance, scapegoating, institutional capacity, and limitations of deterrence in effecting thoroughgoing reform of corporate cultures. Specifically, this mechanism recognizes and accepts both the strengths and weaknesses of the prosecutorial/enforcement model. That is, it accepts that prosecutors do not have the resources or inclination to engage in ongoing, deep reform efforts at individual corporations, although they have significant flexibility in crafting case-specific remedies.[168] In addition, to a certain degree, Reform Undertakings uncouple the liability phase of prosecution or enforcement from the remedial phase. By setting parameters for a post-settlement process mediated by a Third Party rather than directly by a prosecutor, Reform Undertakings create a temporal, structural, and dialogical space for trying to work through stubborn cultural problems. This reduces (though obviously cannot eliminate) the pressure toward strategic action by the corporation. At the same time, Reform Undertakings can be even more

[168] Perhaps counterintuitively, prosecutors and regulatory enforcement staffers may in some ways be more receptive to New Governance style methods than mainstream regulators. S*ee* MALCOLM SPARROW, THE REGULATORY CRAFT: CONTROLLING RISKS, SOLVING PROBLEMS, AND MANAGING COMPLIANCE 49-64 (2000). Some of the key priorities underlying New Governance regulation – pragmatism, flexibility, incrementalism, learning by doing – should be familiar to them. Prosecutors and regulators work in flexible, temporary, case-specific teams. They work from the specific to the general, not the other way around. The nature of the concrete problem facing them requires that they take an outcome-oriented and pragmatic, rather than philosophical or ideological, approach. Prosecutors and enforcers have also become accustomed to decentralization and delegating some aspects of their operations (such as information gathering and, more recently, implementation of compliance processes) to the corporations being investigated.

"destabilizing"[169] to a corrupt corporation than regular prosecutions or enforcement actions, and do so in a more constructive manner; they put in motion a process with unpredictable effects, and this amplifies the impact of the process on the corporation.

Moreover, Reform Undertakings, through their explicit problem-solving methods, have the capacity to distinguish between cosmetic compliance and genuine compliance. Unlike one-shot deterrent sanctions where the broader effect is hard to ascertain, Reform Undertakings present an opportunity for prosecutors and enforcers to discern the underlying causes of corporate wrongdoing and then work towards determining how to reform corporate culture. This gives prosecutors and enforcers a stronger evidentiary basis for the application of Ayres' and Braithwaite's famous enforcement pyramid.[170] Consequently, the entire process becomes more transparent and credible, which potentially can have positive effects throughout the industry or relevant community by granting a sense of legitimacy and fairness to the entire enforcement process.[171]

2. Reform Undertakings: How

There are certain fundamental attributes that are necessary to ensure that Reform Undertakings serve as a powerful tool for effecting meaningful change in corporate cultures. First, the Reform Undertaking must be transparent in its processes and explicit in its reason-giving. Transparency fosters credibility and trust, which are fundamental to

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[169] *See* Charles F. Sabel and William H. Simon, *Destabilization Rights: How Public Law Litigation Succeeds*, 117 HARV. L. REV. 1015 (2004) (adopting the concept of destabilization from Roberto M. Unger to the public law litigation context)

[170] *See supra* note 151 and accompanying text.

[171] *See generally*, Tyler, *supra* note 78 (observing that people are more likely to abide by laws they consider rational and fairly applied)

the sort of iterative and investigative exercise contemplated here.[172] Second, the Third Party must employ a forward-looking, problem-solving methodology rather than a retrospective, blame-allocating one.[173] This entails constructively identifying and responding to problems, and precludes whitewashing efforts by the corporation. Although the process should be remedial instead of punitive, a credible enforcement capacity should be held in reserve should the Reform Undertaking fall apart, as is currently the case with current deferred prosecution agreements.[174] Indeed, whether considering the regulatory environment (where purely punitive measures are impermissible) or the prosecutorial one (where they are almost assumed), forward-looking remedial mechanisms are better suited to dealing with corporate actors.[175]

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[172] *See* Ford, *supra* note 23. The kind of transparency that matters here is transparency toward the participants in the Reform Undertaking process. Whether documents like the Third Party's reports should be made available to others, including members of the public, is a more difficult question. This kind of openness fosters accountability, but also imposes a potentially crippling chill on parties' willingness to communicate freely. Existing Reform Undertakings make no provision for public dissemination of third party reports. One of the author of this article's requests for such documents under the Freedom of Information Act have thus far been declined, generally on the basis that the disclosure of documents could reasonably be expected to interfere with law enforcement activities. *See* 5 U.S.C. § 552(b)(7)(A), 17 CFR § 200.80(b)(7)(i).

[173] In other words, the Third Party must, in part, serve as a valued member of the team seeking to solve the problem at-hand and achieve a common goal, as opposed to an external agent seeking to discover who is at-fault. *See* Kathleen M. Eisenhardt et al., *How Management Teams Can Have a Good Fight*, HARV. BUS. REV., July/Aug. 1997, at 77**,** 80-81 (stressing the importance of finding a common goal for the team to work towards to avoid discussions deteriorating into unproductive arguments over blame); see also David A. Garvin & Michael A. Roberto, *What You Don't Know About Making Decision*s, HARV. BUS. REV., Sept. 2001, at 108 (contrasting an advocacy approach to argument, which focuses on persuading and blaming, versus an inquiry approach, which focuses on problem-solving and constructive criticism).

[174] *See Baker Hughes Incorporated*, *Deferred Prosecution Agreement*, *supra* note 60, at 20-22 (stating that if Baker Hughes violates any terms of the agreement (determined by the "sole discretion" of the DOJ) then it may be subject to prosecution and that prosecution "may be premised on information provided by Baker Hughes").

[175] For example, many argue that attributing criminal liability to corporations is incoherent. *See*, *e.g.*, V. S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?,* 109 HARV. L. REV. 1477 (1996). A classic statement of this position is "Did you ever expect a corporation to have a conscience, when it has no soul to be damned and no body to be kicked?" John C. Coffee, Jr., "*No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386 (1981) (quoting Edward, the first Baron Thurlow, from the 18th Century). Moreover, criminal enterprises aside, corporations provide important public benefits (including shareholder and economic value, employment, and goods and services), meaning that there is good reason to attempt to reform rather than vindictively

Third, the Reform Undertaking process should be flexible. To be successful, Reform Undertakings must be capable of engaging in the experimentation necessary to determine what works, learn from past experience, and be updated based on new information. These capabilities are necessary to ensure the development of remedial measures tailored to each corporation's unique history and current situation. Organizational cultures are complex and the relevant factors—such as, leadership, reward systems, communication norms, and employee perceptions of justice—combine in different ways in different corporations, although the end result may be same: a culture that accepts the payment of bribes by employees and agents.[176] Thus, flexibility is necessary to ensure that the Reform Undertaking is appropriately sensitive to challenge at-hand and has the capacity to evolve as the actors gain new knowledge into the root causes of the corporation's problems.

The fourth attribute is closely related to the third, and goes to the ultimate goal of this regulatory approach: the Reform Undertaking should seek to "grow" endogenous connections between its own processes and the corporation's unique profile. Because the problem of corruption within these "worst actor" firms is embedded in their culture, Reform Undertakings must seek to leverage the corporation's resources, capabilities, strategic orientation, and values, in the service of effecting thoroughgoing reform. Among other things, this means avoiding unreflective mimicry of what may have worked

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hobble them. This concern is reflected in the McNulty Memo's direction to prosecutors that they consider the "collateral consequences" to society when deciding whether or not to prosecute a corporation. McNulty, *supra* note 64, at 4.

[176] *See supra* Part II.D.2

for other corporations that engaged in similar conduct.[177] Consistent with integrity-based compliance programs,[178] the Reform Undertaking must encourage the corporation to internally develop its values and then support those values with the appropriate structures and systems.[179]

In principle, none of the above attributes seem beyond the capacity of any existing Reform Undertaking, although empirical verification still remains to be done. Three additional factors seem equally essential. Anecdotal evidence, however, suggests greater difficulty in incorporating these attributes into Reform Undertakings. First, there should be broad and well-managed participation by all levels of the organization in the process. It is difficult to overstate the importance of such participation when the goal is to effect change to existing culture through the questioning of current practices[180] and the internal development of organizational values that support ethics over the continuation of corruption.[181] This importance becomes clear when considering such cases as Schnitzer Steel[182] and Baker Hughes,[183] where employees at various levels of the corporate hierarchy and in various geographic locations apparently participated in longstanding and widespread wrongdoing. Without the participation of employees representing these different positions, then the organization is more likely to misperceive the true causes of

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[177] *See* Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, *in* THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS (Walter W. Powell & Paul J. DiMaggio, eds., 1991).

[178] *See supra* notes 139-40 and accompanying text.

[179] Paine, *supra* note 139, at 112.

[180] *See supra* notes 131-37 and accompanying text (discussing Brief and colleagues arguments in support of "functional disobedience" to reverse corrupt corporate cultures).

[181] *See supra* notes 139-40 and accompanying text (discussing the importance of integrity-based compliance programs).

[182] *See supra* notes 154-60 and accompanying text.

[183] *See supra* notes 161-67 and accompanying text.

the breakdown in the organization's software. In brief, changing corporate culture requires a combination of top-down, demonstrated leadership commitment to ethics, and bottom-up, direct employee participation in self-governance. Top management, with its skewed view of the ethical climate of the firm and how employees perceive their ethical leadership, [184] cannot meaningful change corporate culture without this participation.

Although there is evidence that the drafters of some settlement agreements recognize the importance of broad participation,[185] in other cases, this factor may pose significant challenges to allowing Reform Undertakings to achieve their full potential. This includes incorporating meaningful participation from not just lower-level employees, but also top management. For a number of Third Party monitorships in securities law enforcement, these problems result from an expert-centric approach to the role of the monitor.[186] Although these types of monitors can bring valuable expertise to the process, an approach centered on top-down recommendations for structural change from the Third Party cannot be a substitute for a corporation's own problem-solving process. The endogenous changes necessary to create a sustainable ethical culture must include the corporation's direct and meaningful involvement.

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[184] *See supra* note 103 and accompanying text (citing empirical evidence from the Ethics Resource Center and Treviño).

[185] For example, the Schnitzer Steel Settlement Order stipulates that "Schnitzer shall require the Compliance Consultant to formulate conclusions based on sufficient evidence obtained through, among other things … meetings with and interviews of Schnitzer employees, officers, directors and any other relevant persons." Schnitzer Steel, *Cease-and-Desist*, *supra* note 154.

[186] For examples of such approaches, consider the Breeden reports in the WorldCom and Hollinger cases. *See* Richard C. Breeden, *Restoring Trust: Report to the Hon. Jed S. Rakoff, United States District Court for the Southern District of New York, On Corporate Governance for the Future of MCI* 20, 25 (Aug. 2003), available at http://www.sec.gov/spotlight/worldcom/wcomreport0803.pdf; *Report of Investigation by the Special Committee of the Board of Directors of Hollinger International Inc.*, August 30, 2004, available at http://www.sec.gov/Archives/edgar/data/868512/000095012304010413/y01437exv99w2.htm; s*ee also* Ford, supra note 23, at 807-09.

Even if the Third Party takes on the more appropriate role of a consultant or team member, the selection of the monitor will play a significant role in the ultimate success of the Reform Undertaking. For the DOJ's recent DPAs, monitors are generally legally-trained and behave much like lawyers—collecting documents and assembling a "case" of sorts.[187] This raises the question of whether the role enacted by these Third Parties will lead to a sufficiently open-ended and participatory dialogic process.[188] Meeting the necessary participation requirements is challenging and costly to create and maintain relative to more centralized exercises in information analysis. Such a process cannot be expected to spring forth organically from the Reform Undertaking without direct attention to the matter on the part of those drafting the Reform Undertaking terms and those implementing them.

The selection of the Third Party, then, is crucial – not only because the Third Party's background and expertise affects her approach to the project, but also because the Third Party's role requires a formidable range of skills and qualifications to function effectively. As an external change agent, the monitor should not simply audit corporate efforts to implement or improve compliance programs and internal controls, but must also work to ensure their effectiveness through changes in the organization's software. To do this, monitors need to understand the various organizational hurdles related to the flow of information in the firm (especially bad news), how the incentive system works in

[187] *See* Khanna and Dickenson, *supra* note 17, at 1725 (2007) (describing how monitors carry out their role).

[188] Khanna and Dickenson also note that Third Parties and their subject corporations frequently disagree about the scope and purview of the monitor's task – or what corporations call "scope creep." Khanna and Dickenson, *supra* note 17, at 1725. This suggests, predictably, that subject corporations are preoccupied with circumscribing the process and minimizing the destabilization it represents, while Third Parties are, perhaps for any number of reasons ranging from ensuring efficacy of the process to paternalistic power-seeking, interested in expanding its ambit.

practice, the social norms of the organization, and other factors related to the firm's culture and ethical climate. In addition, to be successful and sustainable, the changes a Third Party proposes must be consistent with the strategic needs of the corporation.

To accomplish these goals, corporate monitors should have several necessary characteristics. First, the Third Party must have an appropriate skill set, including being able to facilitate dialogue and manage a collective deliberative process, with an appreciation for relevant power imbalances within the corporation. Second, the Third Party must have credibility, both with the corporation and with prosecutors and regulators. This likely requires experience in the industry (or in analogous business settings) and a reputation for fair dealing.[189] Furthermore, the Third Party must be both structurally and psychologically independent from the corporation.[190] The monitor should have no prospect of future business with the firm,[191] and should have her own reputational capital at stake.[192] Independence also requires that the Third Party be able to access outside support, from prosecutors or regulators, in the event of material non-compliance by the corporation. Third, the Third Party must be accountable for her actions – this means being answerable to the SEC, the Department of Justice, or the court, regarding not only for her recommendations for the corporation, but also for her own conduct.[193] Collectively, these characteristics allow the Third Party to develop the trust

[189] Ford, *supra* note 23, at 811.

[190] Id.

[191] Most settlement orders underlying modern Reform Undertakings set out a period of time, after the Reform Undertaking is concluded, during which the third party monitor may not accept any other business from the corporation. Id. at 811n.179.

[192] *See* John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403 (2002) (using the term "reputational capital").

[193] Ford, *supra* note 23, at 813-14.

necessary to make the Reform Undertaking a meaningful process. Whether or not actual Third Parties conform to this profile remains to be seen, but Reform Undertakings—as products of the legal system—must not simply default to the selection of Third Parties that are more likely to possess legal skills than the broader problem-solving and facilitative skills that are necessary.

The selection of appropriate Third Parties may not be as daunting as it initially appears. Since the passing of the Sarbanes-Oxley Act there has been significant growth in the attempts to understand the appropriate role and qualifications of ethics and compliance officers, [194] and even to professionalize the role.[195] These developments should continue to be valuable for understanding the appropriate skills of the Third Parties, identifying potential candidates to serve as Third Parties, and providing resources and experiences for understanding how to perform the role.

In addition, the recent empirical work by Susan Sturm on ending discrimination within organizations provides significant insights.[196] As stated earlier, Sturm is concerned with "second generation" discrimination, which is discrimination that is embedded in the organization's structures and culture.[197] Thus, Sturm's analysis is directly instructive to understanding how Third Parties can and should function in the Reform Undertaking

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[194] For organizations devoted to compliance and ethics professionals, see *Society of Corporate Compliance and Ethics Website*, at www.corporatecompliance.org; and the *Open Compliance and Ethics Group website*, at http://www.oceg.org. For a recent discussion of the appropriate role of an ethics officer, see CHIEF ETHICS & COMPLIANCE OFFICER (CECO) DEFINITION WORKING GROUP, LEADING CORPORATE INTEGRITY: DEFINING THE ROLE OF THE CHIEF ETHICS AND COMPLIANCE OFFICER (2007), available at http://www.darden.edu/corporate-ethics/pdf/Leading_Corporate_Integrity_Report.pdf.

[195] *Society of Corporate Compliance and Ethics, CCEP Candidate Handbook* (2006), available at http://www.corporatecompliance.org/CCEP/CCEP_2006_handbook.pdf

[196] Susan Sturm, *The Architecture of Inclusion: Advancing Workplace Equity in Higher Education*, 29 HARV. J.L. & GENDER 247 (2006) [hereinafter Sturm, *Architecture*].

[197] *See supra* notes 115-17 and accompanying text.

context. In her study of anti-discrimination efforts at higher educational institutions, Sturm focuses, in part, on the role of key third parties she calls "organizational catalysts."[198] Sturm describes organizational catalysts as "individuals who operate at the convergence of different domains and levels of activity," and who consequently "leverage knowledge, ongoing strategic relationships, and accountability across systems."[199] As with the potential for Third Parties retained in Reform Undertakings, Sturm's organizational catalysts are effective in part because they have knowledge, influence, and credibility across domains. Their skill sets allow them to serve as "information entrepreneurs," by drawing together information from various sources to assist the corporation in improving its culture.[200] They act as gadflies and keep the pressure on the organization to focus on the task at hand, as well as grant legitimacy and voice to those within the organization that seek positive change.[201] In addition, these organizational catalysts cultivate new collaborative relationships amongst employees at all levels of the firm, as well as potentially with important outside entities.[202] This connects employees with mutual interests and complementary roles in reducing corruption that would not have otherwise met, and cultivates the necessary open communication norms that allow employees to find support for their ethical beliefs.[203] This is consistent with the observations of several scholars, in different contexts, that the ability to foster dialogue and identify shared interests across seemingly impermeable

[198] Sturm, *Architecture*, *supra* note 197, at 250-51.

[199] Id. at 287.

[200] Id. at 290-95.

[201] Id. at 297-99.

[202] Id. at 295-97.

[203] *See supra* notes 131-37 and accompanying text (discussing mechanisms necessary to support "functional disobedience").

group boundaries is an especially important trait of the dialogic, pragmatic nature of New Governance problem-solving.[204]

The third outstanding attribute of a truly effective Reform Undertaking—in addition to broad participation and a qualified Third Party—exists at the macrolevel. This is the need for some form of centralized data collection, aggregation, and analysis. Information capture is a major advantage of Reform Undertakings relative to other prosecutorial and enforcement tools. Each undertaking captures a specific case study of what went wrong in a particular corporation, and what steps seem to work (and what do not) in breaking through and reversing the stubborn problems of organizational culture. This is invaluable information for all stakeholders in Reform Undertakings, including regulators, prosecutors, compliance professionals, corporations, scholars, interested members of the general public, and for the credibility of the Reform Undertaking project as a whole. Centralized data collection and analysis provides an opportunity to determine the generalizability of lessons from each corporation's experience.

Third Party monitors, then, should have the responsibility to collect the information generated from each Reform Undertaking in a form that makes it possible to compare experiences across firms.[205] Centralized coordination of discrete problem-solving exercises is a core component of the New Governance approach.[206] The SEC is

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[204] *See, e.g.,* Charles F. Sabel & William H. Simon, *Destabilization Rights: How Public Law Litigation Succeeds*, 117 HARV. L. REV. 1015, 1097-1100 (2004); Brandon L. Garrett & James S. Liebman, *Experimentalist Equal Protection*, 22 YALE L. & POL'Y REV. 261, 323-27 (2004).

[205] Currently, Third Party monitors reports under deferred prosecution agreements are not required to be made public. Garrett, *supra* note 18, at 897; *see also supra* note 172 (noting the lack of public access to Third Party's reports).

[206] On the consensus among New Governance scholars regarding the need for a clearinghouse: *see* Ford, *supra* note 23, at 814-15n.187.

positioned to have in place systems that can accommodate this informational task,[207] and the DOJ should be encouraged to do likewise. Other interested parties, such as industry associations, may also play a role in aggregating and analyzing information arising out Reform Undertakings.[208] Regardless, effective use of the information requires prosecutors and enforcement staffers to utilize greater data management skills than they have traditionally been required to use. In particular, those working with the data will only be truly effective if they operate as flexibly as the Reform Undertaking participants themselves; taking a nuanced and evolving view of the best practices to emerge from various undertakings as opposed to relying solely on static checklists or established practices. [209]

B. Institutionalizing Reform

For Reform Undertakings to produce sustainable change on widespread basis the learning processes they stimulate and the reforms they catalyze must be

[207] Consider, e.g., the SEC's Office of Risk Assessment. The ORA was formed in 2004 "to help the SEC anticipate, identify, and manage risks." Information about the ORA on the SEC website is still sparse, however: see http://www.sec.gov/about/offices/ora.htm.

[208] In addition to industry associations, other organizations, such as trade councils, public watchdogs like Transparency International, or nonprofits focused on compliance and ethics programs (*supra* note 194), may become involved. In Sturm's model, some combination of these groups and regulators could function collectively as "institutional intermediaries," which she defines as those "public or quasi-public organizations that leverage their position within preexisting communities of practice to foster change and provide meaningful accountability." Sturm, *Architecture*, *supra* note 197, at 251. Institutional intermediaries perform such functions as pooling knowledge, structuring collaborative relationships amongst various interested entities, developing accountability processes for the knowledge created, and supporting a community of scholars, practitioners, and policy-makers, to sustain the process of knowledge creation. Id. at 251, 280, 312-23. Although Sturm focused on one institutional intermediary performing all of these functions, multiple organizations working collaboratively could serve the same purpose.

[209] Other interested organizations, *see supra* note 208, may also play a role in articulating the "best practices" to emerge from Reform Undertakings. On the relationship between third parties such as industry associations and trade councils, and regulators, with respect to reconciling a "best practices" approach within a "light touch" securities regulatory regime, see Cristie Ford, *New Governance, Compliance, and Principles-Based Securities Regulation* (forthcoming AM. BUS. L. J. 2007).

institutionalized.[210] Even a Reform Undertaking's multi-year destabilization exercise will not overcome self-serving organizational stasis if it fails to change the ground rules by which the organization operates. This kind of institutionalization requires action by several different parties.

Prosecutors and regulators must be prepared to engage in their own ongoing learning about, for example, best compliance practices so that they are credible in their interactions with corporations. Just as importantly, prosecutors and enforcers must maintain a credible enforcement "stick" at the ready, and they must be prepared to respond to wrongdoing, including stonewalling in the course of a Reform Undertaking, quickly and effectively. Such a hard-line approach reinforces the fact that the *status quo* is not an option. Reform Undertakings should not be viewed as an all-purpose alternative to other available sanctions against corporations. In addition, New Governance strategies, such as Reform Undertakings, do not have to, and should not, operate as a mutually exclusive alternative to traditional enforcement mechanisms.[211] Rather, regulators and prosecutors should have at their disposal the full range of possible sanctions. Reform Undertakings do not function primarily in terms of a deterrent

[210] *See* Sturm, *Architecture, supra* note 197, at 299-301.

[211] Bradley C. Karkkainen, Reply, *"New Governance" in Legal Thought and in the World: Some Splitting as Antidote to Overzealous Lumping*, 89 MINN. L. REV. 471 (2004) (clearing up any misconception that New Governance means "soft law" and reiterating importance of enforceability). There are very few actual instances in which a Reform Undertaking style monitor was appointed without the simultaneous imposition of fines, civil penalties, or a restitution order on a corporation. The rare exceptions in the criminal context appear to be Aurora Foods, Inc, 2001, and Merrill Lynch, 2003. *See* Khanna & Dickinson, *supra* note 17, at 1745 & 1750. In practice, clearly, Reform Undertakings coexist with other sanctions. This is not to suggest that most, or even any, Reform Undertaking settlement agreements reflect the idealized or "true" Reform Undertaking model. However, even the "true" Reform Undertaking should be able to operate effectively in tandem with fines, restitution orders, individual penalties, and other sanctions.

capacity,[212] but instead seek to address problems to which deterrence alone can provide only a partial and unpredictable response.[213] Overall, Reform Undertakings should be viewed as embedded within the more traditional enforcement and prosecutorial functions.[214]

The continual, active maintenance of the ethical culture must also be institutionalized within the corporation. The establishment of the necessary organizational hardware is not sufficient.[215] The software of the corporation—which it should be noted is significantly less auditable for monitoring by external agents than a corporation's hardware—must be actively managed and updated to handle the new risks the corporation faces as it enters new markets, adjusts its strategies to remain competitive, and generally adapts to the changing business environment. For example, top management must ensure that employees appropriately perceive their demonstrations of ethical leadership and that norms of open communication on ethical issues are not eviscerated by the demands of short-term profitability.[216] In short, "functional disobedience" must be allowed to flourish and new employees must be socialized into positive organizational values and not into routinized corruption.

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[212] *But see* Khanna & Dickinson, *supra* note 17, at 1727-31 (describing corporate monitors as a deterrence mechanism and comparing their use to cash penalties)

[213] *See supra* Part III.B; *see also* Ford, *supra* note 23, at 766-74 (discussing the limits of deterrence-based approaches in addressing corporate cultural problems).

[214] The continuing specter of sanctions means that there will be costs at the margins. That is, the Reform Undertaking process may not be characterized by dialogue as free as would take place without any coercive "stick" in the background. But while trust is important to dialogue, Reform Undertakings do not require a level of mutual trust and open-ended dialogue between a corporation and a Third Party that is impossible in the enforcement/prosecutorial context. *cf* Mark Tushnet, *Governance and American Political Development*, in LAW AND NEW GOVERNANCE IN THE EU AND THE US 381 (Graínne de Burca & Joanne Scott, eds., 2006). On the contrary, Reform Undertakings open up a space that would not otherwise exist within the enforcement superstructure. It is within this space that there is the best chance of having the type of dialogue that necessary to sufficiently address corporate culture problems.

[215] *See supra* notes 80-87 and accompanying text.

[216] *See supra* notes 131-42 and accompanying text.

To create an environment in which the corporation no longer needs the Reform Undertaking to further its own compliance progress and solve its organizational culture problems, requires a broader reorientation. To this end, Third Parties and all participants in the Reform Undertaking process should remain alive to the new strategic alliances that emerge from its dialogic process. Third Party should also take steps to entrench and encourage these alliances where they further law-abiding or "watchdog" behavior. Working in concert increases each party's capacity to effect change.[217] The multiple stakeholder groups that determine the content of the corporation's broader "license to operate" also play a key role.[218] No prosecutorial or enforcement action on its own can achieve meaningful reform if it operates in isolation from, or in opposition to, the larger law-favoring forces at work on the corporation.[219] The Reform Undertaking is an important prosecutorial and enforcement tool not only for its processes during its active term, but especially for the ongoing reformative process that it has the potential to catalyze into the future.

[217] *See* Hess, *supra* note 80, at 1812-14 (discussing the potential role of intermediary groups in improving the use of integrity-based compliance and ethics programs)

[218] Gunningham et al., *supra* note 21, at 329-39.

[219] For example, in examining when financial executives would actually use their company's code of ethics in strategic decision making, Stevens and colleagues found that regulatory pressure was insignificant. John M. Stevens et al., *Symbolic or Substantive Document? The Influence of Ethics Codes on Financial Executives' Decisions*, 26 STRAT. MGMT. J. 181, 188 (2005). Instead, significant factors included market pressure (such as from shareholders, customers, suppliers, and banks) and the need to develop a positive corporate image for stakeholders generally. Id. at 188-90.

V. Conclusion

Over the past decade the problem of corruption has finally started receiving the attention it deserves from policy makers.[220] Over the past few years the Securities Exchange Commission and Department of Justice have finally started making serious efforts at enforcing the United States' anti-bribery laws against corporations.[221] These efforts will not be effective against the worst offenders, however, if they do not address the issue of corporate ethical culture. Over time, the use of improper payments can become embedded in a corporation's culture and its day-to-day routines. The organizational actors treat payments of bribes, or the use of agents the company suspects of paying bribes, solely as economic issues and not as legal and ethical issues. Through the DOJ's use of deferred prosecution and non-prosecution agreements and the SEC's use of settlement agreements, these agencies are attempting to address these root causes of corruption in many corporations. These agreements typically require corporations to adopt more effective compliance programs and to retain independent corporate monitors to oversee the implementation process.

This article analyzed the potential effectiveness of these agreements through a New Governance perspective and developed the idea of a Reform Undertaking. Based on the essential features for effectiveness that this article identified, Reform Undertakings have a lot in common with the currently used deferred prosecution agreements and SEC settlements, but there are also significant differences. Of primary importance is the role of the third party independent monitor. This Third Party should serve not as a simple

[220] Hess & Dunfee, *Fighting Corruption*, *supra* note 24, at 600 (quoting the president of the World Bank as stating in September 1997, "Only 18 months ago, the word corruption was never mentioned. Today, there is a publicly expressed revulsion, on moral, on social, and on economic grounds.").

[221] *See supra* notes 3-5 and accompanying text.

monitor or as an all-powerful czar,[222] but must take on facilitating and problem solving roles. These are roles which require significantly different sets of skills and characteristics than someone serving a monitoring role or a czar role. Overall, through the use of a New Governance perspective, this article identified essential features of Reform Undertakings that can more effectively tackle the root cause of persistent corrupt behavior by corporations—the corporation's ethical culture—than alternative regulatory mechanisms.

[222] Khanna and Dickenson, *supra* note 17, at 1727.