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Lehman 10 Years Later: The Dodd-Frank Rollback

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Accountability Lost and the Problem(s) of Asymmetry

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Professor Gilchrist argues that calls for more individual prosecutions in cases of corporate malfeasance are ultimately misguided. In this Essay, Gilchrist discusses the asymmetries of information and power within corporations that make criminal prosecutions of high-level executives particularly difficult and often inappropriate.

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INTRODUCTION

Whither accountability? Loyola University Chicago recently posed this question at a symposium marking ten years since the Lehman collapse and all that followed.¹ The answer, both implied and correct, is yes.

Few people faced any consequences following the crisis, and this lack of consequences eroded public confidence in the justice system. As Judge Rakoff famously wrote nearly five years ago, “if . . . the Great Recession was in material part the product of intentional fraud, the failure to prosecute those responsible must be judged one of the more egregious failures of the criminal justice system in many years.”²

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1. Program, Loyola’s Annual Institute for Investor Protection Roundtable Conference, Lehman 10 Years Later: Lessons Learned? (Sept. 14, 2018), http://www.ilep.info/pdf/symposia/2018_LUC_IIP_Program.pdf.

2. Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), <https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/>.

Five years later, there have been no further consequences, and none are likely. Accordingly, “[i]n the popular imagination, the people who caused the crisis got away with it scot-free, and, as what scientists call a first-order approximation, that’s about right.”³ The banks were bailed out, the bankers were not prosecuted,⁴ and the public suffered years of austerity and fallout from one of the worst financial crises in history.

The public demand for accountability is strong. It most often takes the form of demanding that those real people who engage in misconduct on behalf of corporations be criminally prosecuted. This demand extends beyond the financial industry to all forms of corporate malfeasance. We hear the call when something goes seriously wrong, whether it is a financial crisis with links to financial instruments of practically alchemical provenance, or the catastrophic harm to the Gulf of Mexico following the failure of an offshore drilling rig: *Jail the bankers, lock up the executives!*

The most formal—and accordingly tempered—iteration of this push is the Yates Memorandum (Yates Memo), published by then-Deputy Attorney General Sally Yates in 2015.⁵ The Yates Memo provided guidance to federal prosecutors and directed particular changes to the Principles of Federal Prosecution of Business Organizations, all aimed at generating more prosecutions of individuals in cases of corporate wrongdoing.⁶ Specifically, the Yates Memo precluded leniency for corporations cooperating with the Department of Justice unless the entity provided all information about individuals involved in the misconduct.⁷

3. John Lanchester, *After the Fall*, LONDON REV. BOOKS (July 5, 2018), <https://www.lrb.co.uk/v40/n13/john-lanchester/after-the-fall>.

4. To be clear, in the popular imagination, this is the crux of the problem. Most criticism, both popular and scholarly, has been of the failure to hold individuals working in the financial sector responsible. After all, these “bankers” introduced unacceptable risks to the economy while insulating themselves and their firms from the failure. That bankers are most responsible for the crisis mirrors the conventional wisdom; it’s also probably correct simply as a matter of proximate cause. As with any crisis of this magnitude and complexity, however, there were other culprits too. For example, the vast majority of the American public accumulated greater and greater debt on the now-incredible-but-then-widely-held assumption that real property would always appreciate. This Essay, following the lead of the Symposium, concentrates on the lack of accountability for those working in the financial sector.

5. See Memorandum from Sally Quillian Yates, U.S. Deputy Attorney Gen., to All U.S. Attorneys 2 (Sept. 9, 2015), <https://www.justice.gov/dag/file/769036/download> [hereinafter Yates Memo]. As I discuss further below, the demand for more individual accountability is not a singular or uniform call. The pure populist demand for blood is quite distinct from the measured call by Judge Rakoff, former Deputy Attorney General Yates, and others who are carefully trying to improve the legal system. My contention, however, is that the populist demand empowers measured efforts like the Yates Memo, and such efforts, in turn, are likely to result in quite different prosecutions than their drafters might have hoped.

6. *Id.*

7. *Id.* at 3.

Additionally, it directed federal prosecutors to prioritize individual prosecutions when investigating and resolving corporate crimes.⁸

Sally Yates's successor, Rod Rosenstein, has said this policy is under review, but any changes are unlikely to represent a significant shift away from prioritizing individual accountability. First, Rosenstein said as much: "[A]ny changes will reflect our resolve to hold individuals accountable for corporate wrongdoing."⁹ Moreover, the call for individual prosecutions remains as popular as ever, and it seems politically unwise to roll back this policy. Finally, the Trump administration has continued to promulgate new policies and advisories—in the context of both the Foreign Corrupt Practices Act (FCPA)¹⁰ and the United States Commodity Futures Trading Commission¹¹—consistent with the Yates Memo's emphasis on individual prosecutions.

Accordingly, there is little reason to expect a shift away from public and official demands for individual liability in cases of corporate misconduct. Demanding individual accountability in the abstract makes good sense. Prosecuting corporations is, and always has been, problematic. Doing so visits the wrongs of an agent on generally innocent owners. Punishing innocent owners for wrongs committed through property is not without precedent or reason.¹² Indeed, when I teach a seminar on corporate criminal liability, we always read a terrific maritime case about piracy on the Atlantic during the summer of 1840.¹³ The case is interesting because the court permits the seizure and forfeiture of the

8. *Id.* at 4.

9. See Rod J. Rosenstein, U.S. Deputy Attorney Gen., Keynote Address at the NYU Program on Corporate Compliance & Enforcement (Oct. 6, 2017), http://www.law.nyu.edu/sites/default/files/upload_documents/Rosenstein%2C%20Rod%20J.%20Keynote%20Address_2017.10.6.pdf.

10. See U.S. DEP'T OF JUSTICE, U.S. ATTORNEYS' MANUAL § 9-47.120; see Rod J. Rosenstein, Remarks at the 34th International Conference on the Foreign Corrupt Practices Act (Nov. 29, 2017), <https://www.justice.gov/opa/speech/deputy-attorney-general-rosenstein-delivers-remarks-34th-international-conference-foreign> (emphasizing the "Department's commitment to hold individuals accountable for criminal activity" and further stating, "Effective deterrence of corporate corruption requires prosecution of culpable individuals. We should not just announce large corporate fines and celebrate penalizing shareholders.").

11. U.S. Commodity Futures Trading Comm'n, Div. of Enforcement, Enforcement Advisory: Cooperation Factors in Enforcement Division Sanction Recommendations for Companies, <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf> (stating that quality of corporate cooperation should be assessed in part on whether there was full disclosure of the "identities of individual wrongdoers within the organization, including culpable senior executives, where applicable").

12. For an excellent overview of two ancient rationales for such punishments, see Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359 (2009).

13. See *Harmony v. United States*, 43 U.S. 210 (1844).

brig involved, notwithstanding the fact that the owners were entirely innocent and unaware of the piracy.¹⁴

Corporate criminal liability functions similarly. Fining a corporation most directly affects shareholders—not management and not those who engaged in misconduct.¹⁵ Whether viewed through a retributive or deterrence lens, entity-level liability is at best unsatisfying.¹⁶ Moreover, even accepting the viability of deterring corporate malfeasance through criminal liability, the mechanism is extremely attenuated. The agency problem, differing time horizons, and variable risk tolerances make entity-level punishment an inefficient method of deterring individual corporate agents.

There are good reasons to punish corporations *qua* corporations. The best reason, I believe, is that a system that never holds corporations criminally accountable sends a harmful message that threatens to undermine its perceived legitimacy: namely, at the corporate level, crimes are merely priced.¹⁷ But for those who want to actually punish and deter wrongdoing, it is difficult to improve upon individual accountability.

The call for more individual criminal prosecutions is therefore understandable and unlikely to dissipate, either as a matter of public demand or formal policy. And yet, I believe that it is misguided.

Demanding more criminal prosecutions against individuals in cases of corporate misconduct will mostly impact relatively low-level offenders. The engineer, the site manager, the accountant—not the senior executive or director—bears the brunt of these policies. Yet low-level prosecutions, even if deserved, accomplish little in terms of changing corporate culture. Moreover, prosecuting lower-level employees for corporate misconduct risks aggravating the perceived accountability problem through the appearance of scapegoating, as senior personnel still evade punishment.

At the Symposium, I offered a host of reasons for why increasing individual prosecutions will fail to achieve the goals of those calling for

14. See Gregory M. Gilchrist, *Individual Accountability for Corporate Crime*, 34 GA. ST. U. L. REV. 335, 345–48 (2018).

15. See 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, 401 (1981). There can be, and generally is, overlap between these categories because management and employees frequently number among shareholders; however, if the penalty falls on shareholders, it does so with no regard for differing degrees of culpability.

16. There is no good theory of desert-based punishment of corporations, and while corporations are subject to deterrence, that alone cannot justify the imposition of criminal (as opposed to civil) penalties. See Gregory M. Gilchrist, *The Expressive Cost of Corporate Immunity*, 64 HASTINGS L.J. 1, 7 (2012).

17. *Id.*

such an increase. I have written on this issue before,¹⁸ and the topic generates controversy.¹⁹ In this Essay, I will elaborate on one particular challenge for individual prosecutions: the asymmetry problem.

There are three forms of asymmetry worth immediate mention in this context. The most fundamental asymmetry is the knowledge gap between corporate management and law enforcement. That is, in most—but not all—scenarios, the insiders (management) know more about the targeted conduct than the outsiders (law enforcement). This is not unique to corporate law enforcement; it is generally the case that those involved in criminal conduct know more about the conduct than those tasked with policing it.²⁰ The entire enterprise of policing might be understood as an effort to bridge an epistemic gap between some part of the public and the government. This Essay necessarily considers this informational asymmetry between the government and individual corporate actors, but it is not my primary topic.

Two other forms of asymmetry, internal to the firm, are my focus. First, management has less information than the entity as a whole. Second, executives have disproportionate power over the course of most investigations. The former represents informational asymmetry, and the latter represents power asymmetry. Each creates problems for individual accountability. In what follows, I consider each in turn.

I. INFORMATION ASYMMETRY

The most fundamental problem for individual prosecutions in cases of corporate misconduct is that many individuals who may be, in some sense, “responsible” for the misconduct will not be aware of it. The corporate hierarchy systematically shields management and senior personnel from a lot of corporate knowledge. Corporate leaders often lack

18. See generally Gilchrist, *supra* note 14; Gregory M. Gilchrist, *Opacity, Fragility, & Power: Lessons from the Law Enforcement Response to the Financial Crisis*, 83 BROOK. L. REV. 647 (2018) [hereinafter Gilchrist, *Opacity, Fragility, & Power*].

19. See Rakoff, *supra* note 2; see also MARY KREINER RAMIREZ & STEVEN A. RAMIREZ, *THE CASE FOR THE CORPORATE DEATH PENALTY: RESTORING LAW AND ORDER ON WALL STREET* (2017).

20. While not unique to big business, it may be particularly pronounced in the financial industry. See Henry T.C. Hu, *Misunderstood Derivatives: The Causes of Informational Failure and the Promise of Regulatory Incrementalism*, 102 YALE L.J. 1457, 1499 (1993) (arguing that the “ephemeral nature of financial truths,” aggravated by disincentives to publish findings and the lack of personnel movement between industry and regulators resulting from extreme salary differentials, puts financial regulators at a distinct informational disadvantage); see also Steven L. Schwarcz, *Intrinsic Imbalance: The Impact of Income Disparity on Financial Regulation*, L. & CONTEMP. PROBS., 2015, at 97, 109 (“[I]nformation asymmetry [in the financial industry] can prevent regulators from fully understanding financial innovations and products.”).

knowledge, and hence lack a guilty mind, or mens rea.²¹

Corporations, of course, are not real and do not know anything. Corporate knowledge refers to the set of knowledge held by all corporate agents. Corporations act only through agents.²² Corporate awareness of those acts is coextensive with the set of agents' knowledge of those acts. Because the agents are distributed throughout the corporate structure, so too is the knowledge.

Accordingly, corporations often mask individual conduct. The corporate form is an elegant shorthand for something far more complex. It may be easy to describe a particular corporate action by referencing a corporate act, such as, "Apple introduced a new iPhone today." And yet it may be nearly impossible to describe that same action only by referencing actions by real, live people. This is not to say it is actually impossible; indeed, it is necessarily possible. Any corporate action can only be comprised of acts by real people.²³ But, to discuss the matter at the level of individual actions introduces tremendous complexity and undermines comprehension or even comprehensibility.²⁴ Imagine trying to describe the action of a wave only by referencing actions at the molecular level. With sufficient time and computing power, there is no reason this could not be done; but even were it done, something would be lost. The wave matters. So too with corporations.

Consider a company's decision to introduce code into a car's computer system that will evade environmental testing requirements.²⁵ For the corporation to do this, at least one employee must write that code. Assume a single employee wrote the code; it does not follow that she understands that the code will be triggered by a government test. Moreover, quite likely the coder does not know the legal standard measured by the prospective test. To evade that standard, someone, likely a different person, will need to determine the relevant standard. Someone, possibly yet different, will need to learn how the test is conducted. Yet another person may need to figure out what condition correlates with testing and not with routine driving, so as to trigger the cheating code at the appropriate time. Someone else may need to instruct the coder what

21. Joseph W. Yockey, *FCPA Settlement, Internal Strife, and the "Culture of Compliance"*, 2012 WIS. L. REV. 689, 695 ("[I]ssues of mens rea are often the most difficult elements in FCPA and other white-collar crime cases to prove.").

22. 2 NICHOLS CYCLOPEDIA OF FEDERAL PROCEDURE FORMS § 59:61 (2018) ("Corporations can act only through natural persons such as its directors, employees or other agents.").

23. *Id.*

24. See Gilchrist, *supra* note 16, at 16–18.

25. See Jack Ewing, *10 Monkeys and a Beetle: Inside VW's Campaign for 'Clean Diesel'*, N.Y. TIMES (Jan. 25, 2018), <https://www.nytimes.com/2018/01/25/world/europe/volkswagen-diesel-emissions-monkeys.html>.

code she should write, though notably, maybe not why. Even this illustration is itself almost surely too simple. Many more people will likely be involved in generating this single corporate action.

For any corporate action, many people will have some knowledge of the action or events that led to it. Also, many people will need to act in a particular manner to contribute to that ultimate action. But, it is also true that, sometimes, no person will have knowledge of all these links in the chain. No one person may be aware of all the facts and actions that make up the corporate act. This is true whether the act is the decision to raise sales quotas, the decision to hire a particular individual, or the decision to introduce code to cheat emissions tests.

Preet Bharara captured this phenomenon when he explained that “[a] particular person may have had only partial knowledge, and contributed in a chain of actions.”²⁶ He described this “problem in business culture,” as “siloeing,” and pointed out that it could undermine compliance.²⁷ Silos have traditionally developed in large companies along product lines (e.g., food; home care; beauty and personal care), and along functions (e.g., human resources; legal; sales; design; manufacturing), and along geographic locations (e.g., Asia, Latin America, Europe).²⁸ Given the matrices of product, function, and location, silos can and do overlap; however, silos effectively limit information transfer to some degree, even as they create other efficiencies.²⁹

The hierarchical nature of corporations probably requires siloeing of some sort. Consider Kroger. As of February 2018, the company operated 2782 supermarkets and employed approximately 449,000 people.³⁰ Kroger, like any massive corporation, likely has a corporate culture that, to some degree, influences all operations. However, each brick-and-mortar store also develops its own culture. Managers, clientele,

26. David Ingram, *Corporate ‘Siloeing’ an Obstacle to Charging GM Employees: Prosecutor*, REUTERS (Sept. 17, 2015, 5:17 PM), <https://www.reuters.com/article/us-gm-settlement-individuals/corporate-siloeing-an-obstacle-to-charging-gm-employees-prosecutor-idUSKCN0RH31B20150917>.

27. *Id.*

28. See Trevor W. Nagel & Elizabeth M. Kelley, *The Impact of Globalization on Structuring, Implementing, and Advising on Sourcing Arrangements*, 38 GEO. J. INT’L L. 619, 627 n.21 (2007).

29. Silos, while probably necessary in any large organization, are generally perceived as problematic, leading to efforts to “‘flatten silos’ and make it easier for people in different departments to work together.” Linda L. Hardenstein, *Building Better Relationships*, LEGAL MGMT., December 2008/January 2009, at 19, 19. While efforts to limit the silo effect are understandable from a number of managerial perspectives, the reality of silos within large organizations persists.

30. See KROGER, NOTICE OF 2018 ANNUAL MEETING OF SHAREHOLDERS 2018 PROXY STATEMENT AND 2017 ANNUAL REPORT at A-5, <http://ir.kroger.com/Cache/1001237179.PDF?O=PDF&T=&Y=&D=&FID=1001237179&iid=4004136>.

employee dedication, windows, break rooms, quality of parking lots, number of trees—all of these factors and more will contribute to a particular store’s culture. And all of these vary between stores. Policies seek to introduce uniformity, but that is an elusive aspiration. Given the extent and complexity of such a massive operation, it is inconceivable that senior management would have any particularized understanding of store-level operations. At Kroger, one would expect silos to exist along department lines, along brand lines, along regional lines, and between individual stores.

The more complex the industry, the more pronounced siloing becomes. An obvious “cure” to siloing is enhancing the exchange and availability of information, but change and complexity work against that effort. The financial industry suffers acutely from both challenges. Henry Hu describes the problem in the context of SEC disclosures:

[I]t can be difficult for even the most well-intentioned of intermediaries to craft good depictions of reality, especially when the reality is highly complex. Modern financial innovation has resulted in objective realities that are far more complex than in the past. For instance, the true economic characteristics of new, esoteric financial products and of major banks involved in such innovative products are far different, and more subtle, than the characteristics of traditional stocks and bonds and of banks that only took deposits and made loans.³¹

For large and complex operations, siloing does not represent a design failure; it represents a consequence of computational limits. There is no mechanism by which to describe total operations in a way that one person with limited time and multiple responsibilities can grasp.

Hu introduced this problem in the context of public disclosures by large banks, and he recognized the possibility that if “a major bank is indeed ‘too complex to depict’ and pure information-type models are insufficient,” it raises the question of “whether it is also ‘too complex to exist.’”³² For the problem of public disclosures, Hu offers a possible technological solution: replace descriptive disclosures with direct public access to operational data. He explains:

With advances in computer and Internet technologies, it may sometimes be possible to allow investors to “see” (download) what is effectively the real world itself in all its grandeur and detail. Such pure information can be far richer, clearer, and more granular than information that can be gleaned from intermediary depictions. Moreover, because of the

31. Henry T. C. Hu, *Too Complex to Depict? Innovation, “Pure Information,” and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601, 1608 (2012).

32. *Id.* at 1612.

disintermediation, the information conveyed is free from the taint of possible biases or misunderstandings on the part of the intermediary.³³

Alas, while open access may offer hope for disclosures, it cannot help management know more about their firm. Disclosures protect the public as they decide how to invest their money. Open data allows investors to analyze risk for themselves, using whatever tools and models they feel appropriate.

This solution already exists for management, and it does little to address the siloing problem. A massive industry has sprung up around various databases for managing personnel, inventories, and every aspect of a business. Still, colorful graphs and numeric ratings fail to capture the extent of information available on the ground. Indeed, the very problem is that the extent of information available on the ground far exceeds human capacity to comprehend. Just as we cannot imagine a wave solely by reference to molecules, it is also true that we cannot imagine a month of operations at Kroger solely by reference to individual people.

Management will always know less than the sum total of information known to employees down the chain. Information is limited at the top. Accordingly, where there is wrongdoing within a large organization, there is always the possibility, and indeed the likelihood, that senior management was simply unaware of the misconduct. This asymmetry of information, by itself, probably accounts for the vast majority of corporate criminal prosecutions with no accompanying individual prosecutions. The senior personnel that the public wants targeted are, for lack of a better word, innocent.

Of course, innocence is both a legal concept and a moral one, and part of the challenge law enforcement officials face when explaining nonprosecutions is bridging that gap. The public may be correct to condemn corporate leadership for moral failings. When Tony Hayward pressed for more risk to achieve more reward, even at the cost of safety, that surely influenced the decision of on-site engineers to push forward with drilling on the Deepwater Horizon.³⁴ Hayward's push arguably represented a moral failing, but that does not preclude him from being legally innocent. In large and complex organizations, where criminal liability generally—and rightly³⁵—requires mens rea, we ought to expect

33. *Id.* at 1714.

34. Christina Ingersoll, Richard M. Locke & Cate Reavis, *BP and the Deepwater Horizon Disaster of 2010*, MIT SLOAN MGMT. 3 (Apr. 3, 2012), <https://mitsloan.mit.edu/LearningEdge/CaseDocs/10%20110%20BP%20Deepwater%20Horizon%20Locke.Review.pdf> (Hayward maintained an “aggressive growth strategy” and “spoke publicly about his desire to transform BP’s culture to one that was less risk averse.”).

35. See Daniel C. Richman, *Corporate Headhunting*, 8 HARV. L. & POL’Y REV. 265, 270 (2014) (“The de facto requirement of blatant culpability—demanding that a defendant be shown to have

less culpability among senior management if only because senior management is aware of only a fraction of activity within the corporation.

This informational gap between management and the entirety of corporate agents is a key problem with the demand for more individual prosecutions. Viable cases will more often exist against lower-level employees.³⁶ The corporate structure aggregates most corporate action—be it making a sales pitch, billing for a medical procedure, hiring a new employee, or any other of the myriad of ways corporations act thousands of times every day—well below the level of senior management.

For any given corporate function, with a few limited exceptions, such as board reports, public disclosures, or firm-level initiatives, lower-level employees will have more awareness and responsibility for any particular actions. Yet, those are the people who may actually have less moral guilt than legal guilt.

Prosecuting lower-level employees within a massive organization—even where guilt is straightforward as a legal matter—raises difficult questions of fairness. “Do individuals sufficiently influence companies as large as KPMG to the extent that distributive justice is served by holding select midlevel employees accountable for widespread practices within the institution?”³⁷ This is a real and powerful question. In the case of the Deepwater Horizon disaster, two men were charged with manslaughter and other crimes.³⁸ The manslaughter charges were eventually dismissed, but other charges stuck, and any prosecution inflicts a serious toll on the defendant.³⁹ It is worth asking whether those

had a subjective awareness of real wrongdoing— . . . isn’t a bug in our system but a feature.”).

36. Indeed, pushing too hard for individual prosecutions against high-level personnel in cases of corporate wrongdoing can simply backfire if the evidence is insufficient. As one firm has noted of the post-Yates Memo prosecutions in the healthcare industry: “despite the overall high conviction rate in criminal cases brought, the evidence required to prove criminal intent and get convictions in cases of corporate wrongdoing is often lacking.” Eoin P. Beirne, *Health Care Enforcement Review and 2017 Outlook: Yates Memo in Action*, MINTZ, <https://www.mintz.com/insights-center/viewpoints/2017-01-health-care-enforcement-review-and-2017-outlook-yates-memo> (citing “two recent examples of individuals who went to trial in criminal health care enforcement cases after issuance of the Yates Memo” only to be acquitted on the major counts).

37. Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 333 (2007).

38. See Superseding Indictment for Involuntary Manslaughter, Seaman’s Manslaughter and Clean Water Act at 9, *United States v. Kaluza*, No. 12-265, 2013 WL 6490341 (E.D. La. Nov. 14, 2012), <https://www.justice.gov/iso/opa/resources/2520121115143638743323.pdf>.

39. One defendant pled guilty to a misdemeanor offense, while the other was acquitted at trial. See Associated Press, *BP Engineer Is Not Guilty in Case from 2010 Gulf Oil Spill*, N.Y. TIMES (Feb. 25, 2016), http://www.nytimes.com/2016/02/26/business/energy-environment/bp-engineer-is-not-guilty-in-case-from-2010-gulf-oil-spill.html?_r=0.

men, working a job where their superiors were pushing them for results, deserved to be held criminally accountable. It is also worth asking whether holding those individuals accountable could ever accomplish anything positive for corporate governance generally.⁴⁰

The information asymmetry between senior management and the entity as a whole simply means that in many—probably most—cases of corporate criminality, management cannot and should not be prosecuted. There will be cases in which senior executives ought to be prosecuted.⁴¹ This, I believe, is what critics of the status quo, like Judge Rakoff, are really demanding. They are not asking for more prosecutions of mere employees behaving badly within a bad culture. They are calling for the dedication required—both in terms of resources and resolve—to make the difficult cases against senior executives where appropriate.⁴²

The problem lies in the disconnect between the understandable desire to promote more such prosecutions and the likely effect of a policy directing prosecutors to target individuals. To the extent prosecutors are driven by the prospect of recognition and success, deferred prosecution agreement or non-prosecution agreement resolutions accompanied by eye-popping fines and a *New York Times* headline is a relatively easy path. Once misconduct is public, corporations have little incentive to do anything other than conduct a vigorous investigation and cooperate with the government. In doing so, the corporation funds most of the investigative legwork, and presents a near complete case to the DOJ.⁴³

The prosecutors involved reap the rewards of having successfully confronted wrongdoing on a large scale within a powerful organization, with relatively little work. Contrast this scenario with the effort required to secure a conviction against a powerful individual within an

40. David M. Uhlmann, *The Pendulum Swings: Reconsidering Corporate Criminal Prosecution*, 49 U.C. DAVIS L. REV. 1235, 1277 (2016) (“[T]he weight of criminal prosecution falls on individuals who, while culpable, had no control over the corporate policies that led to criminal activity.”).

41. Critics of the failure to prosecute individuals following the financial crisis frequently point to Enron for the proposition that power has not always precluded prosecution. As I have written elsewhere:

Enron, however, is a weak proxy for the aftermath of the financial crisis as it involved the failure of a single entity predicated on plain financial misstatements. The process of identifying wrongdoers and allocating blame was far simpler than it could ever have been for wrongdoing that spanned not only multiple firms, but also many industries and even the private and public sectors.

Gilchrist, *Opacity, Fragility, & Power*, *supra* note 18, at 656 (footnote omitted).

42. See Rakoff, *supra* note 2 (describing the difficult work required to make these cases and urging that prosecutors rededicate themselves to doing that work).

43. See *id.* (describing the process by which corporations under criminal investigation fund and outsource the investigation which, upon completion, will be neatly presented to the prosecutor).

organization (regardless of whether that organization is a corporation, a criminal gang, or a political party). These are hard cases, involving burdensome investigative techniques—like wire taps—and the drudgery of building a case piece by piece, starting with low-level prosecutions and moving up the chain through cooperation agreements.⁴⁴ Still, after all this work, there is no guaranteed payoff. The net result may not even be a “win” from the prosecutor’s perspective, either because the effort fails to secure sufficient evidence to target senior executives or because the government might still lose at trial.

Critics of the status quo believe that federal prosecutors have become more reluctant to try to build these more difficult cases against individuals. I agree. And, I think the reason is obvious: there is little incentive to engage in this effort when a massive corporate settlement is equally lauded, or nearly so.⁴⁵ Having said that, the problem remains: will instructing prosecutors to target guilty individuals in cases of corporate misconduct lead to more fulsome investigations? I am skeptical. Most simply, as a matter of information asymmetry, guilt will aggregate lower in the corporate hierarchy. Additionally, we can expect a differential in reported cases favoring those in which management actually has no exposure, regardless of how much work prosecutors are willing to put into building a case; this is the subject of the next section.

II. POWER ASYMMETRY

Formally, the board of directors wields ultimate power and hence control of internal investigations. Practically, management does. In any event, some combination of management and the board determines how a company handles potential criminal conduct. Lower-level employees have no direct⁴⁶ input on the corporate response; the power over this issue

44. *Id.* (“If you are a prosecutor attempting to discover the individuals responsible for an apparent financial fraud, you go about your business in much the same way you go after mobsters or drug kingpins: you start at the bottom and, over many months or years, slowly work your way up.”).

45. The reluctance to prosecute corporations and individuals in a more adversarial manner is not uniformly distributed throughout the Department of Justice.

[S]ome parts of the Justice Department never stopped prosecuting corporate crime. The Environment and Natural Resources Division, historically the source of the largest number of corporate prosecutions, entered only two deferred prosecutions in the seventeen years between 1993 and 2009; the Antitrust Division, the source of the third largest amount of corporate prosecutions, entered only three deferred prosecutions during the same timeframe.

See Uhlmann, *supra* note 40, at 1238–39 (footnote omitted).

46. They may, however, have indirect means of influencing the response, either by filing a formal whistleblower complaint or otherwise disclosing the issue to the public. See *infra* notes 56–58 and accompanying text.

rests entirely at the top of the hierarchy.

Maximally prioritizing individual prosecutions generates problematic incentives. The Yates Memo provides that if a corporation is “[t]o be eligible for any cooperation credit, corporations must provide to the Department all relevant facts about the individuals involved in corporate misconduct.”⁴⁷ Were this enforced literally, one would expect selective reporting only in those cases that do not implicate management or the board. “The ‘all or nothing’ approach to cooperation may backfire because it not only allows the corporation to choose ‘nothing,’ but may encourage that choice.”⁴⁸

Corporations cooperate with law enforcement investigating corporate malfeasance because and to the extent it is in the corporate interest to do so. At least in theory. Those responsible for directing the corporation’s response to possible wrongdoing are not only fiduciaries, they are people with their own, sometimes countervailing, interests. The agency problem is a powerful factor when it involves asking whether to limit corporate exposure if doing so increases personal exposure. If the entity is entitled to leniency only where the entity discloses all individual involvement, in cases where management or the board have exposure, the very people deciding whether to seek leniency for the company must do so at their own (potentially significant) peril.

This conflict is not solely generated by the call for individual prosecutions or the policy of the Yates Memo. There will always be a disincentive for management to report corporate malfeasance where doing so could implicate management. That said, the starkness of choice presented by the Yates Memo—*no* leniency absent *full* disclosure of individual involvement—potentially exacerbates the conflict. If applied strictly, it is reasonable to expect less cooperation from corporations in those cases where the misconduct implicates⁴⁹ management or the board.

The prospect of selective self-reporting in cases that do not implicate management or the board highlights the need for alternative methods of law enforcement where management or the board is involved. The policing of corporations is overwhelmingly outsourced to the corporations themselves. Yet leniency for the entity is unlikely to incentivize management personnel to turn themselves in. Corporate governance can work to address this problem in various ways, such as

47. See Yates Memo, *supra* note 5, at 3.

48. Elizabeth E. Joh & Thomas W. Joo, *The Corporation As Snitch: The New DOJ Guidelines on Prosecuting White Collar Crime*, 101 VA. L. REV. ONLINE 51, 58 (2015).

49. This could be directly, such as cases where management was involved in the wrongdoing; it could also be indirectly, such as where management or the board failed in some way to timely or appropriately detect or address misconduct within the organization.

appointing a compliance officer who reports directly to the board. The board has a duty to monitor and faces its own liability for failure to do so.⁵⁰ Appointing an officer with responsibility for identifying and, if necessary, reporting criminal conduct to the board, can mitigate the problem of conflicted management.

Empowering the board is a key aspect of contemporary corporate governance. The board of directors suffers from a greater deficit of information than management, and a concomitant lack of power. Yet, the board, as ultimately responsible and less plainly conflicted than management, represents the clearest avenue for directly confronting corporate misconduct. Empowering the board requires informing the board.

Nicola Sharpe has suggested that companies empower their boards by adopting a process-oriented approach (POA). This approach holds:

[D]irectors should employ a decision-making process that has at least four elements: (1) a forward-looking approach to information and data; (2) independent information-gathering mechanisms; (3) directors that play a proactive role in organizational goal setting; and (4) deliberation techniques such as a system for generating and resolving constructive conflict.⁵¹

The POA thus aims to remedy information *and* power deficits at the board level. Specifically, by opening new and relatively unbounded channels of information to the board of directors, this POA curtails the problem of too little information. By introducing deliberative mechanisms such as a “devil’s advocate approach,”⁵² the POA further broadens the information that is likely to be presented to the board.⁵³ By adopting a forward-looking and proactive role for directors, the POA addresses the practical limits of the disempowered board.

Such an approach, like having a compliance officer who directly reports to the board, will not ensure perfect compliance or perfect enforcement. Nothing will. The POA, however, can contribute to better

50. See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959, 970 (Del. Ch. 1996).

51. Nicola Faith Sharpe, *Questioning Authority: The Critical Link Between Board Power and Process*, 38 J. CORP. L. 1, 34 (2012).

52. *Id.* at 39.

53. Getting material information to the board presents a continuing challenge. Most efforts to address this challenge rely in some manner on gatekeepers. See Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 162 (2010) (“These gatekeepers should reduce the problems associated with informational asymmetries by providing independent directors with an alternate and impartial source of information, thereby ensuring that they are not wholly dependent on insiders.”); JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 1 (2006) (“[A]ll boards of directors are prisoners of their gatekeepers. No board of directors—no matter how able and well-intentioned its members—can outperform its professional advisors.”).

corporate conduct generally.

More still is likely necessary, however, if law enforcement is to identify those cases—arguably the most important cases to the public trust—where management or even the board itself is involved in the misconduct. For this, traditional law enforcement will be required. It is, of course, wholly unrealistic and undesirable to expect the FBI or other law enforcement agencies to infiltrate and surveil day-to-day corporate life. Most simply, the scale of corporate conduct dwarfs any conceivable law enforcement effort; moreover, the intrusiveness of any such surveillance would introduce a police state that would outweigh any possible benefits of more vigorous law enforcement.

No, the law enforcement solution to the reporting gap lies not in enhanced surveillance; it lies in expanding the pool of likely reporters. If management is unlikely to report a predictable range of cases—that is, those inculcating management—empower alternative reporters. The “broken windows” approach to street crime functioned by increasing contact between police and insiders generally, in hopes that the police could use that contact, by threat if necessary, to gain information about target crimes.⁵⁴ It aimed to give the police “eyes on the street.”⁵⁵ The whistleblower approach to corporate misconduct is similar in effect—it gives law enforcement access to inside information. But, it is distinct in that it requires neither an enhanced police presence nor threats against potential informants; instead it relies on carrots: protecting reporters from retaliation and paying them for successful reports.

This is the fundamental theory behind whistleblower protections and incentives. Knowledge within large, publicly traded corporations is diffuse and widespread. Just as criminal conspiracies risk exposure by the unavoidable fact that more people know of the wrongful conduct, corporate conduct is rarely secret. Someone—often many someones—within the organization know about any particular conduct. This is true whether the conduct is lawful, plainly criminal, or somewhere in between. Strong whistleblower protections and incentives effectively deputize all corporate agents, increasing the chance that someone will report misconduct to the relevant authority.⁵⁶

54. See Charles F. Sabel & William H. Simon, *The Duty of Responsible Administration and the Problem of Police Accountability*, 33 YALE J. ON REG. 165, 188 (2016). “The ‘broken windows’ theory formulated by George Kelling and James Q. Wilson suggested that ‘quality-of-life’ policing could prevent the emergence of hot spots in transitional neighborhoods by encouraging law-abiding people to act as crime-inhibiting ‘eyes on the street’ and to provide information to the police.” *Id.* (footnote omitted).

55. *Id.*

56. See Geoffrey Christopher Rapp, *Four Signal Moments in Whistleblower Law: 1983-2013*, 30 HOFSTRA LAB. & EMP. L.J. 389 (2013).

Indeed, as the risk of whistleblower disclosure increases,⁵⁷ management's calculus about self-reporting changes. As Andrew Ceresney, then-Director of the SEC Division of Enforcement stated:

The SEC's whistleblower program has changed the calculus for companies considering whether to disclose misconduct to us, knowing that a whistleblower is likely to come forward. Companies that choose not to self-report are thus taking a huge gamble because if we learn of the misconduct through other means, including through a whistleblower, the result will be far worse.⁵⁸

If management will not report, and we know sometimes they will not, then help others report. That is what whistleblower laws do, and they must be maintained if we are to have effective law enforcement in the corporate sphere.⁵⁹

Management's influence over internal investigations is powerful, and if control over reporting is limited to management, the reports will rarely expose managerial misconduct. Alternative reporters are thus necessary. However, even with strong whistleblower protection and incentives, it is still reasonable to expect more wrongdoing will be reported against lower-level employees than management. In part, this conclusion merely restates the conclusion one ought to draw from informational asymmetry: there will be more knowing misconduct down the hierarchy of the corporation simply because that is where most knowledge resides.

The whistleblower reports information or makes allegations, sometimes to external regulators, watchdog groups, or the media, and sometimes internally (though often outside of the chain of command). From the beginning of the practice we now call whistleblowing such employees have faced retaliation—the threat of which, along with other incentives, favored remaining silent. The law, thankfully, has evolved to provide both protection and positive incentives for whistleblowers.

Id. at 390 (footnotes omitted).

57. Whistleblower actions have generally been on the rise. The SEC reports: in FY 2017, “the SEC ordered whistleblower awards totaling nearly \$50 million to 12 individuals. Since the agency issued its first award in 2012 through the end of September 2017, the program has awarded approximately \$160 million in whistleblower awards to 46 individuals.” U.S. SEC. & EXCH. COMM'N, 2017 ANNUAL REPORT TO CONGRESS: WHISTLEBLOWER PROGRAM 1, <https://www.sec.gov/files/sec-2017-annual-report-whistleblower-program.pdf> [hereinafter SEC 2017 REPORT]. Additionally, the SEC reports an increase in whistleblower tips from 334 in FY 2011 to 4484 in FY 2017. *Id.* at 23.

58. Andrew Ceresney, Dir., Div. of Enf't, U.S. Sec. & Exch. Comm'n, Remarks at CBI's Pharmaceutical Compliance Congress in Washington, D.C.: FCPA, Disclosure, and Internal Controls Issues Arising in the Pharmaceutical Industry (Mar. 3, 2015), <http://www.sec.gov/news/speech/2015-spch030315ajc.html>.

59. The SEC concludes that “the promise of monetary awards to whistleblowers whose information leads to successful enforcement actions, provisions to safeguard whistleblower confidentiality, and enhanced anti-retaliation protections” are the key components of a successful whistleblower program. *See* SEC 2017 REPORT, *supra* note 57, at 3.

CONCLUSION

When there is a great failure, the public demands consequences for those responsible. With limited information, there will often be confusion about who is responsible for the failure. Moral responsibility, leadership responsibility, and cultural responsibility are all important; they are also all distinct from legal responsibility. This can be lost on an angry public.

Demanding accountability is natural. Prosecuting individuals is something different; it is not natural, it is highly structured and controlled. Prosecutors ought to bring cases where they are convinced that they can prove guilt of a crime beyond a reasonable doubt. For the vast majority of crimes at issue in cases of corporate wrongdoing, that requires proving, at a minimum, that the defendant was aware of the actions at issue. As a simple matter of corporate structure, this awareness will often be lacking for senior personnel.

Such informational asymmetry is thus perhaps the strongest argument against a formulaic push for individual prosecutions. Power asymmetry amplifies the problem. To the extent senior personnel can influence which instances of misconduct come to light, they can be expected to avoid disclosing the problems for which they have legal exposure. Whistleblowers and better governance may ameliorate this problem, but they will not eliminate it.

Both types of in-firm asymmetry suggest that the push for more individual prosecutions will result largely in prosecutions against bit players in massive organizations. These prosecutions will hardly satisfy the public demand for accountability, and they may do affirmative harm. Even where the real person is actually guilty, there remain open questions about desert. How should we punish someone for a wrong she committed while functioning in a culture and structure that influenced her actions? Indeed, how should we punish her when it becomes clear that she could never hope to influence the culture and structure that were but-for causes of her crime?

This is not to suggest that a person ought to be excused by the culture in which they are operating. My suggestion is more modest. Calling for more individual prosecutions in cases of corporate crime is understandable, but we ought to think about what the call is likely to net. In part because of the asymmetries discussed in this Essay, it is unlikely to net a significant increase in accountability at the top. It is far more likely to net increased responsibility for lower-level personnel. And there are many reasons to question whether that result is actually desirable.