



Center for Corporate Ethics and Governance

CHILDREN AND FAMILIES
EDUCATION AND THE ARTS
ENERGY AND ENVIRONMENT
HEALTH AND HEALTH CARE
INFRASTRUCTURE AND
TRANSPORTATION
INTERNATIONAL AFFAIRS
LAW AND BUSINESS
NATIONAL SECURITY
POPULATION AND AGING
PUBLIC SAFETY
SCIENCE AND TECHNOLOGY
TERRORISM AND
HOMELAND SECURITY

The RAND Corporation is a nonprofit institution that helps improve policy and decisionmaking through research and analysis.

This electronic document was made available from www.rand.org as a public service of the RAND Corporation.

Skip all front matter: [Jump to Page 1](#) ▼

Support RAND

[Purchase this document](#)

[Browse Reports & Bookstore](#)

[Make a charitable contribution](#)

For More Information

Visit RAND at www.rand.org

Explore the [RAND Center for Corporate Ethics and Governance](#)

View [document details](#)

Limited Electronic Distribution Rights

This document and trademark(s) contained herein are protected by law as indicated in a notice appearing later in this work. This electronic representation of RAND intellectual property is provided for non-commercial use only. Unauthorized posting of RAND electronic documents to a non-RAND website is prohibited. RAND electronic documents are protected under copyright law. Permission is required from RAND to reproduce, or reuse in another form, any of our research documents for commercial use. For information on reprint and linking permissions, please see [RAND Permissions](#).

This product is part of the RAND Corporation conference proceedings series. RAND conference proceedings present a collection of papers delivered at a conference or a summary of the conference. The material herein has been vetted by the conference attendees and both the introduction and the post-conference material have been reviewed and approved for publication by the sponsoring research unit at RAND.



Culture, Compliance, and the C-Suite

How Executives, Boards, and Policymakers Can
Better Safeguard Against Misconduct at the Top

Michael D. Greenberg





Center for Corporate Ethics and Governance

Culture, Compliance, and the C-Suite

How Executives, Boards, and Policymakers Can
Better Safeguard Against Misconduct at the Top

Michael D. Greenberg

The research described in this report was supported in part, by the generosity of RAND's donors and by the fees earned on client-funded research, with additional support provided by Pepper Hamilton LLP, and was conducted in the RAND Center for Corporate Ethics and Governance, a part of the RAND Institute for Civil Justice within RAND Justice, Infrastructure, and Environment.

Library of Congress Cataloging-in-Publication Data is available for this publication.

ISBN: 978-0-8330-8214-5

The RAND Corporation is a nonprofit institution that helps improve policy and decisionmaking through research and analysis. RAND's publications do not necessarily reflect the opinions of its research clients and sponsors.

Support RAND—make a tax-deductible charitable contribution at www.rand.org/giving/contribute.html

RAND® is a registered trademark.

Cover image: © Franck Boston, Fotolia.com

© Copyright 2013 RAND Corporation

This document and trademark(s) contained herein are protected by law. This representation of RAND intellectual property is provided for noncommercial use only. Unauthorized posting of RAND documents to a non-RAND website is prohibited. RAND documents are protected under copyright law. Permission is given to duplicate this document for personal use only, as long as it is unaltered and complete. Permission is required from RAND to reproduce, or reuse in another form, any of our research documents for commercial use. For information on reprint and linking permissions, please see the RAND permissions page (www.rand.org/pubs/permissions.html).

RAND OFFICES

SANTA MONICA, CA • WASHINGTON, DC

PITTSBURGH, PA • NEW ORLEANS, LA • JACKSON, MS • BOSTON, MA

DOHA, QA • CAMBRIDGE, UK • BRUSSELS, BE

www.rand.org

Preface

Despite widespread recognition that “tone at the top” is an important ingredient for ethical culture within organizations, misconduct and unlawful acts among top executives continue to present serious problems for a wide spectrum of companies across diverse industries. Studies in the past decade have spotlighted indictments against hundreds of top executives, while suggesting that a high proportion of corporate frauds involve awareness or complicity on the part of such executives. These sorts of observations suggest that, when it comes to the executive suite, an analysis of culture and behavior well beyond tone at the top is long overdue. They also raise basic questions both for senior management within corporations and for the boards that monitor them. Why do compliance and ethics efforts frequently fall short when it comes to top executives? How do those executives contribute to, and respond to, cultural norms within their own organizations? What kinds of executive incentive structures should boards seek to put in place to support an ethical leadership mandate at the C-suite level?¹ And how does the role of the chief ethics and compliance officer buttress the management of compliance risk within the C-suite?

On May 2, 2013, the RAND Corporation convened a symposium in Washington, D.C., to address these and related questions. Invited participants included senior thought leaders from the ranks of public company directors and executives, ethics and compliance officers, and stakeholders from the government, academic, and nonprofit sectors.

These proceedings summarize key issues and topics from the symposium discussions. The document is not intended to be a transcript. Rather, it is organized by major theme and serves to highlight areas of agreement and disagreement among participants. With the exception of four invited papers that were written in advance and presented at the symposium, we do not attribute remarks to individual participants.

This report was funded with pooled resources from the RAND Center for Corporate Ethics and Governance, with additional support provided by Pepper Hamilton LLP. These proceedings should be of interest to policymakers, regulators, corporate directors and executives, compliance and ethics practitioners, shareholders, nongovernmental organizations, and other stakeholders with interests in corporate governance, ethics, and compliance practice issues, both in the United States and abroad.

¹ *C-suite* typically refers to the level of management involving the top executives within any given company. The titles of many such executives begin with the word “chief,” so the C-suite is typically made up of the chief executive officer, chief financial officer, chief operations officer, and others with similar titles and levels of responsibility.

RAND Center for Corporate Ethics and Governance

The RAND Center for Corporate Ethics and Governance is committed to improving public understanding of corporate ethics, law, and governance and to identifying specific ways in which businesses can operate ethically, legally, and profitably. The center's work is supported by contributions from private-sector organizations and individuals with interests in research on these topics.

The center is part of the RAND Institute for Civil Justice, which is dedicated to improving the civil justice system by supplying policymakers and the public with rigorous, nonpartisan research. Its studies identify trends in litigation and inform policy choices concerning liability, compensation, regulation, risk management, and insurance.

Questions or comments about this report should be sent to the project leader, Michael Greenberg (Michael_Greenberg@rand.org). For more information on the RAND Center for Corporate Ethics and Governance, see <http://www.rand.org/jie/cceg> or contact the director (cccg@rand.org).

Contents

- Preface..... iii
- RAND Center for Corporate Ethics and Governance iv
- Contents v
- Summary vii
- Invited Remarks from Panelists..... ix
- What Are the Fundamental Compliance and Ethics Challenges Facing the C-Suite, and What Oversight Role Should the Board Play? ix
- How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management, and Policymakers Do Next? x
- Acknowledgments..... xiii
- Abbreviations xv
- 1. Introduction..... 1
- 2. Invited Remarks from Symposium Participants 5
- Summary: Prosecution of Frauds and Crimes in the C-Suite—What Can We Learn from These Cases and Trends? 7
- Summary: “C” Is for Crucible—Behavioral Ethics, Culture, and the Board’s Role in C-Suite Compliance 9
- Summary: Compliance in the C-Suite 11
- 3. What Are the Fundamental Compliance and Ethics Challenges Facing the C-Suite, and What Oversight Role Should the Board Play? 13
- Crime and Misbehavior in the C-Suite Represent an Important Problem Not Sufficiently Addressed by the Current Focus on “Tone at the Top” 14
- Deficiencies in C-Suite Ethical Culture, Including Groupthink and Motivated Blindness, Are an Antecedent to Many Instances of Misbehavior..... 15
- Misconduct in the C-Suite Reflects a Basic Gap in Compliance 16
- Compliance Needs to Be Embedded Throughout Management, but Achieving This Requires a Strong Compliance Leadership Position Within Management 17
- For Boards, Key Stumbling Blocks in Carrying Out Effective C-Suite Monitoring Include Lack of C&E Insight and Expertise 18
- 4. How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management, and Policymakers Do Next? 21
- Both Structural and Nonstructural Factors Are Important Targets for Contributing to C-Suite Integrity 22
- Training, Incentives, Monitoring, and Risk and Culture Assessment Are All C&E Practices That Can Be Elevated Up to the C-Suite Level 23
- The CECO Role Should Be Elevated and Empowered to Better Support C&E at the C-Suite Level ... 24

Board Priorities for Preventing and Detecting Misconduct in the C-Suite Can Draw on a Range of Structural and Cultural Reforms	25
Policy and Enforcement Efforts Will Continue to Shift the Landscape of Compliance in the C-Suite .	26
Appendix A: Symposium Agenda	29
Appendix B: Symposium Participants	31
Appendix C: Invited Keynote Address by Judge Ruben Castillo.....	33
The Technology Challenge of the United States’ Aggressive Compliance Environment	33
Appendix D: Invited Papers from Symposium Participants	39
Prosecution of Frauds and Crimes in the C Suite: What Can We Learn from These Cases and Trends?	39
“C” Is for Crucible: Behavioral Ethics, Culture, and the Board’s Role in C-Suite Compliance	51
Compliance in the C-Suite.....	69
References.....	81

Summary

Despite the widely acknowledged leadership insight that “tone at the top” of corporations is important, C-suite-level² compliance failures and episodes of executive misconduct abound. Recent studies and press releases have spotlighted that (1) a high proportion of occurrences of corporate fraud feature some level of involvement by the senior executive team, (2) criminal prosecutions against executives and high-value deferred-prosecution agreements involving their firms both appear to be on the rise, and (3) the reputational harm to a corporation can be substantial when an instance of senior executive misconduct does occur. These observations suggest that the conventional wisdom of relying on the board to appoint the right CEO and then simply hoping that “tone at the top” will therefore ensue may no longer be an adequate approach to supporting compliance in the C-suite. In some respects, the C-suite setting itself may put its denizens at heightened risk for ethical lapses and missteps because that environment arguably combines strong performance pressures and demands for rapid decisionmaking with a range of other social and cognitive vulnerabilities to bias. For business leaders and policymakers, a basic question then follows: Are there practical ways to strengthen the C-suite as an institution and to better support executives in their commitment to high ethical standards, compliance with the law, and transparency toward shareholders and employees?

A serious inquiry into the challenges involved in C-suite-level compliance touches on many strands of management and governance practice within organizations. Among these strands are the role and capability of corporate boards, whose fiduciary duty encompasses the monitoring of C-suite-level compliance and ethics (C&E) risks; the responsibility and empowerment of the chief ethics and compliance officer (CECO), who has day-to-day authority for helming the C&E program (including at the C-suite level); and the influence of government enforcement efforts in helping to drive compliance activity more broadly. To the extent that compliance practice and ethical standards within too many C-suites are falling short, the question then becomes how to modify or leverage these various strands, in supporting better C-suite practice and ethical tone in the future.

It was in this context that RAND convened a symposium on May 2, 2013, titled “Culture, Compliance and the C-Suite: How Executives, Boards and Policy-Makers Can Better Safeguard Against Misconduct at the Top.” The objective was to stimulate a broad conversation about the challenges posed by executive misconduct within the C-suite, on the risk factors that contribute

² *C-suite* typically refers to the level of management involving the top executives within any given company. The titles of many such executives begin with the word “chief,” so the C-suite is typically made up of the chief executive officer (CEO), chief financial officer, chief operations officer, and others with similar titles and levels of responsibility.

to such misconduct, and on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of directors, top executives, CECOs, and government regulators and policymakers in pursuing those steps.

The symposium brought together a group of 20 senior thought leaders from the ranks of public company directors and executives, CECOs, and stakeholders from the government, academic, and nonprofit sectors. Discussions focused on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of directors, top executives, CECOs, and government policy in pursuing that end. Prior to the symposium, several of the invited participants were asked to prepare and present formal remarks on corporate culture, compliance, and the C-suite. Their white papers, distributed in advance of the event, represent varied perspectives on law enforcement, organizational behavior, and compliance activity, all relating to instances of C-suite misconduct. The speakers presented their remarks during the first session of the symposium. The second and third sessions engaged the symposium participants in interactive discussions, launching from the foundational remarks initially offered by the white-paper authors.

Several major themes emerged from the symposium discussions. The first was that misconduct in the C-suite often reflects a basic compliance gap in corporate management. That gap manifests itself in multiple ways: between what top executives say is important and what they actually model through their behavior; between “tone at the top” as a vague expression of values and the embodiment of those values through an effective, management-driven C&E program; and between a legalistic, check-the-box approach to compliance in the C-suite and a deeper commitment to ethical culture as a basic element embedded in the operating fabric of the corporation. A second major theme focused on the role of corporate boards in addressing C-suite-level compliance risk. There is a broad range of board-level interventions that could be undertaken to improve C&E oversight within the C-suite. Examples of these interventions include enhanced board training; adding new board members with professional experience as CECOs, undertaking board-instigated assessments of C-suite compliance risk and ethical culture, and improving board practice in vetting new CEO candidates to reduce related compliance risks. A third broad symposium theme highlighted the importance of an empowered, independent CECO in contributing to C-suite-level compliance and ethical culture and related implications for restructuring the CECO role. In particular, it was observed that the seniority, positioning, and power of the CECO need to be fundamentally congruent with the functional responsibilities that that person is expected to carry out. To the extent that the CECO is tasked with training and engaging the C-suite, serving as an independent voice in the C-suite, and evaluating C-suite compliance culture and risks, while contributing a C&E perspective to top-level strategic and operational decisions within the company, the CECO will require sufficient access and authority in order to carry out those various tasks successfully.

Invited Remarks from Panelists

The first session of the symposium began with a keynote address from Judge Ruben Castillo of the U.S. District Court for the Northern District of Illinois, speaking on the topic of new technology as an aggravating factor to the challenges posed by C-suite-level compliance. Judge Castillo's remarks were followed by remarks from three invited white-paper authors, who respectively focused on trends in criminal prosecution, C-suite ethical culture, and application of corporate compliance strategy to the C-suite. The speakers were Stanley R. Soya, a partner with the law firm Pepper Hamilton LLP; Scott Killingsworth, a partner with the law firm Bryan Cave LLP; and Michael Volkov, CEO and owner of the Volkov Law Group LLC. Their remarks were based on invited white papers titled "Prosecution of Frauds and Crimes in the C-Suite: What Can We Learn from These Cases and Trends?" (Soya); "'C' Is for Crucible: Behavioral Ethics, Culture, and the Board's Role in C-Suite Compliance" (Killingsworth); and "Compliance in the C-Suite" (Volkov). The three invited white papers were distributed to symposium participants in advance of the May 2 meeting to set the context and facilitate a dynamic discussion.

What Are the Fundamental Compliance and Ethics Challenges Facing the C-Suite, and What Oversight Role Should the Board Play?

The second session of the symposium addressed the basic compliance and ethics challenges facing members of the C-suite. It was observed that the initial selection of top executive candidates with a track record of superior achievement and ambition, when combined with short-term performance pressures, the subsequent autonomy of the executives, and their need to make executive decisions collectively in small groups, tends to make people in top executive positions inherently more vulnerable to C&E misadventures. As one symposium participant observed, "If you wanted to design an incubator for generating misconduct, it would look a lot like the C-suite." Several other participants noted that the C-suite typically "operates with very little oversight," that "motivated blindness" and cognitive bias are not uncommon, and that, too often, "there is no lid on the cookie jar." Other symposium participants, however, offered more moderate views. One person suggested that "misconduct in the C-suite is a complex proposition" with many contributing factors that give rise to it. Another emphasized that the substantial majority of senior executives are noteworthy for their integrity and high standards of conduct, notwithstanding the pressures of the C-suite. Several symposium participants put more emphasis on the prevalence and consequences of executive misconduct. One person noted that "there is a flawed assumption that those in the C-suite will tend to do the right thing." Another pointed out that, even if the majority of executives are highly conscientious, that provides small comfort when "even a single act [of malfeasance] at the senior level can be catastrophic [to a company]."

Much of the discussion in this session focused on the appropriate oversight role for the board in connection with compliance and misconduct in the C-suite. Some participants noted that basic

C&E problems and instances of misconduct also occur at the board level, as well as within the C-suite, and that an important priority for boards is simply to self-police their members' behavior more effectively. Others argued that boards have a responsibility to "be at the forefront of the culture they expect [from the C-suite]" and that boards "need to inject a greater sense of responsibility into the C-suite." There were mixed opinions among the symposium participants about how well boards are currently doing in terms of C-suite oversight and how much it is reasonable to expect them to do when it comes to policing the C-suite on C&E issues. One participant said that he had "seen good boards and bad boards, [though] a lot more bad ones." Another observed that, in context of the high rate of malfeasance involving C-suite executives, "boards have not served very well as gatekeepers." Finally, there was also some discussion in the symposium session addressing the tie between the boardroom and broader organizational culture and the varied ways in which incentives and norms established by the board of directors can feed into the culture of the C-suite and ultimately into the organization as a whole.

Session participants generally agreed on several key points:

- Crime and misbehavior in the C-suite represent an important problem not sufficiently addressed by the current focus on "tone at the top."
- Deficiencies in C-suite ethical culture, including groupthink and motivated blindness, are an antecedent to many instances of misbehavior.
- Misconduct in the C-suite reflects a basic gap in compliance.
- Compliance needs to be embedded throughout management, but achieving this requires a strong compliance leadership position within management.
- For boards, key stumbling blocks in carrying out effective C-suite monitoring include lack of C&E insight and expertise.

How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management, and Policymakers Do Next?

Participants in the final session of the symposium focused more deeply on identifying potential solutions to the problems of compliance and misconduct in the C-suite and on tangible next steps that might be taken by boards, executives, regulators, and policymakers. Some strands of the discussion focused primarily on the governance role of the board of directors, while other strands touched more strongly on the C&E function and the role of the CECO. There was broad consensus that both boards and CECOs have meaningful parts to play in seeking to improve the compliance climate of the C-suite: the former (in part) through more effective, proactive exercise of their oversight responsibility, and the latter (at a minimum) by helping to inform and empower the former and by serving as an independent voice in the C-suite. A separate strand of the symposium discussion focused on the Federal Sentencing Guidelines, enforcement activity, and the prospects for new policy aimed directly at influencing compliance and ethical culture in the C-suite. In context, it was observed that high-profile enforcement efforts and criminal prosecutions that target senior executives are already sending a compliance signal to members of

the C-suite. The question then becomes, what other options should policymakers be considering? Finally, another theme in the discussion touched on the larger corporate governance framework within which C-suite compliance and ethical-culture problems are manifesting themselves. One of the symposium participants notably remarked that “based on the theory that animates the corporate law, none of these problems [with criminal misconduct in the C-suite] ought to exist.” It was pointed out that various of the traditional governance functions and responsibilities of the board (including with regard to CEO hiring and compensation) could be remodulated to try to better detect and prevent misconduct in the C-suite. However, it was also observed that some of the relevant governance levers (e.g., executive compensation) may also be associated with broader structural problems in the corporate form, which go beyond the issues of C-suite compliance to fully address.

The major points of discussion and agreement during the session included the following:

- Both structural and nonstructural factors are important targets for contributing to C-suite integrity.
- Training, incentives, monitoring, and risk and culture assessment are all C&E practices that can be elevated up to the C-suite level.
- The CECO role should be elevated and empowered to better support C&E at the C-suite level.
- Board priorities for preventing and detecting misconduct in the C-suite can draw on a range of structural and cultural reforms.
- Policy and enforcement efforts will continue to shift the landscape of compliance in the C-suite.

Acknowledgments

I wish to thank the panelists, speakers, and all those who participated in the round-table discussions, without whom the exchange of ideas documented here would not have been possible. I would also like to thank our sponsor, Pepper Hamilton LLP, for its generous support of this symposium event.

I would particularly like to acknowledge the invited authors and speakers at the symposium: Judge Ruben Castillo, Stanley Soya, Scott Killingsworth, and Michael Volkov. Larry D. Thompson and Justice Jack B. Jacobs both made notable contributions to the conversation, particularly in opening each of the symposium discussion sessions. A full list of participants and their affiliations can be found in Appendix B. My symposium co-chair, Donna C. Boehme, provided invaluable contributions in structuring and facilitating the discussions and in helping to bring the right group of people to the conference table.

Finally, I would also like to thank Jamie Morikawa, Stephanie Shedd, Jennifer Miller, and Sarah Hauer at RAND for their assistance in organizing the symposium, managing logistics, capturing the discussions on the day of the event, and generating these proceedings.

Abbreviations

CCO	chief compliance officer
C&E	compliance and ethics
CECO	chief ethics and compliance officer
CEO	chief executive officer
CFO	chief financial officer
DOJ	U.S. Department of Justice
DPA	deferred-prosecution agreement
FCPA	Foreign Corrupt Practices Act
FDCA	Federal Food, Drug, and Cosmetic Act
LIBOR	London Interbank Offered Rate
NCFRR	National Commission on Fraudulent Financial Reporting
NPA	nonprosecution agreement
RCO	Responsible Corporate Officer
USSC	U.S. Sentencing Commission

1. Introduction

Power tends to corrupt, and absolute power corrupts absolutely.

—Lord Acton³

It is a piece of wisdom widely acknowledged that “tone at the top” is an important ingredient for strong ethical culture within organizations. When top executives provide clear signals about corporate values and ethical attitudes through their own conduct and leadership, their behavior can then serve as a model for similar good behavior and workplace integrity among rank-and-file employees. Accounting authorities going back to the 1980s have notably identified “tone at the top” as a key factor in helping to protect companies against the occurrence of financial fraud.⁴ Regardless of the strength of corporate controls and compliance procedures on paper, it has been suggested that, where top management sets a lax ethical tone, fraud becomes more likely to occur.

Despite this basic leadership insight, misconduct and unlawful acts among top executives continue to present a serious problem. According to a 2006 study compiled by the Compliance and Ethics Leadership Council, 86 percent of observed occurrences of corporate fraud involved misconduct either perpetrated by or known to members of the senior executive team.⁵ In a related vein, in 2007, the U.S. Corporate Fraud Task Force summarized its indictments against hundreds of chief executive officers (CEOs), chief financial officers (CFOs), and other senior executives during the preceding five-year period. These findings were echoed more recently by the U.S. Department of Justice (DOJ) in 2012 in a press release spotlighting criminal indictments against more than 170 executives in the wake of the financial crisis. Recent newspaper headlines trumpeting scandals and senior-level resignations within large companies underline the same basic problem: There appears to be no shortage of misconduct, cover-up, and botched judgment originating from within the C-suite itself.

High-profile instances of senior executive misconduct can sometimes result in highly consequential damages to corporations and their shareholders. Several recent deferred-prosecution agreements (DPAs) and nonprosecution agreements (NPAs) have notably involved direct monetary penalties well in excess of \$100 million, as illustrated by the cases against Barclays Bank and HSBC.⁶ A recent tally of the ten largest federal corporate criminal fines in

³ John Emerich Edward Dalberg, Lord Acton, *Historical Essays and Studies*, John Neville Figgis and Reginald Vere Laurence, eds., London: Macmillan, 1907.

⁴ National Commission on Fraudulent Financial Reporting (NCFRR), 1987; Bonine-Blanc and Brevard, 2009.

⁵ Corporate Executive Board, 2006.

⁶ Bray, 2013; Schaefer, 2012.

history (totaling \$6.75 billion) indicated that fully half were imposed or agreed to in 2012.⁷ Meanwhile, and apart from astronomical criminal fines, the financial and nonpecuniary damages associated with loss of corporate reputation may sometimes be even greater. One recent study estimated that two-thirds of the value loss to corporations associated with federal securities law enforcement actions was attributable to adverse reputational impact, as distinguished from direct losses through accounting restatements, criminal fines, or class-action settlements.⁸ This result finds anecdotal support in other recent commentary describing episodes of corporate reputational crisis, in which large stock value losses to companies were associated with various instances of putative executive misconduct and wrongdoing.⁹

A basic question is invited by the reality that bad behavior within the C-suite can sometimes be highly consequential: Are there unique compliance and integrity risks inherently posed by the C-suite setting itself? As Scott Killingsworth described in detail, the C-suite may sometimes combine unique performance pressures and demands for rapid management decisions, together with other social and cognitive vulnerabilities to bias in human decisionmaking.¹⁰ Put another way, the social psychology and behavioral economics of the C-suite may make even conscientious senior executives more vulnerable to missteps. Assuming, for the sake of argument that this is true, it invites a series of self-diagnostic questions for those who actually reside in the C-suite. Are there structural or cultural ways to strengthen the C-suite as an institution and to better support executives in their commitment to high ethical standards, compliance with the law, and transparency toward shareholders and employees? Complementary questions are likewise invited regarding the appropriate role for corporate boards, whose fiduciary duty surely encompasses oversight for compliance and reputational risk within the ranks of senior management. What can and should boards reasonably seek to accomplish with regard to monitoring compliance in the C-suite and encouraging or incentivizing high standards of conduct among senior executives?

Still another facet of the problem involves the relationship between compliance within the C-suite and the role and structure of existing compliance and ethics (C&E) programs in many corporations. In the past two decades, policymakers at the U.S. Sentencing Commission (USSC) and DOJ have incrementally sought to strengthen internal corporate compliance efforts and the chief ethics and compliance officers (CECOs) who lead them. This being said, many traditional compliance programs have arguably tended to focus their efforts downward, rather than upward, within their organizations. To the extent that there is a public policy aim for CECO to promote and enforce C&E standards at the C-suite level, what are the implications for how the CECO role

⁷ Cassin, 2013.

⁸ Karpoff, Lee, and Martin, 2008.

⁹ Kossovsky, 2012.

¹⁰ Killingsworth, 2012.

ought to be structured and resourced? And if it is indeed true, as one former compliance officer recently observed, that, “when the big people get in trouble, the little people get ethics training,” does that suggest a basic misalignment or reactive focus in what the C&E function is sometimes set up to accomplish?

A final set of issues regarding C-suite compliance and misconduct arises around the role of policymakers in considering future reforms. Here again, the USSC has been involved for more than two decades in setting standards to drive corporate compliance programs and activity. Recent revisions to the Federal Sentencing Guidelines for Organizations have notably emphasized the salience of culture and of “*promot[ing] an organizational culture that encourages ethical behavior and compliance with the law.*” Given this emphasis on culture, together with the increasing attention that has been devoted to high-profile occurrences of senior executive misconduct, what role might future policy reforms play in seeking to prevent such misconduct and in strengthening compliance and ethical culture at the C-suite level? Are there ways in which the USSC or DOJ might usefully modify sentencing or prosecutorial guidelines in support of these ends? Likewise, how might these ends be promoted by other executive branch agencies, in the context of future DPAs and NPAs associated with corporate criminal wrongdoing?

It was in this context that RAND convened a symposium on May 2, 2013, titled “Culture, Compliance and the C-Suite: How Executives, Boards and Policy-Makers Can Better Safeguard Against Misconduct at the Top.” The objective was to stimulate a broad conversation about the challenges and opportunities posed by compliance and ethical-culture risk within the C-suite, as well as to explore business and policy ramifications of seeking to make C-suite-level ethics and compliance practice more robust. The symposium also built on a series of previous RAND-hosted round-table meetings, more broadly addressing the roles of corporate boards, chief compliance officers (CCOs), and internal whistleblower mechanisms in helping firms to address C&E and cultural challenges.¹¹

The May 2013 symposium brought together a group of 20 senior thought leaders from the ranks of public company directors and executives, CECOs, and stakeholders from the government, academic, and nonprofit sectors. Discussions focused on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of

¹¹ See Michael D. Greenberg, *Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know*, Santa Monica, Calif.: RAND Corporation, CF-258-RC, 2009; Michael D. Greenberg, *Directors as Guardians of Compliance and Ethics Within the Corporate Citadel: What the Policy Community Should Know*, Santa Monica, Calif.: RAND Corporation, CF-277-CCEG, 2010; Michael D. Greenberg, *For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd-Frank*, Santa Monica, Calif.: RAND Corporation, CF-290-CCEG, 2011; and Michael D. Greenberg, *Corporate Culture and Ethical Leadership Under the Federal Sentencing Guidelines: What Should Boards, Management, and Policymakers Do Now?* Santa Monica, Calif.: RAND Corporation, CF-305-CCEG, 2012.

directors, top executives, CECOs, and government policy in pursuing that end. The symposium agenda can be found in Appendix A of these proceedings, and the full list of participants is provided in Appendix B.

Prior to the symposium, several of the invited participants were asked to prepare and present formal remarks on organizational culture, compliance, and the C-suite. Their white papers, distributed in advance of the event, represent varied perspectives on law enforcement, organizational behavior, and compliance activity, all relating to instances of C-suite misconduct. The speakers presented their remarks during the first session of the symposium; Chapter Two of these proceedings features short summaries of these remarks, and Appendix D presents the full text of the invited papers. Appendix C includes the full text of an invited keynote address by Judge Ruben Castillo on the related topic of technology as an aggravating factor that contributes to the fundamental challenge of C-suite-level compliance.

The second session of the symposium involved a moderated discussion on the C&E challenges facing C-suite executives and lessons to be learned from the recent cases and enforcement trends. Chapter Three summarizes the major themes and topics of conversation in the session.

The final session of the symposium involved a moderated discussion of practical steps for overcoming the barriers to high standards of compliance and integrity in the C-suite. Chapter Four summarizes the major themes and ideas from that session.

2. Invited Remarks from Symposium Participants

The symposium began with a keynote address from Judge Ruben Castillo (reproduced in Appendix C herein). The keynote was followed by invited remarks from three of the participants in attendance: Stanley Soya, a partner with the law firm Pepper Hamilton LLP; Scott Killingsworth, a partner with the law firm Bryan Cave LLP; and Michael Volkov, CEO and owner of the Volkov Law Group LLC. Their remarks were based on invited white papers, which are reproduced in Appendix D of this report. Each author and topic brought an important expert viewpoint and helped set the context for the symposium discussions. This chapter presents a brief summary of each of the three white papers.

Summary: Prosecution of Frauds and Crimes in the C-Suite—What Can We Learn from These Cases and Trends?

Stanley R. Soya, Pepper Hamilton LLP

The DOJ “Prosecution Gap:” The Growing Importance of DPAs and NPAs

Statistics compiled by the government and by Gibson, Dunn and Crutcher suggest that the annual frequency of DPAs entered into by DOJ increased by an order of magnitude over the past decade, rising from approximately four in 2003 to approximately 35 in 2012. The amount of money recovered through DPAs rose even more dramatically, from about \$300,000 in 2003 to about \$9 billion in 2012. However, DOJ has faced considerable criticism from media, Congress, and judges in connection with perceived inadequacy in the criminal prosecution of corporate executives. Some have viewed the increasing prevalence of high-value DPAs as an indicator of laxity in DOJ’s enforcement approach.

DOJ’s Response to Criticism of Its Prosecutorial Vigor

Assistant Attorney General Lanny A. Breuer has underlined DOJ’s basic commitment to prosecuting individual executives whenever the evidence supports doing so, regardless of whether a DPA is negotiated with the parent corporation. Breuer has also asserted that DPAs have helped to ensure greater accountability among corporations, particularly in situations in which DOJ would otherwise have been unable to sustain a criminal prosecution. In sum, the deterrence effects both of prosecutions and of DPAs are important elements in DOJ’s enforcement tool kit.

Recent Cases

Enforcement examples grabbed from recent headlines include both DPAs and high-profile prosecutions. In 2012, DOJ entered into an NPA to resolve claims of criminal wrongdoing against Barclays Bank in connection with the London Interbank Offered Rate (LIBOR) scandal. Although the bank was fined \$160 million and wound up replacing its top management, its cooperation with DOJ was also recognized as extraordinary and therefore worthy of relief through the NPA. In an unrelated Foreign Corrupt Practices Act (FCPA) case in 2009, the founding executive of Dooney and Bourke (a handbag manufacturer) was found guilty of turning a blind eye to bribes paid to foreign officials. The case was noteworthy for imposing criminal liability on an executive defendant, even where his misconduct arose from failing to prevent a crime of which he should have been aware and not from committing the crime directly.

Responsible Corporate Officer Prosecutions

Another set of relevant executive prosecutions has taken place under the Federal Food, Drug, and Cosmetic Act (FDCA). Pursuant to that act, the Responsible Corporate Officer (RCO) doctrine holds responsible officers in pharmaceutical and medical device companies criminally liable where those officers fail to prevent or to correct violations under the act. Examples of recent RCO criminal prosecutions of executives have included the CEOs of KV Pharmaceutical and of the Purdue Frederick Company and have resulted in jail sentences, large fines, disgorgement of executive compensation, and debarment of executives from related employment.

KBR and HSBC: Settlements Designed to Influence Compliance Within Firms

Other recent settlement examples showcase efforts to use episodes of scandal and executive misconduct to drive a stronger compliance agenda within firms. In the case of KBR, the underlying facts involved allegations of major FCPA violations and multimillion-dollar bribes of foreign officials with the direct involvement of the CEO of the company. In the case of HSBC, the facts involved large-scale, serial violations of anti-money-laundering statutes and HSBC's failure to carry out an effective compliance program or due-diligence activities. Both cases were notable for compliance obligations that were imposed by settlement.

Observations and Recommendations

Careful examination of recent prosecutions, DPAs, and NPAs can help companies keep abreast of risk areas and of DOJ's view of sound compliance practices, while helping the companies to benchmark their own compliance programs. Among the recent take-aways are the following:

- DOJ is committed to prosecuting executive offenders whenever the evidence supports it.
- DPAs do not provide corporate executives amnesty from prosecution.
- Prosecutions of responsible executives take time to investigate and develop and may occur years after a DPA has been signed.
- In at least some instances, senior executives can face criminal risk when they passively allow fraud to occur.
- DOJ expects the head of the C&E program to have direct access to the board of directors and that the C&E program will be separate from the legal department.
- DOJ expects executive compensation policies to make incentive pay contingent on meeting compliance standards and values.

Summary: “C” Is for Crucible—Behavioral Ethics, Culture, and the Board’s Role in C-Suite Compliance

Scott Killingsworth, Bryan Cave LLP

The C-suite as an institution has some basic compliance vulnerabilities, fueled by external performance pressure and magnified by the intrinsic limitations of human judgment in any insular and powerful group. The board can best monitor and support C-suite C&E performance by leveraging organizational culture and by forging connections with the firm’s C&E program.

The Crucible

The C-suite affords ample means, motive, and opportunity for poor ethical judgment and misbehavior. Key factors include money (i.e., strong incentives and temptations), power (i.e., authority and freedom from controls), velocity (i.e., need for quick decisions), and competitive personalities (i.e., selecting executives for superior achievement may also yield aggression and risk-seeking).

How the Crucible Amplifies Ethical Infirmities: Behavioral Ethics

Moving beyond these “crucible” factors, research in behavioral ethics has uncovered a range of situational and social influences that can undermine moral decisionmaking despite the best ethical intentions. Examples observable within the C-suite include conflict of interest, motivated blindness, irrational loss avoidance, overconfidence, and group conformity biases.

What Not to Do in Board Oversight of the C-Suite

In addressing the risk of C-suite misconduct, boards can best fulfill their oversight responsibility by taking positive actions to model and support good conduct. Adopting an adversarial or suspicious posture toward the C-suite may be self-defeating by provoking suspicion, distrust, and defensive tactics by executives while reducing the board’s access to information.

Board Oversight: Leadership Selection

One of the board’s chief responsibilities is hiring the right people as senior executives (and avoiding hiring the wrong people). “Very good” CEOs may be preferable to “stars” because the latter are (by definition) more prone to narcissism or psychopathy or to viewing the company’s success as indistinguishable from, or secondary to, their own. And board involvement in the selection of other senior officers can safeguard against undue C-suite “connectedness.”

Board Oversight: Working with the Chief Compliance Officer

The board should develop a supportive, direct report relationship with the CCO. For one thing, the company cannot receive leniency under the Federal Sentencing Guidelines in connection with C-suite misconduct unless a direct report relationship exists. But it is also desirable because the CCO is in a unique position to speak “truth to power,” both within the C-suite and in private conversations with the board. A CCO with a real “seat at the table” in senior management can help the board to monitor the climate of the C-suite and to flag emerging C&E concerns.

Board Oversight: Modeling the Message

The board and the C-suite depend on each other to instill ethical organizational culture. Thus, the board must model and enforce the highest standards of conduct, vigilantly addressing even minor lapses by its own members or senior management. The board is also uniquely positioned to counter some of the cognitive traps that can lead to C-suite compliance breakdowns, such as motivated blindness, business-only framing, and tunnel vision in strategic decisionmaking.

Culture and Expectations of the C-Suite

The board should challenge senior leadership to take ownership of the organization’s ethical culture and to be accountable for results. Setting this expectation has two purposes: first, to benefit the entire organization by engaging the C-suite in modeling and supporting ethical culture, and second, to increase the salience of ethics in the minds of the executives themselves.

Culture and the “Information and Reporting System”

The board’s fundamental compliance obligation is to monitor an information and reporting system sufficient to support informed board judgments about compliance. This reporting system does not end with the CCO and other control officers. An important aim of ethical culture is to make rank-and-file employees comfortable in “speaking up” when ethical violations or compliance problems are observed, bringing these problems to the attention of supervisors and compliance officers and, ultimately, back to the board.

Summary: Compliance in the C-Suite

Michael Volkov, Volkov Law Group LLC

The occurrence of criminal conduct within the C-suite is on the rise. Statistics compiled by DOJ, KPMG, and the Compliance and Ethics Leadership Council suggest increasing rates of criminal prosecution and conviction of C-suite executives; high prevalence of top management involvement in serious compliance violations; and a growing percentage of CEOs, CFOs, and board members complicit in observed episodes of corporate fraud. Although there has been a corresponding law enforcement response to these trends, the continuing problems of C-suite crime raise a question about additional preventive measures that should be taken. In particular, what should corporations themselves be doing to better address C-suite misconduct and culture problems from within?

The Risks of C-Suite Misconduct: Some Recent Examples of Criminal Prosecutions

Responding to public opinion and political pressure, federal authorities have intensified their prosecutorial efforts and adopted enhanced enforcement tactics, including wiretaps and “ambush interviews.” Recent examples of high-profile prosecutions include WellCare (Medicaid fraud perpetrated by CEO, CFO, and executive co-conspirators); Synthes (multiple senior executives violated the RCO doctrine and FDCA through duplicitous marketing of an orthopedic bone cement product); and Purdue Pharma (corporate president and top executives pleaded guilty to misleading the public about the risks of OxyContin). All resulted in criminal convictions, jail time, or debarment for the executives involved. Enforcement examples like these suggest that corporate leaders themselves should be concerned with the potential for misconduct and with improving compliance at the highest executive levels within their companies.

C-Suite Compliance: An Ignored Risk and Disastrous Consequences

Despite efforts within many companies to improve their compliance programs and thereby reduce risk, compliance within the C-suite itself has often been neglected. Paradoxically, this seems to reflect an implicit assumption that positive “tone at the top” may make compliance at the C-suite level superfluous. In fact, the opposite is true. When compliance is visibly lacking at the C-suite level, this omission sends a contradictory message downward through the organization about whether the institutional commitment to compliance and transparency is truly meaningful. The cultural costs can be severe, as illustrated by the recent Best Buy scandal in which both the CEO and board chairman were forced to resign, in part because of a failure at the board and C-suite levels to adhere to the firm’s compliance policies.

Step One Toward Improving C-Suite Compliance: Redefine the Board's C&E Role

Corporate directors need to conduct a rigorous self-examination of their own performance and responsibility and to identify ways to minimize compliance risks throughout the company. Proactive steps that can be taken at the board level include (1) setting up a board-level compliance committee, (2) empowering the CCO and ensuring a direct report relationship to the board or its compliance committee or both, and (3) supporting the CCO in the formation of a rigorous compliance and ethics program. In order to carry out board-level responsibilities for monitoring compliance, including at the C-suite level, boards need a flow of performance information that can be provided only by an empowered CCO sitting at the helm of an effective compliance program.

Step Two Toward Improving C-Suite Compliance: Empower an Independent CCO

Going back at least to 1998, various authorities have trumpeted the importance of ensuring an independent and effective compliance function within the hierarchy of corporate management. Related principles have notably been embedded in the Federal Sentencing Guidelines. In line with these principles, some companies are now embracing the idea of a C-suite-level CCO. Among the reasons for elevating the CCO position to senior executive status is the likelihood that a C-suite-level officer can more effectively pursue a compliance agenda within the C-suite itself and identify and communicate any related lapses both to the C-suite and, where appropriate, the board.

Step Three Toward Improving C-Suite Compliance: Assess and Respond to Risk

In order for the CCO to address compliance risk at the C-suite level, he or she needs to have the authority, resourcing, and board access to make this role practical. This being granted, the next step is for the CCO to apply the same professional tools used in other aspects of the job, beginning with a formal risk assessment. Such an assessment can ground subsequent compliance training, certification, and communication efforts within the C-suite and once again spotlights the importance of the CCO's reporting tie back to the board. To the extent that compliance risk assessment or subsequent compliance activity identifies specific vulnerabilities or resistance within the C-suite, only an empowered CCO and a board that is actively monitoring the program are likely to be able to address those compliance problems.

3. What Are the Fundamental Compliance and Ethics Challenges Facing the C-Suite, and What Oversight Role Should the Board Play?

The second session of the symposium addressed a series of questions about the basic C&E challenges facing members of the C-suite. It was observed that the initial selection of top executive candidates with a track record of superior achievement and ambition, when combined with short-term performance pressures, the subsequent autonomy of the executives, and their need to make executive decisions collectively in small groups, tends to make people in top executive positions inherently more vulnerable to C&E misadventures. As one symposium participant observed, “If you wanted to design an incubator for generating misconduct, it would look a lot like the C-suite.” Other participants noted that the C-suite typically “operates with very little oversight,” that “motivated blindness” and cognitive bias are not uncommon, and that, too often, “there is no lid on the cookie jar.” One participant invoked a stronger metaphor in suggesting that the conduct of some top executives may, at times, resemble that of “a junkie who is seeking a bigger and better high” and that the environment of the C-suite can actively feed into similarly appetitive, aggressive, and risk-seeking behavior. Other symposium participants, however, offered more moderate views. One person suggested that “misconduct in the C-suite is a complex proposition” with many contributing factors that give rise to it. Another emphasized that the substantial majority of senior executives are noteworthy for their integrity and high standards of conduct, notwithstanding the pressures of the C-suite. Several other symposium participants put somewhat more emphasis on the prevalence and consequences of executive misconduct. One person noted that “there is a flawed assumption that those in the C-suite will tend to do the right thing.” Another pointed out that, even if the majority of executives are highly conscientious, that provides small comfort when “even a single act [of malfeasance] at the senior level can be catastrophic [to a company].”

Much of the discussion in this session focused on the appropriate oversight role for the board in connection with compliance and misconduct in the C-suite. Some participants noted that basic C&E problems and instances of misconduct also occur at the board level, as well as within the C-suite, and that an important priority for boards is simply to self-police their own behavior more effectively. Others argued that boards have a responsibility to “be at the forefront of the culture they expect [from the C-suite]” and that boards “need to inject a greater sense of responsibility into the C-suite.” There were mixed opinions among the symposium participants about how well boards are currently doing in terms of C-suite oversight and how much it is reasonable to expect them to do when it comes to policing the C-suite on C&E issues. One participant said that he had “seen good boards and bad boards, [though] a lot more bad ones.” Another observed that, in the

context of the high rate of malfeasance involving C-suite executives, “boards have not served very well as gatekeepers.” Finally, there was also some discussion in the symposium session addressing the tie between the boardroom and broader organizational culture and the varied ways in which incentives and norms established by the board of directors can feed into the culture of the C-suite and, ultimately, into the organization as a whole.

The discussion included several major points of consensus among participants:

- Crime and misbehavior in the C-suite represent an important problem not sufficiently addressed by the current focus on “tone at the top.”
- Deficiencies in C-suite ethical culture, including groupthink and motivated blindness, are an antecedent to many instances of misbehavior.
- Misconduct in the C-suite reflects a basic gap in compliance.
- Compliance needs both to be embedded throughout management, but achieving this requires a strong compliance leadership position within management.
- For boards, key stumbling blocks in carrying out effective C-suite monitoring include lack of C&E insight and expertise.

Crime and Misbehavior in the C-Suite Represent an Important Problem Not Sufficiently Addressed by the Current Focus on “Tone at the Top”

Perhaps the most basic theme in this symposium session was simply a collective acknowledgment that C-suite misconduct and criminality do indeed represent an important problem for corporations and for society as a whole. It was observed that top executive misconduct has become a recent lightning rod for high-profile enforcement efforts, with literally billions of dollars in resulting fines and settlement penalties now being collected by government authorities every year. One symposium participant notably observed that related concerns about managing corporate reputational risk and avoiding the potential for major financial losses have become a priority focus for public company investors and boards alike. For C-suite executives, these trends herald both increased personal liability risk for putative episodes of misconduct and an increasingly difficult enforcement environment within which to shepherd their companies toward successful performance. Moreover, several symposium participants also suggested that the challenges associated with C-suite compliance and misconduct are likely to grow even more difficult in coming years, at least from the standpoint of senior executives and board members who are seeking to manage and mitigate compliance risk. In part, this is so because the tide of law enforcement effort seems unlikely to ebb any time soon, given that observable trends are continuing to move in the opposite direction. In a somewhat different vein, one symposium participant emphasized the transformational impact of technologies, including email, electronic record-keeping, and ubiquitous access via smart phone. Taken together, it was suggested, these will make senior executives responsible for an increasingly overwhelming flood of 24/7 information about corporate operations and practices. Ultimately, it was suggested that, until the C-suite is able to harness new technology to effectively manage the informational tide, the risks

of inadvertent but consequential compliance violations among senior executives are likely only to grow greater.

Deficiencies in C-Suite Ethical Culture, Including Groupthink and Motivated Blindness, Are an Antecedent to Many Instances of Misbehavior

The symposium participants generally agreed that problems in “culture” (i.e., shared attitudes and values) lie near the heart of many instances of misconduct within the C-suite. There were diverse views, however, regarding the extent to which these cultural deficiencies are primarily a corporate phenomenon, as opposed to a broader social problem. One person observed that there is a pervasive “culture of rewarding misbehavior” that goes well beyond any specific company. Another pointed out that “external culture warps leadership” and that society at large has become accustomed to “celebrating criminals.” Several symposium participants, however, identified culture problems more closely with the behavior and influence of senior executives themselves. One person observed that, “under perfectly controlled conditions, animals [including members of the C-suite] will do whatever they damn well please.” Another person pointed out that “arrogance within the C-suite isn’t necessarily criminal but can have a strong impact on [broader] organizational culture.” Another suggested that, when the C-suite embeds the attitude that “winning takes care of everything,” that atmosphere presents a serious compliance risk for the company, as well as a potentially corrosive influence on the rest of the company’s workforce.¹ As still another participant observed, “People do what they see.” When the top executives in a company behave in ways that subordinate integrity and compliance to short-term self-interest, that trade-off sets the stage for other workers within the company to do the same.

The symposium participants wrestled with a series of practical questions about what could reasonably be done to strengthen ethical culture within the C-suite. Several people observed that the Federal Sentencing Guidelines had been revised in the past decade to incent companies to encourage and support stronger ethical cultures. It was noted that future revisions to the guidelines might be designed specifically to address similar culture and behavior issues but focusing on the C-suite. A countervailing sentiment was also expressed, however, that, “ultimately, you can’t legislate trust and culture.” Several participants voiced skepticism about the role of government in directly influencing something as intangible as C-suite ethical culture. Others emphasized instead that corporate boards “should be driving culture and trust” within their respective C-suites and ought to be viewed as having direct oversight responsibility on this issue. On a related point, it was noted that several of the more conventional responsibilities for corporate boards, including executive screening and hiring, compensation, and risk oversight, all relate to culture within the C-suite. It was noted that these sorts of board oversight functions also

¹ See also related discussion in Boehme, 2013.

represent levers that can be used to influence C-suite ethical culture. Finally, it was suggested that corporate boards need to directly model the kind of culture that they expect their C-suites to follow. This is so because top executives may take their cues from the board on what kinds of behavior are consistent with company culture and because the board offers a continuity of perspective on firm ethical culture, moving beyond the limited tenure of any individual senior executive within the management hierarchy.

Misconduct in the C-Suite Reflects a Basic Gap in Compliance

One of the basic observations shared by several participants was that “there is a fundamental compliance gap within the C-suite.” Participants offered a range of suggestions regarding what that “compliance gap” really entails. One participant observed that neither the Federal Sentencing Guidelines nor the C&E function within most organizations is focused on the problem of addressing misconduct at the C-suite level. Another participant amplified on the same theme and said that most compliance programs have implicitly been designed to drive compliance in *other* parts of the corporation, not the C-suite. For instance, one participant observed that “today’s compliance gap in the C-suite is like diversity training [was] in the 1990s—everyone except the C-suite got the training.” It was also observed that there is little likelihood that a C&E program would be able to directly influence the C-suite when that program is siloed within another functional area of management (e.g., legal or human resources) and when the CECO is several levels subordinate to the C-suite within the management hierarchy. As another participant pointed out, “If the aim of the CECO role is at least partly to monitor problems within senior management and to offer the board an effective point of contact and information when instances of C-suite misconduct actually do arise, then it follows that the CECO role needs to be sufficiently senior and well-resourced in order to make those aims plausible.” On this note, it was also observed that “the CECO is not a whistleblower, yet blows the whistle internally all the time.”

Several other viewpoints were offered concerning other gaps in management and governance that might contribute to C-suite-level misconduct and criminality. One person observed that a meaningful gap often arises between what top management says is important and what it actually models as important through their own behavior. “The gap is about actionables and walking the talk when it comes to compliance at the top of the organization.” Other participants questioned whether boards have truly put themselves in a place to be able to carry out effective oversight on C-suite compliance, notwithstanding their putative responsibility to do so. For varied reasons, it was suggested that many boards may lack the insight, the motivation, or the knowledge to carry out that role effectively. Still another perspective on the C-suite “gap” focused on the difference between a senior executive team that views “compliance” as a deep commitment to the rule of law and to responsible behavior and one that sees it as an exercise in parsing legal rules “to figure out what they can away with.” In a similar theme, another participant observed that senior

management can sometimes become preoccupied with “trying to understand the legal requirement and asking the question how close can they skirt it: How far can they go before reaching the point where somebody might go to jail? When they have that outlook, you know that people are in danger of going off the cliff.” Still another participant paraphrased Richard Breeden in pointing out that “it is not an adequate standard of organizational integrity to get through the day without being indicted.” In sum, when members of the C-suite view the compliance obligation in overly legalistic or opportunistic terms, then the essence of ethical practice is at risk of being lost, and the likelihood of executive misbehavior or a serious compliance breach becomes magnified. This was also noted by several symposium participants as a powerful reason not to subordinate the compliance function to the general counsel because, “when you put compliance into the law department, the threshold judgment [often] becomes, at what point will we get convicted?”

Compliance Needs to Be Embedded Throughout Management, but Achieving This Requires a Strong Compliance Leadership Position Within Management

One of the major strands of discussion in the symposium involved the foundational importance of focusing the C&E function under an empowered CECO as opposed to trying to diffuse or indoctrinate C&E more broadly throughout the corporation. One participant expressed concern about the drawbacks associated with any kind of siloing of the C&E function within management and the possibility that doing so might, at times, detract from the rest of the organization (including the C-suite) viewing C&E as an integral part of everyone’s collective responsibility. Another expressed concern about the limits of effective “policing” of senior executive behavior, no matter how powerful the CECO role becomes: “It’s possible to have a perfectly good board and a strong [CECO and C&E function] in place, and something bad can still happen.” Other symposium participants expressed strongly contrasting views. One person said that the presence of a robust CECO is “the minimum requirement for ensuring an effective compliance effort,” whether at the C-suite level or throughout the organization. Another person suggested that “the CECO is not a magic bullet. But when nobody in management is tasked with a responsibility for taking care of something, then that thing generally doesn’t get done.” Others pointed out that the Federal Sentencing Guidelines have described in detail what an effective C&E program needs to look like and that one of the defining features of such a program is a CECO—i.e., a person who has day-to-day responsibility for leading and managing the program. The guidelines go on to assert that adequate independence and access to the board of directors are some of key features for structuring an effective CECO role.

Another symposium participant argued that the superficial tension between focusing C&E responsibility in the person of the CECO and diffusing C&E culture throughout an organization really represents a false dichotomy:

The essence of the CECO role lies in oversight. The role serves to ensure that every functional area of the corporation that has compliance obligations [including the C-suite] is actually meeting those obligations. And whenever the CECO finds a compliance gap, he or she then makes sure that somebody appropriate within line management picks it up and takes responsibility for it.

Other symposium participants noted that among the typical responsibilities of the CECO role are corporation-wide C&E training, support for anonymous violation reporting, related investigations, and outreach to the other branches of management. Far from sapping ethical culture and broader responsibility for C&E within the corporation, the intent of the CECO position is to help empower ethical culture and ensure that broader responsibility is genuinely taken within the organization. Another symposium participant underlined the point and noted again that the more fundamental problem with C&E tends to involve overcoming a “check-the-box, Kumbaya” approach within many companies. An empowered CECO was spotlighted as a necessary but not sufficient step toward that end.

Finally, a related strand of discussion in the symposium focused on the C-suite dimension of the CECO role. If training, oversight, and safeguarding culture are elements of what the C&E function is supposed to do more broadly, then it follows that those are also elements of what a C&E function could attempt to support within the C-suite. By extension, the CECO role, in principle, could be structured to support the same C-suite-level ends. The symposium returned to this point in subsequent discussion later in the afternoon.

For Boards, Key Stumbling Blocks in Carrying Out Effective C-Suite Monitoring Include Lack of C&E Insight and Expertise

Another theme in the discussion focused on some of the more prominent challenges facing boards in carrying out effective C&E monitoring within the C-suite. In particular, one observation was that many boards lack the expertise and knowledge to be able to carry out this kind of C&E oversight role effectively: “There is a need for more compliance expertise on boards so that there will be greater sensitivity to the importance of C&E and more understanding of what proactive questions need to be asked.” Another participant observed that “compliance and ethics is a tough field [for boards], and board *oversight* requires board *insight*.” He continued that a lot of corporate boards simply “depend on managers to tell them what they need to know [about C&E]” and that, by extension, that is often a difficult position for directors to be in. Several other symposium participants spoke to the value of recruiting one or more board members with direct compliance expertise in their own professional backgrounds, as a way to seed and energize board capabilities on C&E issues. One participant noted that the same kind of compliance expertise could also be helpful to boards in safeguarding organizational integrity and culture and in emphasizing their importance at the C-suite and board levels. As another participant with both directorship experience and a C&E background noted, “The entire board sometimes will look [to me] at times as if to say, are we going down the right path?” Ensuring

some level of board expertise on C&E can help to guarantee that basic compliance and ethical culture problems are not overlooked, that basic questions do not go unasked by the board, and that the C&E function within management is appropriately structured and resourced, in order to protect against even C-suite-level risks.

4. How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management, and Policymakers Do Next?

Participants in the final session of the symposium focused more deeply on identifying potential solutions to the problems of compliance and misconduct in the C-suite and on tangible next steps that might be taken by boards, executives, regulators, and policymakers. Some strands of the discussion focused primarily on the governance role of the board of directors, while other strands touched more strongly on the C&E function and the role of the CECO. There was broad consensus that both boards and CECOs have meaningful parts to play in seeking to improve the compliance climate of the C-suite: the former (in part) through more effective, proactive exercise of their oversight responsibility and the latter (at a minimum) by helping to inform and empower the former and by serving as an independent voice in the C-suite. A separate strand of the symposium discussion focused on the Federal Sentencing Guidelines, enforcement activity, and the prospects for new policy aimed directly at influencing compliance and ethical culture in the C-suite. In context, it was observed that high-profile enforcement efforts and criminal prosecutions that target senior executives are already sending a compliance signal to members of the C-suite. The question then becomes, what other options should policymakers be considering? Finally, another theme in the discussion touched on the larger corporate governance framework within which C-suite compliance and ethical-culture problems are manifesting. One of the symposium participants notably remarked that, “based on the theory that animates the corporate law, none of these problems [with criminal misconduct in the C-suite] ought to exist.” It was pointed out that various of the traditional governance functions and responsibilities of the board (including with regard to CEO hiring and compensation) could be remodulated to try to better detect and prevent misconduct in the C-suite. However, it was also observed that some of the relevant governance levers (e.g., executive compensation) may also be associated with broader structural problems in the corporate form; addressing these fully goes beyond the issues of C-suite compliance.¹

The discussion included several major points of consensus among participants:

- Both structural and nonstructural factors are important targets for contributing to C-suite integrity.
- Training, incentives, monitoring, and risk and culture assessment are all C&E practices that can be elevated up to the C-suite level.

¹ Compare, for example, Jacobs, 2011.

- The CECO role should be elevated and empowered to better support C&E at the C-suite level.
- Board priorities for preventing and detecting misconduct in the C-suite can draw on a range of structural and cultural reforms.
- Policy and enforcement efforts will continue to shift the landscape of compliance in the C-suite.

Both Structural and Nonstructural Factors Are Important Targets for Contributing to C-Suite Integrity

One basic observation from the symposium session involved distinguishing between structural and nonstructural factors designed to inoculate the C-suite against misconduct. At many points during the symposium, the discussion touched on very concrete attributes of corporate anatomy and management hierarchy—e.g., compensation practice, whistleblower protection processes, appointment of an empowered CECO with direct access to the board. All of these are examples of structural levers that can influence the degree of compliance risk within the C-suite. It was observed that the common element among these levers is that they are all tangible. They are straightforward to describe and to prescribe and capable of objective measurement. They all relate to the structure of management and governance relationships within the corporation. And they all correspond to action items, things that can be readily documented when changed and that are intuitively tied to behavioral incentives, information flow, or management practice within a given organization. The symposium participants had mixed views on whether or not any particular structural intervention (e.g., forming a board-level compliance committee), if implemented in isolation, would be likely to have a potent impact on the occurrence of C-suite misconduct. But, among participants, there was general recognition that structural factors make up a broad category of interventions for seeking to influence corporate behavior.

However, it was also observed that there is another important influence on the behavior of senior executives, in the form of ethical culture—i.e., a shared set of attitudes, norms, and beliefs among the executives about how business in the corporation ought to be conducted. These sorts of attitudes and values can be understood as a nonstructural or “soft” factor in the C-suite, as well as among the corporate workforce more broadly. Ethical culture is notably not subject to direct manipulation in the same way that the structural factors are.² Nevertheless, it represents an important influence on executive behavior, and one arguably more central to what many C&E programs are fundamentally trying to address and modify. As several symposium participants

² Although, as one participant pointed out, the Federal Sentencing Guidelines do contemplate that, by establishing the elements of an effective compliance program, corporations will be following a pathway toward achieving a strong ethical culture.

observed, the 2004 amendments to the Federal Sentencing Guidelines explicitly focused on promoting ethical culture in firms, with the implicit rationale that corporate integrity ultimately goes well beyond the narrow parsing and following of legal rules. In a related vein, another symposium participant observed that it is ethical culture, rather than a purely mechanical approach to improving compliance with legal rules, that corporations, executives, and policymakers should ultimately be striving to achieve.

All of this was summed up by one of the symposium chairs in the following way:

Improving C-suite compliance is likely to involve both structural and nonstructural steps. The structural steps have the advantage of being more concrete and therefore easier to put in practice. The nonstructural steps are less tangible but at least as important to accomplish. Based on our conversation, it seems unlikely that any single step is likely to solve the problem of C-suite misconduct by itself. Nevertheless, there [is] a range of structural and nonstructural steps that collectively can help to reduce C-suite risk while improving C&E performance among senior executives.

Training, Incentives, Monitoring, and Risk and Culture Assessment Are All C&E Practices That Can Be Elevated Up to the C-Suite Level

One of the prominent observations in the symposium session was that there are many structural C&E measures that can be undertaken to improve the compliance climate of the C-suite and to prevent episodes of misconduct from occurring. Many of those measures correspond to traditional aspects of the C&E function but elevated up to the C-suite level. Several symposium participants particularly commented on the importance of C&E training for senior executives and observed that, sometimes, the people who need the training the most are actually those least likely to receive it:

On one occasion [when I was responsible for compliance in a large corporation], I received a phone call from the CEO's administrative assistant, who said that the CEO was too busy to fit in an ethics training session and could they just mark him off as having done it? I answered no. The big people often need the training more than the little people do.

Another observed witnessing something similar in a large law firm, where C&E training sessions “are mostly attended by associates and staff but not by the partners. The [default] assumption seemed to be that [the partners] already knew everything.” Still another person observed that senior executives tend to fall into two categories: “those who are conscientious and have no intention to violate laws [or ethical norms] and therefore don't believe they need training and those who are less committed to upright behavior and who also don't believe they need training.” In response to these sorts of observations, several ideas were shared in the symposium for strengthening C&E training at the C-suite level and for overcoming inertia or noncompliance among senior executives. One involved the notion of a training “cascade,” in which top executives would both receive their own C&E training and take on responsibility for helping to

train others beneath them. It was observed that this is an “old trick” and one that can subtly co-opt executives into viewing themselves as owning and representing the ethical-culture banner.

Another related idea that was discussed involved the use of compensation incentives to drive compliance and good behavior.³ It was observed that executive compensation could be tied to C&E performance in a variety of ways, including (but not limited to) rewarding the successful completion of mandatory C&E training exercises. Several participants in the symposium responded strongly to this idea, stating that “people do what they are economically rewarded for doing” and that, “if you are not looking at [compensation] incentives, then you don’t really have a [meaningful] compliance program.” It was also observed that setting appropriate compensation incentives is one of the areas in which the responsibilities of the board of directors coincides with the implementation of an effective compliance program. In still another vein, it was suggested that undertaking a basic C&E risk assessment is as important in application to the C-suite as it is to the rest of the corporation. Making sure that this kind of risk assessment takes place can help the CECO and the board to understand relevant C-suite-level risks, the senior executives to protect themselves, and all parties to come together on a plan to address the risks. Finally, it was observed that another basic facet of an effective C&E program involves the regular assessment of ethical culture, in part by means of regular employee surveys. Here again, information feedback from an ethical-culture survey can offer useful insights regarding “tone at the top” and the way that C-suite behavior is being viewed from elsewhere within the company. In principle, such surveys could be tweaked in order to draw information more directly about, and from, the C-suite itself.

The CECO Role Should Be Elevated and Empowered to Better Support C&E at the C-Suite Level

Several participants in the session commented again on the crucial role of the CECO in driving an effective C&E program. One participant referred to the Federal Sentencing Guidelines in reemphasizing that “the CECO must be fully empowered and independent” in order to carry out her designated role. Another pointed out that “the CECO protects the company, so we [boards and policymakers] need to protect the CECO.” Some of the discussion touched broadly on the importance CECO role in helming a robust C&E effort and the structural need for CECO independence, appropriate resourcing, and a direct reporting line up to the board level. The discussion delved more deeply, though, into the particular relevance of the CECO to driving C&E practice at the C-suite level and to addressing C&E risk at the very top of the organization. On this note, one participant observed that “we are now on the cusp of pushing the CECO [directly] into the C-suite.” On a similar note, another said that “the way to [better] inject

³ A similar point was also recently addressed in Murphy, 2011.

compliance and ethics into the C-suite is by injecting the CECO into the C-suite.” Although some others expressed more skepticism about elevating the seniority of the CECO role in this way, it was broadly acknowledged that the CECO’s seniority needs to be fundamentally congruent with the functional responsibilities that that person is expected to carry out:

If part of the mandate for the CECO is to influence what’s going on at the C-suite and board levels, to give feedback on related performance information both to the C-suite and the board, and to serve as a crisis management leader when something goes wrong at the top of the company, then it follows that the CECO would need to have sufficient access and authority to [meaningfully] carry out all of those roles.

In this context, it was also pointed out that many of the CECO’s traditional responsibilities, as for C&E training, risk assessment, culture, adverse-event reporting, investigation, and whistleblower protection, all have direct applicability to behavior and risk at the C-suite level, just as they do throughout the rest of the organization. If the intent is for those aspects of the C&E program to reach directly to the C-suite (and the board), then that has to be understood by all the parties in senior management, and the CECO needs to be adequately empowered and positioned to really carry this mandate out. Finally and more specifically, it was also observed that, if one of the aims of a corporate ethical culture is to ensure that there is a C&E voice engaged in the highest level of strategic and operational decisionmaking, then a practical way to achieve that end is to make the CECO a direct party to the C-suite and a direct participant in related meetings and discussions. Although the symposium group did not reach a firm consensus on this point, members did recognize that the CECO role can be set up in a variety of ways to exert C&E influence both on the C-suite and on the board. Consequently, empowerment of the CECO offers an attractive target as a reform designed to reduce C-suite-level risk.

Board Priorities for Preventing and Detecting Misconduct in the C-Suite Can Draw on a Range of Structural and Cultural Reforms

Discussion in this session of the symposium also returned to the role of the board and to interventions that might be instituted at the board level in order to better address C-suite compliance and ethical-culture problems. As noted previously, stronger C&E training for boards, modified executive incentive structures, and cooperation with an empowered CECO were among the ideas offered for improving board C&E oversight at the C-suite level. Another strand of discussion focused on the structure and expertise of the board with regard to C&E matters. One set of suggestions focused on adding one or more board members with C&E backgrounds in order to make the board more savvy and knowledgeable about how to coordinate with the CECO, and on what sorts of proactive C&E questions need to be asked in order to discharge the board’s oversight role. Another suggestion was to move boards structurally in the direction of forming their own discrete compliance committees, with dedicated responsibility to monitor C&E matters (including at the C-suite level), and to apply related expertise. One participant

noted that “only about 20 percent of U.S. companies currently have a board compliance committee, and that needs to change.” Another commented, “When I see a board that actually has a compliance committee, that’s Nirvana . . . group hug time.” Others participants sounded a note of caution though, in observing that there has been an unrelated corporate governance problem involving the proliferation of board-level committees with delegated responsibilities. One participant specifically observed that, regardless of whether a board committee is specifically formed to take the lead on compliance oversight, the full board should not get a free pass on responsibility for this: “I’m very concerned as a board member that, regardless of committees, the full board needs to retain the ultimate responsibility for monitoring most things. We want the full board to be doing deep dive reviews on C&E, enterprise risk, etc.”

Other strands of the symposium discussion tied board oversight back to various of the other avenues for promoting stronger compliance and ethical culture at the C-suite level. It was noted that boards have an important role to play in setting executive compensation targets, requesting and reviewing C&E risk assessments, evaluating ethical-culture survey findings, and serving as the ultimate backstop behind the company’s internal whistleblower reporting process. In particular, it was suggested that boards share an imperative to understand the cultures of the organizations that they serve, by periodically commissioning a culture assessment. As one symposium participant observed, “A board that does not do [this kind of] culture assessment is operating with a blind spot.”

In a somewhat different thread, it was also observed that board involvement is critical to ensuring that the CECO is fully empowered, appropriately placed, and adequately resourced. In the absence of a reporting line between CECO and board, the former is notably likely to be handicapped in elevating C-suite-level concerns to the board’s attention, while the latter will be cut off from the unfiltered information needed to carry out meaningful oversight of C&E within the C-suite. Finally, one participant specifically emphasized that the chief responsibility of the board—namely, to hire and fire the CEO—ties very directly to C&E risk faced by the corporation:

One of the really big risks happens when you get an arrogant, narcissistic person in the role of the CEO, somebody who views financial success for the company as indistinguishable from, or subordinate to, his own financial success. Corporate meltdowns are caused by such people. So one practical suggestion for the board is to look out for those qualities when hiring a new CEO and to try to avoid them. And if, despite best efforts, you do hire somebody like that, then you need to do something about it once you discover it.

Policy and Enforcement Efforts Will Continue to Shift the Landscape of Compliance in the C-Suite

The concluding theme of the symposium involved a discussion about the influence of policy and what federal policymakers ought to consider doing in order better to address C-suite

misconduct and ethical culture in the future. This was a point on which there were different opinions expressed around the symposium table. On one hand, there were some who voiced concern about attempting to “legislate ethical culture” and skepticism about whether and how the USSC and other policymakers could productively influence the C-suite, moving beyond the criminal sentencing and prosecution guidelines that are already in place. A contrasting view was expressed, however, by other participants. One observed that it seemed too early to give up on the Federal Sentencing Guidelines as a tool for driving C-suite behavior, particularly given that the compliance provisions under the guidelines “didn’t start out [in 1991] with any aim to focus the C-suite.” It was suggested that perhaps an expert advisory panel ought to be convened by the USSC to review the options for reform along these lines. Other symposium participants pointed out that there are lots of different policy interventions that could plausibly be added into the Federal Sentencing Guidelines (as well as into DOJ enforcement practice and settlement negotiations), ranging from new educational requirements for board members and C-suite executives to financial incentives and risk and culture assessments imposed at the C-suite level.⁴ On a related point, another participant observed that Congress too might get involved down the line in establishing such policies, in the event that a future episode of financial crisis reveals new instances of senior executive misconduct as a major contributing factor: “[Sooner or later,] Congress will start regulating boards and compliance officers and how they interact [around C-suite risk], just like Congress got involved in executive compensation [in the context of Dodd-Frank].”

A final strand in the discussion on policy touched on the need to motivate new C-suite interventions and better C&E practice with policy “carrots,” rather than just with “sticks.” It was observed by several participants that criminal sentencing and prosecution guidelines are fundamentally about “sticks” and about trying to drive executive behavior through threat. As one participant thoughtfully put it,

Fear has a place [in helping to drive compliance practice], but good people don’t think that they’re doing anything wrong, and bad people don’t think they’re going to get caught, so it tends to be difficult to scare either group. That’s why it’s important to provide positive incentives for the behavior we want to encourage.

Another participant observed that

training for top executives on C&E [in the C-suite] has to frame the basic rationale for C&E in contributing to financial performance. CEOs aren’t interested in the Federal Sentencing Guidelines. For them, the argument in favor of C&E has to be tied to bottom-line performance. They need to understand that this is a part of how [our company is] going to make money. It’s an automatic

⁴ Many of the possibilities are summarized under other subheadings in this chapter.

disconnect for them if the argument is presented [exclusively] the other way, focusing on the law and avoiding criminal prosecution risk.”

Ultimately, the symposium participants reflected on various ways that C&E “carrots” and positive motivation could be injected into policy, as well as into C-suite compliance practice. Offering direct positive incentives to executives and companies for desired behavior, undertaking laudatory public disclosures to acknowledge such behavior when it occurs, and encouraging a “train-the-trainers” cascade to pull the C-suite into directly “owning” the C&E message were all suggested along these lines as low-hanging opportunities that policymakers might consider supporting and leveraging.

Appendix A: Symposium Agenda



Center for Corporate Ethics and Governance

A RAND INSTITUTE FOR CIVIL JUSTICE CENTER

Culture, Compliance & the C-Suite: How Executives, Boards, and Policymakers Can Better Safeguard Against Misconduct at the Top

Ritz-Carlton Hotel, Pentagon City
1250 South Hayes Street, Arlington, VA 22202; RAND Tel: (703) 413-1100
May 2, 2013

Sponsored by

Pepper Hamilton LLP
Attorneys at Law

Symposium Chair: Dr. Michael D. Greenberg
Symposium Co-Chair: Donna C. Boehme

Agenda

- 1:00 p.m. Welcome and Introductory Remarks**
Michael D. Greenberg, Director, RAND Center for Corporate Ethics & Governance
Donna C. Boehme, Principal, Compliance Strategists, LLC
- 1:10 p.m. Keynote Remarks**
Judge Ruben Castillo, Former Chair, U.S. Sentencing Commission
- 1:25 p.m. Invited Remarks from White Paper Authors**
Introductions by Donna C. Boehme, Principal of Compliance Strategists LLC
- Prosecution of Frauds and Crimes in the C-Suite: What Can We Learn from Cases and Trends?
Stanley R. Soya, Partner, Pepper Hamilton LLP
 - "C" Is for Crucible: Behavioral Ethics, Culture, and the Board's Role in C-Suite Compliance
Scott Killingsworth, Partner, Bryan Cave LLP
 - Compliance in the C-Suite
Michael Volkov, CEO, The Volkov Law Group LLC
- 2:15 p.m. Roundtable Session 1: What Are the Fundamental C&E Challenges Facing the C-Suite, and What Oversight Role Should the Board Play?**
First thoughts: Larry Thompson, Former U.S. Deputy Attorney General; Executive Vice President and General Counsel, PepsiCo Inc
- 3:15 p.m. Break**



- 3:25 p.m.** **Roundtable Session 2:** How to Overcome the Barriers to High Standards of Integrity in the C-Suite, and What Should Boards, Management and Policymakers Do Next?
First thoughts: Patrick Gnazzo, Principal, Better Business Solutions; former Chief Compliance officer UTC & CA Inc
- 5:15 p.m.** **Closing Remarks**
Michael D. Greenberg, RAND Corporation
- 5:30 p.m.** **Reception** *(concluding at 6:30 p.m.)*

Appendix B: Symposium Participants



CULTURE, COMPLIANCE & THE C-SUITE: HOW EXECUTIVES, BOARDS, AND POLICYMAKERS CAN BETTER SAFEGUARD AGAINST MISCONDUCT AT THE TOP

Roundtable Conference
RAND Center for Corporate Ethics & Governance
MAY 2, 2013

SYMPOSIUM PARTICIPANT LIST

Michael Greenberg
(Symposium Chair)
Director, RAND Center for
Corp. Ethics and Governance

Donna C. Boehme
(Symposium Co-Chair)
Principal, Compliance
Strategists LLC

Ruben Castillo
U.S. District Court Judge,
Northern District of Illinois;
Outgoing chairman, U.S.
Federal Sentencing
Commission

Stanley R. Soya
Partner, Pepper Hamilton LLP

Scott Killingsworth
Partner, Bryan Cave LLP

Michael Volkov
CEO and Owner, The Volkov
Law Group LLC

Larry Thompson
Former U.S. Deputy Attorney
General; Former Senior Vice
President and General
Counsel, PepsiCo

Karen Bertha
Chief Ethics & Compliance
Officer, MCR, LLC

David K. Colapinto
General Counsel, National
Whistleblower Center

Keith T. Darcy
Executive Director, Ethics &
Compliance Officer
Association

Paula Desio
Former Deputy General
Counsel, U.S. Sentencing
Commission

Patrick J. Gnazzo
Former SYP and General
Manager, U.S. Public Sector,
CA, Inc.; Principal, Better
Business Practices LLC

Mary R. (Nina) Henderson
Director, CNO Financial
Group; Director, Walter
Energy (NYSE)

John P. (Jack) Hansen
Vice President and Corporate
Ethics Officer at RBS Citizens
Financial Group

Ellen Hunt
Director, Ethics &
Compliance, Office of
General Counsel, AARP

Jack B. Jacobs
Justice, Supreme Court of
Delaware

Peter E. Jaffe
Chief Ethics and Compliance
Officer, AES Corporation

Ann McLaughlin Korologos
Former U.S. Secretary of
Labor

Joseph Murphy
Director of Public Policy,
Society for Corporate
Compliance and Ethics

John Steer
Former Vice Chair, U.S.
Sentencing Commission;
Former General Counsel, U.S.
Sentencing Commission

Appendix C: Invited Keynote Address by Judge Ruben Castillo

The Technology Challenge of the United States' Aggressive Compliance Environment

Amended Remarks, Originally Presented on May 2, 2013

Washington, D.C.

I would like to thank the RAND Center for Corporate Ethics and Governance for inviting me to speak on the important topic of culture and compliance in the corporate suite. My basic proposition is that contemporary technology presents a daunting challenge for today's corporate officers, given the government's aggressive compliance environment. Before addressing that topic, however, I must start by recounting my own background with corporate compliance issues and how I have likely contributed to the aggressive enforcement environment that exists today.

My earliest involvement with corporate compliance was in the mid-1980s when I was an Assistant United States Attorney in Chicago prosecuting white-collar crimes. In most of the white-collar cases I handled, the critical issues centered on the following three questions: (1) what did the corporate officer know, (2) when did he or she obtain that knowledge, and (3) what did the corporate officer do as a result of obtaining that knowledge? These questions, when evaluated properly and explained to a jury, always yielded a chronology that translated into innocence or guilt.

An important tool that prosecutors used in those days and that they continue to use today when prosecuting corporate crimes is what is commonly known in criminal circles as the "ostrich instruction." The purpose of the ostrich instruction is to instruct a jury that a defendant "may not escape criminal liability by pleading ignorance if he knows or strongly suspects he is involved in criminal dealings but deliberately avoids learning more exact information about the nature or extent of those dealings." See *United States v. Carrillo*, 435 F.3d 767, 780 (7th Cir. 2006) (citations and quotation marks omitted). In other words, a corporate officer cannot act like our animal friend the ostrich by sticking his head in the proverbial sand and thereby ignore or willfully blunt his own knowledge. In my experience as an Assistant United States Attorney in the mid-1980s, the combination of circumstantial knowledge and the ostrich instruction heightened the chances of a successful prosecution.

I gained different experience in corporate compliance issues in the early 1990s when I began practicing as a defense attorney at the law firm of Kirkland & Ellis LLP and developed the firm's white-collar practice. This timing was fortuitous because it

coincided with the enactment of the first version of the organizational Sentencing Guidelines in 1991. I immediately became aware that all of Kirkland's corporate clients were demanding formal corporate compliance programs, and I became actively involved in formulating those programs. My initial recommendation was that each program had to be customized to the unique risk assessments that each respective corporate client faced. For instance, in customizing each program, the firm had to take into account that an international technology client was not facing the same corporate risks as an oil company client.

In 1994, I was appointed to the federal bench and began to understand corporate compliance issues through the lens of a judicial officer. One of my earliest criminal cases involving a corporate defendant was *United States v. Archer Daniels Midland Co.*, No. 96 CR 640 (N.D. Ill.). In a two-count indictment, the United States alleged that Archer Daniels and others had engaged in an international price-fixing conspiracy. Archer Daniels pleaded guilty and agreed to pay a \$100 million fine, which was the largest antitrust fine ever imposed at the time. See Sentencing Order, *United States v. Archer Daniels Midland Co.*, No. 96 CR 640 (N.D. Ill. Oct. 15, 1996). I commented that if a \$100 million fine did not deter corporate criminal conduct, I did not know what would. Apparently I was wrong because since that time, many corporate fines have exceeded the \$100 million mark. In fact, just this year, the generic drug maker Ranbaxy agreed to pay a \$500 million fine to resolve false claims allegations. See Judgment at 3, *United States v. Ranbaxy USA, Inc.*, No. JFM-13-CR-0238 (D. Md. May 13, 2013).

In 1999, I was appointed as a Vice-Chair to the United States Sentencing Commission and started gaining an inside view of how the organizational Sentencing Guidelines, which had helped me grow a white-collar criminal practice at Kirkland, had come to be enacted. While I served on the Sentencing Commission, it quickly became clear to me that the individual sentences for corporate crimes were insufficient and thus needed to be increased. This was a view shared by the United States Congress, as evidenced by its decision to enact the Sarbanes-Oxley Act of 2002. Sarbanes-Oxley created heightened compliance standards for all publicly held companies. As a direct result of the Sentencing Commission's 2002 Economic Crime Amendment, as well as Sarbanes-Oxley, the average federal sentence corporate executives face has, in most cases, more than tripled since the mid-1980s.

During the early 2000s, the Sentencing Commission also decided to revamp the organizational Sentencing Guidelines once they reached their 10th anniversary. The Sentencing Commission appointed an elite blue-ribbon advisory group, and we decided to strive to make the organizational Sentencing Guidelines a tool that would help corporations reach a higher level of ethical culture rather than merely complying with federal criminal law.

I strongly believe that the correct lens through which corporate executives should view the organizational Sentencing Guidelines is that of trying to positively imprint an ethical corporate culture rather than simply attempting to avoid large criminal fines or the Department of Justice's prosecutorial efforts. It is from that perspective that I present these comments.

I begin with the simple proposition that today's criminal and civil enforcement efforts on the part of government agencies, including the Department of Justice, the Securities and Exchange Commission, and the Federal Trade Commission, will continue to grow in an aggressive direction. Today's financial news is filled with stories of companies of all sizes and varying corporate structures that have agreed to pay large fines to resolve the government's allegations of corporate misconduct. This is readily verifiable by a cursory review of any national newspaper's headlines, especially the business sections of the leading newspapers in the United States. In addition, one only needs to reflect briefly on the recent appointment of Mary Jo White, the former United States Attorney for the Southern District of New York from 1993 through 2002, to the Chairmanship of the Securities and Exchange Commission, to easily deduce that the enforcement conduct of government agencies will continue to be aggressive. For instance, under now-Chairman White's watch while she was the United States Attorney, John Rigas, the founder and former chief of Adelphia Communications Corporation, and his two sons were indicted and arrested in New York for bank fraud, wire fraud, and securities fraud. In an interview with the New York Times shortly after their arrest, now-Chairman White made it clear that the purpose of making a public spectacle of the arrest of a nonviolent executive was "to send a strong message that the government is serious and acting vigorously, to deter other corporate executives."¹⁷

This development of growing aggressive enforcement coincides with increased use of technology, both domestically and internationally. It seems that everyone in the contemporary corporate suite carries with them an iPad, iPhone, or BlackBerry, if not all three. What does that mean for compliance efforts in today's world? In my view, technology can be a sword for prosecutors and it can be a shield for compliance officers.

I have seen prosecutors use technology in the presentation of their evidence when they display various company e-mails in the courtroom. A few years ago, I presided over the criminal trial and conviction of the corporate compliance officer of AbTox, Inc., Robert M. Riley, and its Chief Executive Officer, Ross A. Caputo. *United States v. Caputo*, 456 F. Supp. 2d 970 (N.D. Ill. 2008). In *Caputo*, the government's evidence was primarily composed of various e-mails that were directed towards Caputo. *Id.* Caputo

¹⁷ See Jonathan D. Glater, Five Questions for Mary Jo White: Those Very Public Arrests of Executives, New York Times, July 28, 2002.

personally hired Riley to serve in the role of corporate compliance officer precisely because he totally lacked any valid compliance credentials. Riley had received an MBA, specializing in marketing, and had no compliance experience whatsoever. Due to this fact, Caputo knew that he could easily manipulate his good friend, Riley. The incriminating e-mails described blatantly illegal activity, yet they were met with little or no response from Riley. Considering his lack of credentials, this was not surprising. The easy conviction obtained by the government was followed by my imposition of a ten-year sentence of incarceration on Caputo and a six-year sentence of incarceration on Riley. The only reason I imposed a shorter sentence on Riley was because I truly believed that he had been manipulated and exploited by Caputo. Of course, this is a compliance nightmare story, but I mention it because the use of technology was vital to the presentation of the government's case and its eventual success.

Also illustrative of the trend towards increased fines and penalties for violations of federal corporate law is the Second Circuit's decision in *United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006), in which the Second Circuit affirmed a 25-year sentence for a massive securities fraud conducted by a corporate chief executive officer, holding that the sentence imposed was reasonable. Likewise, the Seventh Circuit affirmed a sentence of 118 months as reasonable, even though it may have been above the advisory Sentencing Guidelines range, due to the overall severity of a fraud offense that involved over \$100 million and an elaborate corruption scheme. See *United States v. Leahy, et al.*, 464 F.3d 773 (7th Cir. 2006). I could list myriad other cases that equally demonstrate this trend towards enhanced sentences for white-collar defendants.

In *Caputo*, I stressed that corporate compliance officers are very much today's corporate "fire personnel." 456 F. Supp. 2d at 984. They are often a company's "first responders," and must focus both on proactive and reactive efforts to be effective. As I stated in *Caputo*: "Proactive efforts need to emphasize the complimentary goals of crime prevention and corporate ethical behavior. Reactive efforts measure how well a corporation reacts when it learns that questionable and potentially illegal corporate conduct has occurred." *Id.*

The tension between today's world and the advice that I gave only seven years ago is that today's technology poses graver dangers because of the great volume of e-mail traffic that flows into the busy corporate suite. If I were a corporate executive, I would be constantly worried that even a well-intentioned and well-resourced compliance program that is truly seeking to adhere to the objectives of the revised organizational Sentencing Guidelines can be torpedoed by contemporary technology. Unless an organization's compliance officers are equipped to triage incoming e-mail traffic, there is a real danger that their compliance efforts can easily fail at any corporate institution. Since much of this e-mail traffic ends up in the corporate suite, there is a legitimate danger that corporate officers might be convicted or fined for a federal offense because of their

failure to take appropriate action in light of information that, perhaps unbeknownst to them, is electronically flowing into the corporate suite. My advice is that a robust effort needs to be undertaken by all corporate institutions to have all electronic mail read by somebody with compliance competence in order to evaluate what is important and what is not important. That is the technology compliance challenge of the modern corporate world.

A proper, proactive compliance effort in the corporate suite should ensure that technology is used as a strong shield against potential compliance problems. First, proper risk assessment is dependent on information from the outer perimeters of a company's activities. For instance, for a company that operates internationally, this may mean ensuring that proper information is forthcoming on a daily basis from the most exterior branches of the company. Technology can surely assist with the quick and timely transmission and evaluation of information from far-flung corners of the world to a United States-based company's headquarters, so as to more easily facilitate compliance efforts. In addition, technology can be used to effectively train an international work force on compliance issues. Periodic risk assessment and compliance training through the use of technology are critical in the modern world.

During our interactive discussions at the RAND symposium, one of the conclusions we seemed to reach was that there exists a real compliance gap in the corporate suite. I suggest that corporate boards need to exert a greater effort to educate high-level corporate officers about contemporary compliance challenges. In my view, the potential use of board members to educate corporate officers will directly increase the success of educational compliance efforts.

One document that can readily be used to educate corporate officers is the Resource Guide that was recently published by the Criminal Division of the United States Department of Justice and the Enforcement Division of the United States Securities and Exchange Commission.¹⁸ While the Resource Guide was specifically geared toward compliance with the United States Foreign Corrupt Practices Act, it has broader implications that may be of use to every company's compliance efforts. In fact, Chapter 5 of the Resource Guide, which is entitled "Guiding Principles of Enforcement," should be used to create effective PowerPoint presentations to relevant corporate officers in an attempt to bridge the compliance gap that currently exists. The guiding principles of the Resource Guide themselves indicate that compliance must start at the top, meaning that the board of directors and senior executives must set the proper ethical tone. As the

¹⁸ See The Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission, *A Resource Guide to the U.S. Foreign Corrupt Practice Act*, (Nov. 14, 2012).

Resource Guide makes clear, “DOJ and SEC thus evaluate whether senior management has clearly articulated company standards, communicated them in unambiguous terms, adhered to them scrupulously, and disseminated them throughout the organization.” *Id.* at 57.

These types of periodic educational efforts by corporate board members, using the very principles recently laid out by the Department of Justice and the Securities and Exchange Commission, will help companies confront the difficult challenges to corporate compliance created by contemporary technology that continues to evolve. Corporations should be proactive in how they use technology and ensure that new technological advances serve as a strong ally in support of their efforts towards corporate compliance.

Appendix D: Invited Papers from Symposium Participants

Prosecution of Frauds and Crimes in the C Suite: What Can We Learn from These Cases and Trends?

Stanley R. Soya, Partner
Pepper Hamilton LLP

The press, members of Congress, and judges have become increasingly vocal in condemning what they perceive to be inadequate criminal prosecution of executives responsible for corporate crimes. In response, U.S. Department of Justice (DOJ) officials have consistently stated that prosecuting such individuals is a high priority. The opposing views highlight the tension between public pressure to hold high-profile executives responsible, and DOJ's need to have evidence to support a conviction (based on proof beyond a reasonable doubt) before proceeding with a criminal prosecution.

In particular, the DOJ's increased use of Deferred Prosecution Agreements (DPAs), Non Prosecution Agreements (NPAs), and civil settlements to obtain record fines and penalties from corporate defendants has been highly controversial. Criticism and calls for more vigorous prosecution of executives have come from the press, members of Congress, and judges. The New York Times, Op Ed columnist, Joe Nocera wrote,

corporate executives need to be prosecuted when corporate crimes take place. It sends a signal to every other executive about what is — and is not — acceptable behavior. The threat of prison can change a culture faster and more effectively than even the heftiest fine.

“Prison is what makes the difference. Otherwise, it’s only money.”¹⁹

In a similar vein, Senator Arlen Specter criticized the initial absence in 2010 of any individual prosecutions in the Siemens FCPA case, and demanded an explanation for why DOJ avoided charging individuals in the biggest FCPA case in history. Subsequently eight individuals were indicted; however none of the eight have been apprehended or prosecuted.²⁰

In another high-profile case involving HSBC, Senator Charles Grassley recently called the DOJ decision to forego individual criminal prosecutions inexcusable. He stated:

¹⁹ The New York Times, April 13, 2012

²⁰ These individuals are all outside of United States jurisdiction.

Even more concerning is the fact that the individuals responsible for these failures are not being held accountable. The Department has not prosecuted a single employee of HSBC—no executives, no directors, no AML compliance staff members, no one. By allowing these individuals to walk away without any real punishment, the Department is declaring that crime actually does pay. Functionally, HSBC has quite literally purchased a get-out-of-jail-free card for its employees for the price of \$1.92 billion dollars.²¹

Meanwhile in the judiciary, U.S. District Court Judge, Jed Rakoff, recently commented on his decision to deny the initial proposed Consent Judgment between the SEC and Bank of America (BAC). Judge Rakoff noted that among its flaws was “the fact that no individual was named for what the SEC asserted was a blatant fraud orchestrated from the very top.”²²

Despite the public pressure, the DOJ necessarily remains constrained by the need to ensure that a prosecution is warranted by sufficient evidence, and is not merely undertaken as publicity grab. Federal prosecutors have an obligation to ensure that in exercising their discretion to prosecute or not, the decision “should promote the reasoned exercise of prosecutorial authority and contribute to the fair, evenhanded administration of the Federal criminal laws.”²³ The Principles of Federal Prosecution state that prosecutors

should commence or recommend Federal prosecution if he/she believes that the person’s conduct constitutes a Federal offense and that the admissible evidence will probably be sufficient to obtain and sustain a conviction, unless, in his/her judgment, prosecution should be declined because: No substantial Federal interest would be served by prosecution; The person is subject to effective prosecution in another jurisdiction; or There exists an adequate non-criminal alternative to prosecution.²⁴

The fact that a company has entered into a DPA or NPA does not mean, without more, that the DOJ will not prosecute responsible individuals. In fact, the standard DPA provisions require the company to cooperate with any investigation or prosecution of responsible individuals, including corporate executives. The standard DPA does not contain any agreement by the DOJ not to prosecute responsible individuals.

²¹ Charles Grassley, Grassley: Justice Department’s Failure to Prosecute Criminal Behavior in HSBC Scandal is Inexcusable (December 13, 2012), http://www.grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=43551

²² Judge Jed Rakoff, CNN Money Interview, Jan 24, 2013, Prosecutions and the Financial Crisis, referring to Memorandum and Order, 09 Civ. 6829 (JSR), Sept. 14, 2009

²³ Principles of Federal Prosecution, U.S. DOJ, United States Attorneys Manual (USAM) 9-27.001

²⁴ USAM 9-27.001

The continued drumbeat of public criticism, together with the DOJ's assurance that it will aggressively prosecute individuals when warranted by the evidence, portend more aggressive action to prosecute executives in the future. Recent prosecutions of C Suite executives suggest that the DOJ's public assurances are being backed up by action.

This paper offers an overview of cases and trends in the prosecution of fraud in the C Suite and in the post Enron era, and extracts from those proceedings what preventive measures corporations and executives can learn from these government enforcement actions. While increased prosecution of responsible individuals sends a strong deterrent message, prosecution by itself is not sufficient to prevent and detect fraud in the C Suite. The complex cases that are the basis for most DPAs and NPAs demonstrate a gap between those cases where C-Suite executives actually committed and are prosecuted for fraud, and many other cases where executives may have condoned fraud or failed to inquire when presented with allegations or red flags of fraud, but in which the DOJ determined the evidence insufficient to successfully prosecute the executives.

The DOJ is attempting to address this gap proactively, by shifting the compliance posture of major companies, and thereby making it more difficult for senior executives to turn a blind eye to instances of fraud. The DOJ is pursuing this course through its DPA provisions, which typically require: (1) increased independence of the Chief Ethics and Compliance Officer (CECO); (2) tying executive bonuses to meeting compliance standards; and (3), implementation of "claw back" provisions related to deferred compensation bonuses of senior executives. As this trend in DPAs continues, corporate boards need to consider whether to implement such measures independently, even in companies not immediately at risk for prosecution. By doing so, boards can seek to improve the effectiveness of their C&E programs, and to minimize the risk of senior executive misconduct and DOJ prosecution in the future.

More on the DOJ "Prosecution Gap": the Growing Importance of DPAs and NPAs

There is no single source for detailed data on DOJ's corporate fraud prosecutions. While the Bureau of Justice Statistics (BJS)²⁵ does collect prosecution and conviction data and publish periodic reports, the focus of BJS is on the large categories of federal crime such as illicit immigration, drugs, weapons and violent crime. The BJS summary reports do not contain any descriptions of DOJ activities and results related to corporate executive fraud.²⁶

²⁵ The Bureau of Justice Statistics is the statistical agency of the U.S. Department of Justice.

²⁶ See, Federal Justice Statistics 2009, BJS, December 2011, NCJ 234184
<http://bjs.gov/content/pub/pdf/fjs09.pdf>

Meanwhile, some of the public criticism of DOJ has found support in a Government Accountability Office (GAO) audit that found:

- DOJ made more frequent use of DPAs and NPAs in recent years;
- DPAs increased from 4 in FY 2003 to 38 in FY 2007 and declined slightly to 24 in FY 2008 and 23 in FY 2009.
- From FY 2004 to FY 2009, for U.S. Attorney's Offices, the number of DPAs and NPAs was less than the number of corporate prosecutions, whereas for the Criminal Division, the number of DPAs and NPAs was comparable to the number of corporate prosecutions.²⁷

Additional data on the use of DPAs and NPAs has been collected by the law firm of Gibson, Dunn and Crutcher, LLP, and shows that the number of DPAs and NPAs rebounded to 39 in 2010, 29 in 2011, and 35 in 2012.²⁸ In addition, the data reflects a staggering increase in the total monetary recovery from DPAs, ranging from a paltry \$300,000 in 2003 to a record \$9 billion in 2012.

DOJ'S Response to Criticism of Its Prosecutorial Vigor

In responding to the criticisms, Assistant Attorney General Lanny Breuer recently explained that

until roughly 20 years ago, prosecutors in the United States, when they encountered corporate misconduct, were usually faced with a stark choice—either to indict, or walk away.,, The increased use of DPAs has meant far greater accountability for corporate wrongdoing. Whereas prosecutors often declined when their only choice was to indict or walk away, now companies know that avoiding the disaster scenario of an indictment does not mean an escape from accountability.²⁹

To address the claims that DPAs undermine individual punishment, Breuer has emphasized that “individual wrong doers can never secure immunity through corporate resolution.”³⁰ He has pointed to the fact that it is a long standing policy of the DOJ, as

²⁷ *Id.*

²⁸ Gibson Dunn, 2012 Year-End Update on Corporation Deferred Prosecution Agreements (DPAS) and Non-Prosecution Agreements (NPAS), (January 3, 2013), <http://www.gibsondunn.com/publications/pages/2012YearEndUpdate-CorporateDeferredProsecution-NonProsecutionAgreements.aspx>

²⁹ Assistant Attorney General Lanny A. Breuer Speaks at IBC Legal's World Bribery & Corruption Compliance Forum, Oct. 23, 2012, <http://www.justice.gov/criminal/pr/speeches/2012/crm-speech-121023.html>

³⁰ Assistant Attorney General Lanny A. Breuer, Speaks at the New York City Bar Association, September 13, 2012. <http://www.justice.gov/criminal/pr/speeches/2012/crm-speech-1209131.html>

stated in the Principles of Federal Prosecution,³¹ to prosecute individuals when warranted by the evidence. In fact, Breuer himself has repeatedly asserted that the strongest deterrent against corporate wrongdoing is the prospect of prison time.³² The DOJ policy on this point is also spotlighted in the Principles of Federal Prosecution of Business Organizations, which state that

[b]ecause a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Only rarely should provable individual culpability not be pursued, particularly if it relates to high-level corporate officers, even in the face of an offer of a corporate guilty plea or some other disposition of the charges against the corporation.³³

In his speeches, Breuer has repeatedly referred to specific examples to demonstrate that a DPA or NPA does not mean an escape from personal criminal liability, and that the DOJ will prosecute responsible corporate executives in appropriate instances. The examples have included the prosecution of criminal trade secret theft charges against Kolon Industries, a South Korean corporation, and five Kolon executives and employees;³⁴ the fraud conviction and 30-year prison sentence of Lee Bentley Farkas, the former Chairman of Taylor Bean & Whitaker, one of the largest private mortgage lending companies in the country;³⁵ and the conviction and 110-year prison sentence of R. Allen Stanford, who misappropriated \$7 billion from Stanford International Bank.³⁶

Recent Cases

A close review of recent case developments sheds more light on the complexities of DOJ criminal prosecution decisions, and the pursuit of DPAs/NPAs, in cases involving corporate fraud.

³¹ Principles of Federal Prosecution, United States Attorneys Manual (USAM), Chapter 9-27.000 http://www.justice.gov/usao/eousa/foia_reading_room/usam/title9/27mcrm.htm

³² Footnotes 9 and 10

³³ Principles of Federal Prosecution of Business Organizations, USAM Title 9, Chapter 9-28.200(B), <http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf>. These principles were first issued in the 1999 Holder memorandum which can be found at: http://federalevidence.com/pdf/Corp_Prosec/Holder_Memo_6_16_99.pdf

³⁴ See footnote 9, “Top Executives at Kolon Industries Indicted for Stealing DuPont’s Kevlar Trade Secrets,” DOJ Press Release October 18, 2012, <http://www.justice.gov/opa/pr/2012/October/12-crm-1257.html>

³⁵ AAG Breuer, Speech Oct. 23, 2012, see also Former Chairman of Taylor, Bean & Whitaker Convicted for \$2.9 Billion Fraud Scheme That Contributed to the Failure of Colonial Bank, DOJ Press Release, April 19, 2011, <http://www.justice.gov/opa/pr/2011/April/11-crm-490.html>

³⁶ Footnote 9 and “Allen Stanford Convicted in Houston for Orchestrating \$7 Billion Investment Fraud Scheme” DOJ Press Release, Tuesday, March 6, 2012, <http://www.justice.gov/opa/pr/2012/March/12-crm-293.html>

For example, in June 2012, the DOJ used an NPA to resolve allegations of criminal wrongdoing against Barclays Bank over the bank's role in the manipulation of the London Interbank Offered Rate, or LIBOR. In addition to a \$160 million fine, Barclays paid a significant price for its conduct. In the wake of the DOJ announcement, the top management of the bank was replaced. However, the DOJ also recognized that Barclays' cooperation with its investigation was extraordinary, which is why an NPA was appropriate.

Meanwhile, the July 2009 FCPA jury trial conviction of Fredric Bourke, founder of handbag maker Dooney & Bourke, provides a powerful reminder that executives can face personal criminal liability, even when their misconduct is limited to turning a blind eye to instances of fraud or bribery. As Pepper Hamilton law partner Gregory Paw notably pointed out,³⁷ the jury concluded it was Bourke's job to know about and prevent the bribes to foreign officials. In finding Bourke guilty, jurors emphasized the importance of the court's "head in the sand" instructions. The foreperson summarized the rationale of his verdict, stating "[i]t was Kozeny, it was Azerbaijan, it was a foreign country. We thought [Bourke] knew and definitely could have known. He's an investor. It's his job to know." Another juror, recalling a timeline used by prosecutors during closing argument, said there were too many "red flags" for Bourke not to have known. Another felt bad for Bourke, but emphasized that he had put himself in a "bad situation."³⁸

"Responsible Corporate Officer" Doctrine Prosecutions

For companies involved in the food and drug industries, the FDA and DOJ have renewed their use of the "responsible corporate officer doctrine" (RCO) to hold executives personally and criminally responsible for violations of the Food Drug and Cosmetic Act (FDCA). Under this doctrine as enunciated in *U.S. v. Dotterweich*, and *U.S. v. Park*,³⁹ a corporate officer, in an industry with a direct relationship to the public health and welfare, who has, by reason of his position in the corporation, responsibility and authority to either prevent in the first instance, or promptly to correct, the FDCA violation complained of, and fails to do so, can be convicted of a criminal offense.⁴⁰ The only defense to such a prosecution is that the "defendant was 'powerless' to prevent or correct the violation."

³⁷ "Guilty Verdict Highlights the Vital Importance of Due Diligence in International Transactions" White Collar and Corporate Investigations Newsletter, Pepper Hamilton LLP, July 14, 2009, http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1546

³⁸ *Id.*

³⁹ *U.S. v. Dotterweich*, 320 U.S. 277 (1943) and *U.S. v. Park*, 421 U.S. 658 (1975)

⁴⁰ *U.S. v. Park*, at 673

While there has been no major ground swell in RCO prosecutions, several recent RCO cases demonstrate that the FDA and DOJ are willing to prosecute corporate executives who are passively involved in violations of the FDCA. For example, Marc Hermelin, former Chairman of the Board and CEO of KV Pharmaceutical Company, pleaded guilty to RCO charges and was sentenced to 30 days in jail and ordered to pay a \$1 million fine, in connection with the guilty plea of Ethex corporation, a wholly owned subsidiary of KV Pharmaceutical. The admitted facts in the Hermelin case demonstrated that the company became aware of two complaints about oversized morphine sulfate tablets, and that the company disclosed these complaints to the FDA and publically recalled various lots of those tablets. However, the company knew but failed to disclose to the FDA that the oversized tablets were made on “BB2” pill press machines, which could randomly produce some oversized tablets and which were also used to make many other tablet drugs.

In another recent case, Purdue Frederick Company executives were prosecuted, pled guilty and were debarred by the Department of Health and Human Services (HHS), under the RCO doctrine. In that case, Purdue was accused of fraudulent misbranding of the painkiller OxyContin. The prosecution alleged that unnamed employees of the company marketed OxyContin as less addictive and less harmful than other painkillers. The company pleaded guilty to felony misbranding under the FDCA, and paid monetary sanctions of about \$600 million. Three Purdue executives—CEO, General Counsel, and medical director—were accused of the misdemeanor of misbranding of a drug and pleaded guilty, for admitted failure to prevent Purdue’s fraudulent marketing of OxyContin. The executives were sentenced to extensive community service, fined \$5,000, and ordered to disgorge compensation totaling about \$34.5 million. In addition, each was debarred by HHS for 12 years. The debarments were upheld by the U.S. Court of Appeals for the District of Columbia Circuit on July 27, 2012.⁴¹

KBR FCPA Case

The FCPA convictions of Kellogg Brown and Root LLC (KBR) and Albert “Jack” Stanley, KBR’s former Chairman and CEO, provide one of the leading examples of the harm that can be caused to a company when a C Suite executive engages in criminal conduct. The case involved Stanley’s and KBR Inc.’s participation in a decade-long scheme (1994–2004) to bribe Nigerian government officials, and to obtain \$6 billion in engineering, procurement and construction (EPC) contracts to build liquefied natural gas

⁴¹ *Friedman*, D.C. Cir. (July 27, 2012), (Case No. 1:09-cv-02028) [http://www.cadc.uscourts.gov/internet/opinions.nsf/459F3439969F140285257A48004F075C/\\$file/11-5028-1386058.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/459F3439969F140285257A48004F075C/$file/11-5028-1386058.pdf)

(LNG) facilities on Bonny Island, Nigeria.⁴² The scheme involved a conspiracy to pay bribes to a wide range of Nigerian government officials, in order to obtain and retain the EPC contracts. To pay the bribes, the conspirators hired two agents—Tesler and Marubeni Corporation, a Japanese trading company headquartered in Tokyo. At crucial points before the award of the EPC contracts, Stanley and other co-conspirators met with successive holders of a top-level office in the executive branch of the Nigerian government, and asked them to designate a representative with whom the bribes could be negotiated. Many millions of dollars were invested into the Nigerian bribery scheme by the conspirators.

KBR Inc.'s successor company, Kellogg Brown & Root LLC, pleaded guilty in February 2009 to FCPA-related charges for bribery, and was ordered to pay a \$402 million fine and to retain an independent compliance monitor for a three-year period to review the design and implementation of its compliance program. KBR's parent company, KBR, Inc. and its former parent company Halliburton Company, both reached civil settlements with the SEC which enjoined both companies from future violations of the FCPA and required Halliburton to disgorge \$177 million in profits and prejudgment interest based on the Bonny Island LNG contracts. Stanley was sentenced to 30 months in prison plus 3 years supervised probation, and ordered to pay \$10.8 million in restitution to KBR, the victim of the separate kickback scheme.

The KBR settlements were the result of five years of internal and governmental investigation and negotiation. The large penalty amounts were the result of both improper payments and the degree to which the corrupt scheme permeated the company's senior management.⁴³

In May 2009, two large institutional investors brought derivative claims against Halliburton and certain of its officers and directors in Texas state court alleging that the company's leadership was at fault for the Bonny Island-related FCPA misconduct, as well as other unrelated and other assorted wrongdoing. This shareholder litigation was settled and finally approved by the court on September 17, 2012.

The settlement required Halliburton to make structural changes to its corporate governance model. It did not require Halliburton to pay any damages aside from attorneys' fees (up to \$7 million). Among other things, the agreement required Halliburton to:

⁴² "Kellogg Brown & Root LLC Pleads Guilty to Foreign Bribery Charges and Agrees to Pay \$402 Million Criminal Fine," DOJ Press Release, Feb. 11, 2009, <http://www.justice.gov/opa/pr/2009/February/09-crm-112.html>

⁴³ "Recent FCPA Enforcement Action" Paul Hastings Stay Current, March 2009, https://www.paulhastings.com/assets/publications/1247.pdf?wt.mc_ID=1247.pdf

- adopt a claw back provision that allows the company to reclaim incentive compensation provided to former officers and directors found by a court or the company itself to have engaged in illegal behavior;
- enhance oversight by the Audit Committee in conjunction with the CEO with respect to compliance functions and risk management;
- establish a Management Compliance Committee to evaluate compliance with the FCPA and other significant state and federal laws; and
- perform annual performance reviews for board members and annual consideration of whether CEO and chairman of the board should be the same person.

HSBC DPA

In December 2012, HSBC⁴⁴ agreed to forfeit \$1.256 billion and to enter into a DPA⁴⁵ with the DOJ for HSBC’s violations of the Bank Secrecy Act (BSA), the International Emergency Economic Powers Act (IEEPA) and the Trading With the Enemy Act (TWEA). Pursuant to the DPA, HSBC admitted that HSBC Bank USA violated the BSA by failing to maintain an effective anti-money laundering program and to conduct appropriate due diligence on its foreign correspondent account holders. The HSBC Group violated IEEPA and TWEA by illegally conducting transactions on behalf of customers in Cuba, Iran, Libya, Sudan and Burma—all countries that were subject to sanctions at the time of the transactions. Assistant Attorney General Breuer commented that “HSBC is being held accountable for stunning failures of oversight—and worse—that led the bank to permit narcotics traffickers and others to launder hundreds of millions of dollars through HSBC subsidiaries, and to facilitate hundreds of millions more in transactions with sanctioned countries.”⁴⁶ The DPA has a 5-year term and contains the standard DOJ provision which states that it only applies to HSBC and does not preclude prosecution of any current or former officers, directors or employees of HSBC. Pursuant to the DPA, HSBC was required, among other things, to take the following actions to address the deficiencies in its C&E program:

- To increase its investment in resources and staff allocated to anti money laundering (AML) compliance by approximately nine-fold, even before the entry of the DPA

⁴⁴ Note that as described here, “HSBC” actually consists of HSBC Holdings plc. (HSBC Group), a United Kingdom corporation; and HSBC Bank USA N.A. (HSBC Bank USA), a federally chartered banking corporation headquartered in McLean, Va..

⁴⁵ HSBC DPA, Dec. 11, 2012, available at http://pdfserver.amlaw.com/cc/HSBC_DPA_Final%5BExecuted%5D.pdf

⁴⁶ “HSBC Holdings plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement,” DOJ Press Release Dec. 11, 2012, <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>

- To strengthen the compliance department’s reporting lines and status within the Bank by:
 - (i) separating the Legal and Compliance departments and elevating the Chief Compliance Officer (CCO) to the ranks of the top 50 executives,
 - (ii) requiring that the AML compliance director report directly to the CCO, and
 - (iii) providing that the AML compliance director report directly to the Board and senior management about the status of the Bank’s BSA and AML compliance program on a regular basis.
- To give the HSBC Group centralized oversight of every HSBC compliance officer worldwide, thereby ensuring that both accountability and information would flow directly to and from HSBC Group Compliance.
- To change HSBC’s senior management bonus structure to require executives to meet compliance standards and values, and to provide that a failure to meet the requirements could result in voiding the entire year-end bonus.

Observations and Recommendations

Careful examination of recent prosecutions, DPAs and NPAs can help companies keep abreast of risk areas and of DOJ’s view of sound compliance practices, while helping the companies to benchmark their own compliance programs. In turn, this practice encourages firms to evaluate and adopt emerging good practices, and improves their position with prosecutors and regulators if they do find themselves facing subsequent allegations of improper conduct.

In reviewing the DPAs and prosecutions of C Suite executives discussed in this paper, it is apparent that:

- DPAs do not provide corporate executives amnesty from prosecution;
- Prosecutions of responsible executives take time to investigate and develop and may occur years after a DPA;
- Companies that enter into a DPA are required to cooperate with the DOJ in prosecutions of responsible corporate executives;
- Senior executives can face criminal risk when passively allowing fraud to occur, in at least some instances;
- DOJ expects the head of the C&E program to have direct access to the Board of Directors and that the C&E program will be separate from the Legal Department;
- DOJ expects company executive compensation policies and practices to require executives to meet compliance standards and values and provide that a failure to meet the requirements can result in voiding the entire yearend bonus; and
- A C&E program cannot be effective unless it:
 - provides a check and balance on C Suite executives and not just employees of the company; and

- ensures that C Suite executives know and understand the legal requirements that apply to their conduct and are provided as much or more training as other employees on the high risk areas of their responsibility.

While prosecutions of responsible executives are widely recognized as providing a strong deterrent to fraud by corporate executives, companies themselves need to do more to deter and detect such misconduct. Where senior executives of a company are involved in committing, condoning or failing to investigate allegations of fraud, the C&E program of the company will not be considered to be effective. At a minimum, companies need to consider additional methods to mitigate the risks of such conduct. In this regard, the requirements reflected in recent DPAs for the chief of the C&E program to have direct access to the board, and not to be subordinate to the legal department, provide additional checks on potential executive misconduct. More, the requirement to tie executive bonus compensation to C&E standards provides a direct incentive for proper conduct, and serves as an additional deterrent for misconduct. Implementing these requirements voluntarily deserves serious consideration by any company seeking to enhance its C&E program, and to manage the risk associated with the potential for fraud in the C suite.

“C” Is for Crucible: Behavioral Ethics, Culture, and the Board’s Role in C-Suite Compliance

Scott Killingsworth, Partner
Bryan Cave LLP

Introduction

The C-suite is a unique environment peopled with extraordinary individuals and endowed with the potential to achieve enormous good—or, as recent history has vividly shown, to inflict devastating harm. Given that senior executives operate largely beyond the reach of traditional compliance program controls, a board that aspires to true stewardship must embrace a special responsibility to support and monitor ethics and compliance in the C-suite.

Operating unchecked, the forces at large in the C-suite would challenge the ability of even the most conscientious and rational executives to make consistently irreproachable decisions. The problem of C-suite ethics has a deeper dimension, though, than the mere impact of strong pressures upon rational decision-makers. Recent behavioral research brings the unwelcome news that the subversive effects of these pressures are amplified by systematic, predictable human failings that can prompt us to slip our moral moorings and overlook when others do so. But we also know that organizational culture can dramatically affect both ethical conduct and reporting of misconduct, by establishing workplace norms, harnessing social identity and group loyalty and increasing the salience of ethical values.⁴⁷ How can these learnings inform the board’s interaction with, and monitoring of, the C-suite? And how can the board help forge a stronger connection between the C-Suite and the organization’s compliance and ethics program?

The Crucible

Several powerful forces converge in the C-suite to test the mettle of executives and the board that supervises them. First, to quote Willie Sutton,⁴⁸ “that’s where the money is”: the stakes are very high both for the organization and, crucially, for the individuals as

⁴⁷ For a review of the effects of cultural factors on workplace compliance and on speaking up about misconduct, see Scott Killingsworth, *Modeling the Message: Communicating Compliance through Organizational Values and Culture*, GEORGETOWN JOURNAL OF LEGAL ETHICS, Vol. XV, No. 4 (Fall 2012), 961, available at <http://ssrn.com/abstract=2161076>.

⁴⁸ Actually, Sutton disavowed his famous quip, attributing it to an enterprising reporter in search of colorful copy. In our context, a genuine quotation from Sutton may be both relevant and cautionary: “Why did I rob banks? Because I enjoyed it. I loved it. I was more alive when I was inside a bank robbing it, than at any other time in my life.” See <http://www.snopes.com/quotes/sutton.asp>.

well—as to pay, status, career prospects, and employment itself. The high stakes for the organization may tempt even faithful executives to cut corners for the benefit of the company and its stakeholders. Separately, at the personal level, the prospect of gaining, or the risk of losing, large performance-based incentives can mean outsized temptations to do what it takes to obtain the desired results.

Another marker of the C-suite and its occupants is power: control over business strategy, tactics, and execution, and over employees and their careers. One facet of power is the ability to operate with great freedom and little supervision: subject to very few effective “hard” controls,⁴⁹ senior executives wield operational command over many compliance-sensitive activities, if not over the compliance function itself. Power also facilitates suppression of dissent, further eroding controls.⁵⁰ With power also comes enormous pressure to perform, particularly in public companies where performance is measured hourly by stock price.⁵¹ Senior executives are accountable to the board, to shareholders and creditors, to the news media and to the public, any one of which can topple them under the right circumstances.

Things happen fast in this crucible, with urgency driven not only by business necessity but also by the inexorable demands of the quarterly reporting cycle. Quick decisions about complex problems are required, often involving forced choices between competing values. (What if skirting a costly environmental requirement will save hundreds of jobs?)⁵²

The final unique feature of the C-suite is its occupants. People arrive there through a process of natural selection which only the most able, motivated and determined survive. We can expect high intelligence, strong ambition, domain mastery, and advanced skills in leadership and persuasion. We can also expect, most of the time, a hard-earned reputation for integrity. But the winnowing process also selects, in some cases, for a much stronger-than-usual attraction to perquisites found in unique abundance in the C-suite: money, power, autonomy, recognition, attention, and status, an attraction that may be strong

⁴⁹ Of course there are significant accounting and systems controls but many of these are vulnerable to collusion at the C-suite level.

⁵⁰ Few compliance officers are unaware of the cautionary tale of Paul Moore, fired by the CEO of HBOS shortly after having warned the board’s audit committee about the bank’s unbalanced sales culture.

⁵¹ According to the Ethics Resource Center’s 2012 National Business Ethics Survey of Fortune 500 companies, public-company employees are significantly more likely to feel pressure to compromise standards than those in privately-held companies—and public-company employees who followed the stock price daily were more than twice as likely to feel pressure as private company employees.

⁵² We might pause to consider the relevance of Nobel Laureate Daniel Kahneman’s observation that “people who are simultaneously challenged by a demanding cognitive task and a temptation are more likely to yield to the temptation.” Daniel Kahneman, *THINKING, FAST AND SLOW*, Farrar, Straus and Giroux 2011, p. 41.

enough to overpower allegiance to ethical or legal rules. And the C-suite has no magical ability to exclude the most dangerous personality types—psychopaths, extreme narcissists, and others who lack conscience but often possess charisma, intelligence, motivation, and advanced manipulative skills.

There is no reason to believe that senior executives, individually or as a group, are innately less ethical than the general population. But experience and headlines tell us that reaching the top is no guarantee of moral invulnerability, and that is all a board needs to know. Where high stakes, strong temptations, vast power, extreme pressure, a fast pace, complex problems and ambitious people come together with few external restraints, could anything major go wrong? A high-impact risk⁵³ exists and must be addressed.

How the Crucible Amplifies Ethical Infirmities: Behavioral Ethics

The worst executives can intentionally cause great damage in pursuit of their self-centered agendas, but even the best are subject to predictable human infirmities. This should particularly worry us in the superheated environment of the C-suite. Over the past two decades, researchers in “behavioral ethics” have shown that an individual’s morality is much more malleable under situational and social forces than formerly supposed, and that most of the unethical behavior in organizations is committed by individuals who value morality and consider themselves ethical, yet regularly fail to resist temptation, or even to recognize that their decisions have a moral dimension.⁵⁴ As we have seen, the C-suite is rife with potent situational and social forces; a few examples of their operation below the plane of conscious thought will be useful.

Conflicts of Interest

One of the core teachings of behavioral ethics research is that it is not just difficult, but impossible, to be truly objective about a decision when you have a significant interest in the outcome.⁵⁵ Good-faith judgments about what is good for the company (or shareholders, or employees) may be infected by an unconscious self-serving bias, and

⁵³ We should recall that most senior executives never get into serious trouble and probably never deserve to. In risk management terms, the statistical likelihood of serious executive misconduct in a given company is quite small, though it is hardly an unforeseeable “black swan;” the potential impact, however, is huge.

⁵⁴ Max H. Bazerman and Francesca Gino, *Behavioral Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty*, ANNUAL REVIEW OF LAW AND SOCIAL SCIENCE, Vol. 8, pp. 85–104, 2012.

⁵⁵ For an early study, see L. Babcock, X. Wang, & G. Loewenstein, *Choosing The Wrong Pond: Social Comparisons That Reflect A Self-Serving Bias*, QUARTERLY JOURNAL OF ECONOMICS 111(1996) pp. 1–19. For a seemingly inexhaustible supply of contemporary examples, and related behavioral science research, see Jeffrey Kaplan’s Conflict of Interest Blog, <http://conflictofinterestblog.com>.

justified by post-hoc rationalization,⁵⁶ if the executive's personal interests weigh heavier on one side of the scales than on the other.⁵⁷ In a C-suite where large incentive compensation for most or all of the executives may hinge sensitively on short-term corporate earnings reports, there is clear potential for these conflicts of interest to influence decisions involving ethics, legal compliance and risk.⁵⁸ This potential has been confirmed in studies that show a significant correlation between unusually large incentive compensation for CEOs and the risk of credit default, large ratings downgrades, accounting restatements, and fraud.⁵⁹

Motivated Blindness and Framing

Rationalization of misconduct is especially tempting where the ethical or legal issues are unclear, uncertain, deferred, or simply not in the frame of reference—and the frame of reference has a way of shrinking. We are subject to “motivated blindness,” a tendency to acquire tunnel vision if it will help us ignore inconvenient facts. This may occur if we inadvertently frame a multidimensional decision as “purely business,”⁶⁰ a hazard that behavioral ethics pioneer Max Bazerman illustrates with the Ford Pinto episode, where Ford used a “formal cost-benefit analysis—putting dollar amounts on . . . lives—and

⁵⁶ Where the financial interests of the company and of the executive are aligned, and cheating will produce a good result or avoid a bad one, the rationalization is particularly seductive through a kind of conflation of Charles E. Wilson's apocryphal “What's good for General Motors is good for the country” with Charles DeGaulle's “L'etat, c'est moi.”

⁵⁷ As Upton Sinclair put it, “It is difficult to get a man to understand something, when his salary depends on his not understanding it.” I, CANDIDATE FOR GOVERNOR, AND HOW I GOT LICKED, (1939), repr., University of California Press, 1994, p. 109.

⁵⁸ The issue of proper alignment between executive compensation and organizational goals is subject to considerable debate and is beyond the scope of this paper; for our purposes the key point is that conflicts do exist and are relatively ineradicable in the presence of large incentive compensation. See Lynn A. Stout, *Killing Conscience: The Unintended Consequences of 'Pay for Performance,'* working paper, 2012.

⁵⁹ See Kenneth Bertsch and Chris Mann, *CEO Compensation and Credit Risk*, Moody's Special Comment, July 2005 (as to credit defaults and ratings downgrades); Merle Erikson, Michelle Hanlon, and Edward Maydew, *Is there a Link between Executive Compensation and Accounting Fraud?*, working paper, University of Michigan, 2004 (as to restatements and accounting fraud). To be fair, CEOs, for all their power, do not act in a vacuum. We should not presume that the directors who oversee these CEOs and approve their strategic moves are immune to similar temptations, in an age where options and restricted stock have become an increasing percentage of board compensation. The outsized CEO incentives in these studies were, after all, granted by corporate boards, and it would be interesting to know what kind of compensation plans those directors had voted for themselves.

⁶⁰ One attribute of “business” framing is that decision-making is typically governed by cost-benefit analysis—another way of saying that tradeoffs are to be expected, and usually negotiable. This approach yields considerable ethical flexibility. In ethical framing, or analysis of illegality, problems may be difficult but the answers are not negotiable.

determined that it would be cheaper to pay off lawsuits than to make the repair.”⁶¹ We can also be blinded if we have a substantial stake in not noticing something: Bazerman recalls how long it took Major League Baseball, the players’ union, and his team’s management to pay attention to the changes in Barry Bonds as his hitting improved.⁶² And being simply too focused on one particular goal can crowd out all competing input—a phenomenon that is often invoked by overly-narrow performance metrics⁶³ and that has been unforgettably demonstrated with a simple basketball exercise that one must see to believe.⁶⁴

Time Pressure

A form of motivated blindness can also take over when we are in a hurry. In a well-known study, seminary students at Princeton were sent across campus to give a short talk on the story of the Good Samaritan. Along the way they had to pass by a groaning man collapsed in a doorway. Under unhurried conditions 63% of the students stopped to give aid, but if the experimenter sent the students off with no time to spare, only 45% helped the man, and if the experimenter instructed them to get to their destination as fast as possible, only about 10% helped.⁶⁵ If this happens to seminarians on their way to preach about helpfulness, what does it suggest about the likelihood that business executives, rushing to meet a launch date, will pause to consider whether the product may present safety, ethical or legal issues? Deepwater Horizon comes to mind.

Irrationality in Loss Avoidance

We are much more likely to act unethically, and to take risks in general, to avoid losses than to obtain equivalent gains, and this holds true even where an identical situation is simply *described*, or *framed*, in terms that emphasize the possibility of either loss or gain.⁶⁶ Here the notion of failing to “hit the numbers,” or of “losing” a bonus one has come to expect, or of failing to close a sale that one has considered likely, has

⁶¹ Max H. Bazerman and Ann E. Tenbrunsel, *Ethical Breakdowns*, HARVARD BUSINESS REVIEW, April 2011, p. 58.

⁶² *Id.*

⁶³ This risk was elegantly portrayed in the following dialogue from the Scott Adams “Dilbert” comic strip of November 28, 2012. Boss: “Your compensation will be based on achieving these goals.” Dilbert: “Awesome. It’s like written permission to ignore everything else you ask me to do.”

⁶⁴ See the video at <http://www.youtube.com/watch?v=vJG698U2Mvo>. See also Christopher Chabris and Daniel Simons, *THE INVISIBLE GORILLA*, HarperCollins Publishers, 2011.

⁶⁵ J. M. Darley and C. D. Batson, *From Jerusalem to Jericho: A Study of Situational Variables in Helping Behavior*, JOURNAL OF PERSONALITY AND SOCIAL PSYCHOLOGY, 27: pp. 100–108.

⁶⁶ Mary C. Kern and Dolly Chugh, *Bounded Ethicality: The Perils of Loss Framing*, PSYCHOLOGICAL SCIENCE, Vol. 20, No. 3: 378–384 (2009).

obvious relevance: risk-taking increases and ethical standards may sag. Taking more risk, of course, doesn't always turn out as hoped; and when this leads to greater losses, even greater risk taking may result—a cycle known as “escalating commitment” that seldom ends well. This is the story of Barings Bank, of the London Whale, and of countless embezzlers who originally planned to repay their employers before the missing funds were discovered.

Overconfidence

Another recurring theme in behavioral ethics and cognitive psychology is overconfidence. Most of us have it to some degree, from the incompetent⁶⁷ to the accomplished, and given their personal histories of success C-suite officers have more than most. Overconfidence leads us to take on more risk than we intend to, and in certain situations, to think that we won't get caught. One especially vicious cycle is that overconfidence can be fueled by early success in high-risk initiatives, leading decisionmakers to recalibrate their risk assessment, discount the risk already taken, and “double down” on risky business going forward. The space shuttle Challenger disaster and the collapse of U.K. banking giant HBOS are tragic products of this beguiling form of self-deception.⁶⁸ Worse, since we tend to attribute our successes to our personal characteristics,⁶⁹ we may not only downgrade our risk assessment, we may

⁶⁷ See Justin Kruger and David Dunning, Unskilled and Unaware of It: How Difficulties in Recognizing One's Own Incompetence Lead to Inflated Self-Assessments, *JOURNAL OF PERSONALITY AND SOCIAL PSYCHOLOGY*, Vol. 77, No. 6, 1121–1134 (1999).

⁶⁸ Space shuttles had repeatedly suffered, without consequence, partial O-ring burn-throughs of the kind that later caused the Challenger explosion. This experience led NASA management to conclude that the burn-throughs, though unexpected and poorly understood, must not pose a significant risk—when any dispassionate analysis would have predicted that if the burn-throughs continued, sooner or later one would cause an explosion. See Nobel Laureate Richard Feynman's APPENDIX TO THE REPORT OF THE PRESIDENTIAL COMMISSION ON THE SPACE SHUTTLE *CHALLENGER* ACCIDENT (1986), admonishing that contrary to NASA's way of thinking, “When playing Russian roulette the fact that the first shot got off safely is little comfort for the next.” With respect to HBOS, see PARLIAMENTARY COMMISSION ON BANKING STANDARDS, *'AN ACCIDENT WAITING TO HAPPEN': THE FAILURE OF HBOS*, April 4, 2013: “The growth of HBOS's Corporate Division was not the result of superior performance but of its high-risk strategy.” As HBOS moved increasingly into credit derivatives and foreign markets, “HBOS was excessively confident that its understanding of UK residential mortgages and related securitizations gave it the ability to understand and evaluate the risks in a wide range of asset-backed instruments.” (at 46–47)

⁶⁹ That we tend to attribute our successes to ability while blaming failures on external situational causes is one of the implications of attribution theory, first developed by Fritz Heider in the 1950s and later elaborated on by Weiner and others. See, e.g., Fritz Heider, *The Psychology of Interpersonal Relations*, Wiley (1958); E. E. Jones, D. E. Kannouse, H. H. Kelley, R. E. Nisbett, S. Valins, and B. Weiner, Eds. *Attribution: Perceiving the Causes of Behavior*, Morristown, NJ: General Learning Press (1972).

simultaneously raise our opinion of our own ability to judge risk and to predict the future.⁷⁰

Power

Power by itself has been shown to breed overconfidence⁷¹ and to increase risk taking.⁷² In the corporate arena there is specific evidence that companies with high-powered CEOs take more risk than those with less-powerful CEOs.⁷³ Approaching the issue from another angle, researchers have shown that companies with very powerful CEOs show significantly above-average variation in performance—higher highs and lower lows—again, consistent with increased levels of risk (and reward).⁷⁴

There is ample reason to believe that the elevated risk tolerance associated with power applies to ethical or legal risks just as it does to business risks. In an experimental setting, participants endowed with power not only committed more moral or legal infractions, they judged their own infractions less harshly than they judged the same conduct by others: they felt they were entitled to their transgressions while others were not.⁷⁵

Does power corrupt? It seems more justified to say that power amplifies one's native tendencies: the core principle seems to be that power lowers inhibitions. Undesirable behavior becomes more likely as inhibition is reduced, and even behaviors desirable in moderation, like risk taking, can become undesirable when limits are lifted.⁷⁶

⁷⁰ For example, according to the Parliamentary Commission, the HBOS “culture was brash, underpinned by a belief that the growing market share was due to a special set of skills which HBOS possessed and which its competitors lacked.” *Id.*

⁷¹ Niro Sivanathan and Adam D. Galinsky, *Power and Overconfidence* (2007), IACM 2007 Meetings Paper.

⁷² See Jeffrey Pfeffer, *POWER: WHY SOME PEOPLE HAVE IT—AND OTHERS DON'T*, HarperCollins Publishers 2010, p. 200: “Studies on the effects of power on the power holder consistently find that power produces overconfidence and risk taking. . . .”

⁷³ Krista B. Lewellyn and Maureen I. Muller-Kahle, *CEO Power and Risk Taking: Evidence from the Subprime Lending Industry*, *CORPORATE GOVERNANCE: AN INTERNATIONAL REVIEW*, Vol. 20, No. 3, 289–307 (2012).

⁷⁴ Renee B. Adams, Heitor Almeida, and Daniel Ferreira, *Powerful CEOs and Their Impact on Corporate Performance*, *THE REVIEW OF FINANCIAL STUDIES*, Vol. 18, No. 4 (2005), pp. 1403–1432.

⁷⁵ Joris Lammers, Diederek A. Stapel and Adam D. Galinsky, *Power Increases Hypocrisy: Moralizing in Reasoning, Immorality in Behavior*, *PSYCHOLOGICAL SCIENCE* Vol. 21, No. 5, pp. 737–734. One is reminded that “rank hath its privileges,” and that “privilege” translates to “private law.”

⁷⁶ D. Keltner, D. H. Gruenfeld, and C. Anderson, *Power, Approach and Inhibition*, *PSYCHOLOGICAL REVIEW*, 110, pp. 265–284 (2003).

Group Dynamics

The C-suite is a group, a small and often rather insular one where members see a lot more of one another than of other employees. Like any group it will develop its own distinct identity, behavioral norms and culture, for better or worse. The risk of groupthink—collegiality and teamwork devolving to uncritical thinking or an absence of dissent—cannot be discounted, particularly on the turf of a dominant CEO.⁷⁷ These themes of in-group identification, conformity and deference to authority have unsettling ramifications for compliance. Experiments have shown that misconduct by an authority figure such as a CEO strongly primes independent episodes of misbehavior by others,⁷⁸ and the “copycat” misconduct can be of any type: the lesson taught by example is not theft, or bribery, or misrepresentation: it’s disregard of rules. This principle can apply within the executive corps between more and less powerful executives, and then “trickle down” throughout the organization via a process Enron seems to have perfected, and even named.⁷⁹

A similar effect operates laterally between those of equal power within a group, even one that is not particularly close-knit. In one study, Francesca Gino and Adam Galinsky discovered that feelings of closeness drawn from group membership, or even a perception of minor commonalities such as birthdays, leads people to rationalize and justify misconduct committed by those they identify with, and worse, to emulate the misbehavior.⁸⁰ In another study of in-group effects, Gino and others showed that college students will more readily cheat if they see another student in the same class cheating—but the effect disappears if the cheater appears to be from another school.⁸¹

⁷⁷ It is hard to say no to any boss, domineering or not, and the “authority bias” compellingly demonstrated by Milgram’s electric shock experiments reminds us that deference to authority can quite easily override ethical qualms. See Stanley Milgram, *Behavioral Study of Obedience*, 67 J. ABNORMAL AND SOCIAL PSYCHOL. 371–378 (Oct. 1963).

⁷⁸ Kees Keiser, *The Spreading of Disorder*, doctoral dissertation, University of Groningen, 2010, summarized and cited in Muel Kaptein, *Why Good People Sometimes Do Bad Things: 52 Reflections on Ethics at Work*, July 25, 2012, available at <http://ssrn.com/abstract=2117396>. See also Kees Keiser, Siegwart Lindenberg, and Linda Steg, *The Spreading of Disorder*, SCIENCE, Vol. 322 (2008), pp. 1681–1685.

⁷⁹ See Lynne L. Dallas, A Preliminary Inquiry into the Responsibility of Corporations and their Directors and Officers for Corporate Climate: The Psychology of Enron’s Demise, Public Law and Legal Theory Research Paper 44, St. John’s University Law Review Symposium (2002), quoting a member of Enron’s Risk Assessment and Management Group about the “Enronizing” of new employees: “[i]f your boss was fudging, and you have never worked anywhere else, you just assume that everybody fudges earnings. . . . It was easy to get into ‘well, everybody else is doing it, so maybe it isn’t so bad’”(at 66).

⁸⁰ Francesca Gino and Adam Galinsky, *When Psychological Closeness Creates Distance from One’s Moral Compass*, paper presented at the 23rd Annual International Association of Conflict Management Conference, Boston, Massachusetts, June 24–27, 2010.

⁸¹ Francesca Gino, Shahar Ayal and Dan Ariely, *Contagion and Differentiation in Unethical Behavior: how One Bad Apple Spoils the Barrel*, PSYCHOLOGICAL SCIENCE, Vol. 20, No. 3, (2009) pp. 393–398.

If these experimental studies seem academic, consider *CEO Connectedness and Corporate Frauds*, a retrospective study of securities fraud in nearly 3,000 public companies over a 10 year period.⁸² The study measured fraud incidence as a function of how many of the other top four C-suite executives were appointed during the current CEO's tenure, a rough index of "connectedness" within the suite based on the assumption that CEOs likely played a role in the selection of others appointed during their term. More connected executive teams may be more susceptible to unhealthy in-group influences, and perhaps more to the point they can collude and cover for one another. The study's bottom line was that in firms where all four of the other executives were appointed during the current CEO's term, the fraud incidence was 34% higher than in firms where none were appointed during that term, with fairly linear results in between these two extremes. Detection was also significantly slower. C-suite closeness probably doesn't cause fraud, but, aided by the kinds of psychological forces discussed above, it certainly seems to enable and prolong it.

This is a fitting time to remind ourselves that this combustible mixture of C-suite pressures and temptations with intractable human frailties doesn't actually explode very often. That tells us a lot about the integrity of the "average" senior executive.

But failures do happen and the damage to the organization can be vast, for two distinct reasons. First, serious C-suite misconduct can directly cause major financial and reputational damage, as the rare but spectacular corporate collapses of the past decade show. Second, and much more common and insidious, the C-suite is the font of corporate culture and whether through the direct and intentional exercise of power or through instructive example,⁸³ it tends to leverage its own culture, ethics, and behavioral expectations throughout the organization. We now consider how a board can address these risks.

What Not to Do

The challenges directors face in working effectively with senior management are legendary. The task requires constant balancing among conflicting goals such as monitoring versus mutual trust, objectivity versus collegiality, collaboration versus independence, and support and motivation versus discipline and deterrence. The answer to C-suite compliance risk is not to double down on controls, confrontation, and suspicion. The board cannot, and should not, manage the corporation nor can it, or should

⁸² Vikramaditya S. Khanna, E. Han Kim and Yao Lu, *CEO Connectedness and Corporate Frauds*, University of Michigan Law School Public Law and Legal Theory Research Paper Series, No. 283, June 2012.

⁸³ See text accompanying notes 75–80 above for examples of how toxic leadership by example can influence follower behavior.

it, directly supervise senior executives in the execution of their duties.⁸⁴ And projecting expectations of misconduct upon executives—very few of whom deserve it⁸⁵—will produce, at best, dysfunction and at worst, a self-fulfilling prophecy.

In the face of a distrustful board, executives can be expected to react defensively and to involve the board only in decisions where its participation is clearly required; and teamwork and effectiveness will suffer. Executives may also react by exerting tighter control over the already-limited information the board receives, even beyond the intrinsic motivation to portray their own performance favorably,⁸⁶ thus actually impairing the board's monitoring capability.⁸⁷

In its role as the ultimate guardian of ethical culture,⁸⁸ the board can be far more effective by taking positive actions than by adversarially positioning itself as the C-suite's "compliance cop." The greatest impact will be achieved if the board focuses on selecting executive leaders with unblemished records of integrity, working supportively with the CCO and other internal-control officers, maintaining continuity of "tone at the top" as executives come and go, and promoting ethical leadership within the C-suite and ethical culture throughout the organization.

Leadership Selection

Good leadership selection, especially *not* hiring the *wrong* people, is critical for compliance. It is not always easy to distinguish between the confidence, ambition, dedication and persuasive power that makes for a successful executive and the aggression, ambition, intensity and manipulative power that characterizes a narcissist or psychopath. Still, it helps to be clear about what you're trying to avoid.

⁸⁴ The customary shorthand for the appropriate engagement level of directors is "nose in, fingers out."

⁸⁵ Needless to say, tighter monitoring is hardly the long-term answer for any executive who has actually earned the board's distrust: they should be encouraged to find a more suitable position elsewhere.

⁸⁶ See Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability*, Georgetown Law and Economics Research Paper number 241402, September 2000, available at <http://ssrn.com/abstract=241402>.

⁸⁷ This key vulnerability in the board's monitoring function—the fact that much of the board's information on the C-suite's performance is provided and to some extent controlled by the C-suite, and most of the board's information on the integrity, character, and ethics of the C-suite is similarly based on direct interaction with the C-suite—points us towards some alternate approaches. See below under "Culture And Expectations Of The C-suite" and "Culture and the 'Information and Reporting System'."

⁸⁸ See Michael D. Greenberg, *Directors as Guardians of Compliance and Ethics Within the Corporate Citadel: What the Policy Community Should Know*, RAND Center for Corporate Ethics and Governance Conference Proceedings 2010.

The august Group of Thirty offers this advice about CEOs who think of themselves as “stars”: “A very good CEO is preferable to a “star” CEO.”⁸⁹ Very good CEOs “care much more about doing the right thing than about being right,” while “star” CEOs “may conflate the [company’s] success with their own personal goals,” “advance their own ideas in preference to listening to the good ideas of others, and they may start to believe their own press.”⁹⁰ Essentially, they are warning against the temptation to hire charismatic CEOs who are high in narcissism, and who in their unending pursuit of admiration, affirmation and applause, have been shown to regularly take greater risks, make more acquisitions, pay higher premiums for them, and produce more extreme results (good or bad) on several measures of corporate performance than those lower in narcissism.⁹¹

To similar effect, in his book *Good to Great*,⁹² Jim Collins pointed out that the successful companies he studied had in common that they were led predominately by 41 “humble CEOs,” or servant-leaders, who were continually described with words like “quiet, humble, modest, reserved, shy, gracious, mild-mannered, self-effacing, understated, did not believe his own clippings, and so on.”⁹³ Similarly, compliance strategist Donna Boehme has observed that “the most enduring, most powerful ethical cultures have at their core some simple, well-worn CEO stories” of humility.⁹⁴

Below the CEO level, the Group of Thirty also recommends direct board involvement in the selection of other C-suite officers, and that “[a]t a minimum, the board must confirm the appointments of corporate officers for whom independence from line of business management is critical. These typically include the internal auditor, the chief financial officer, the chief risk officer, the chief compliance officer, and the chief legal officer.”⁹⁵ Besides offering prophylaxis against undue “connectedness” in the C-suite, this step would underscore the expectation of independence of these officers.

⁸⁹ Group of Thirty, TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, 2012, p. 20. It is worth noting that this 81-page report by some of the world’s most senior and hard-nosed financial executives and scholars uses the word “culture” 126 times, and “values” 86 times.

⁹⁰ *Id.* at 38.

⁹¹ See Arjit Chatterjee and Donald C. Hambrick, *It’s All About Me: Narcissistic CEOs And Their Effects on Company Strategy and Performance*, ADMINISTRATIVE SCIENCE QUARTERLY 52:351–386 (2007). This paper helpfully provides a number of indicia of narcissism that a board could use in vetting management candidates.

⁹² James Collins, *GOOD TO GREAT*, HarperBusiness, 2001.

⁹³ It is noteworthy that the increased misconduct and hypocrisy found in the Lammers study, *supra* note 75, appears only if the subject *also* feels entitled to his power: humility trumps hypocrisy.

⁹⁴ See Donna Boehme, *5 Ethical Culture Lessons for CEOs from Pope Francis*, CORPORATE COUNSEL, April 4, 2013.

⁹⁵ TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, *supra* note 89, at 39.

Working with the Chief Compliance Officer

The board should develop a close and supportive relationship with the Chief Compliance Officer, ensure her independence,⁹⁶ and communicate directly with her on a regular basis. An integral part of the CCO's job is understanding the board's and the C-suite's attitude towards modeling and supporting ethics and compliance within the organization. In a healthy company the CCO should always be in a position to "speak truth to power" in the C-suite itself, but to whatever extent this is not the case, it is all the more essential that she be able to speak frankly, and privately, with the board.

For our purposes, a crucial point with respect to the CCO is that unless the CCO regularly reports directly to the board, the company cannot receive leniency under the Federal Sentencing Guidelines in connection with senior executive misconduct, no matter how excellent the company's compliance program may be in other respects.⁹⁷ Notably, the Guidelines also emphasize that the CCO must have "adequate resources" and "appropriate authority."

Similar considerations apply with respect to other officers whose jobs involve a monitoring element and require independence, as mentioned earlier. In fact, the Group of Thirty's discussion of the Chief Risk Officer (CRO) role applies equally well to the role of the CCO, as well as those of Internal Audit, the General Counsel and the CFO. After observing that, in many of the financial institutions that failed during the recent financial crisis, the CRO "struggled to properly influence their firm's risk-taking activities" and "lacked sufficient independence from and credibility with the firm's top management and business units,"⁹⁸ the report concluded that CROs need the following conditions to be successful:

They need courage and conviction, and they should be willing to walk away from their job if their judgment on major issues is ignored. They should have the right stature in the organization. They should be a member of the senior management team and should report to the CEO. They should have high visibility in the boardroom and should have unfettered access to the chairman of the risk committee and the full board where necessary.⁹⁹

⁹⁶ See Donna Boehme, *Making the CCO an Independent Voice in the C-Suite*, CORPORATE COUNSEL, March 19, 2013.

⁹⁷ United States Sentencing Commission, GUIDELINES MANUAL 8C2.5(f)(3)(C) (2010). This has led no less an authority than the NACD to recommend, in understated fashion, that boards "should at least consider having their chief ethics/compliance officer report to the audit committee and/or board of directors," National Association of Corporate Directors, C-SUITE EXPECTATIONS: UNDERSTANDING C-SUITE ROLES BEYOND THE CORE, 2013, at 16.

⁹⁸ TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS, *supra* note 89, at 48.

⁹⁹ *Id.*

Given a real “seat at the table” in senior management and regular interaction with the board, all of these officers can assist the board’s C-suite monitoring function by providing current information on the climate in the C-suite, on particular issues of compliance and reputational risk, and on “pink flags” or emerging concerns. The board should also pay attention to the relationships between these “control” officers and the rest of the C-suite; distance, antagonism, or portrayal of these officers as the “department of sales prevention” are danger signs. The rest of the C-suite should appreciate that the faster the car, the more it needs a good set of brakes.

Modeling the Message

The final responsibility for corporate culture remains with the board—duties may be delegable but responsibility is not. Our final sections examine three different ways the board can harness organizational culture as a means of effectively monitoring and governing the C-suite: by modeling and articulating the culture the board wishes to instantiate (and thereby sending a powerful implicit message to management); by explicitly engaging the C-suite with cultural and ethical-leadership responsibilities; and by taking advantage of a positive culture’s potential as a compliance “information and reporting system” for the board.

There is no longer doubt that organizational culture drives improved compliance results through a variety of mechanisms,¹⁰⁰ including most broadly the establishment and pervasive reinforcement of behavioral norms, demonstrating the legitimacy of the company’s ethical leadership and rules,¹⁰¹ harnessing group loyalty and engagement¹⁰² and activation of employees’ existing ethical values.¹⁰³ Culture counteracts the undertow of temptation and rationalization by helping people recognize the ethical dimensions of workplace issues, encouraging upright behavior and providing tools for dealing with ethical conflicts. The results are dramatic: the Ethics Resource Center found that the incidence of misconduct at companies in the lower quartile of an ethical culture measure was triple the incidence at companies in the top quartile,¹⁰⁴ and using its own index of ethical culture, the Corporate Executive Board found the same 3-to-1 ratio between the

¹⁰⁰ See, generally, Killingsworth, *Modeling the Message*, *supra* note 47.

¹⁰¹ See, e.g., Tom R. Tyler et al, *The Ethical Commitment to Compliance: Building Value-Based Cultures*, 50 *Calif. Mgmt. Rev.* 31, 35 (2008) and Linda K. Treviño et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 *CAL. MGMT. REV.* 131–151 (1999)

¹⁰² See Steven L. Blader & Tom R. Tyler, *Testing and Extending the Group Engagement Model: Linkages between Social Identity, Procedural Justice, Economic Outcomes, and Extrarole Behavior*, 94 *J. APPLIED PSYCHOL.* 445, 457 (2009).

¹⁰³ See Dan Ariely, *PREDICTABLY IRRATIONAL* 195–216 (2008).

¹⁰⁴ Ethics Resource Center, 2011 National Business Ethics Survey, p. 20.

bottom and top quartiles for violations in high-risk compliance areas such as conflicts of interest and accounting irregularities.¹⁰⁵

If the C-suite is the font of organizational culture, the board is its wellspring. Consider the interaction between these two assertions:

If each level in a corporate hierarchy emulates the one above it, then a corporation can never be better than its board—Alice Peterson¹⁰⁶

You're only as good as the leaders you have underneath you. You might think that because you're projecting our values, then the rest of the company is experiencing the values. What you realize is that the direct supervisors become the most important influence on people in the company.—Victoria Ransom¹⁰⁷

To instill an ethical culture, the board and the C-suite each depend on one another: the board must inspire the C-suite and the C-suite must propagate that inspiration down through the organization.

Directors often overlook the intensity with which their behavior is scrutinized by senior management. The conflict of interest inherent in a board's setting its own compensation, perquisites, meeting sites, and expense reimbursement policies is lost on no one, and the decisions made in that domain, and the process by which they are made, are received as powerful messages about the board's values and integrity.¹⁰⁸ Moreover, some officers may feel that some directors are just as vulnerable to the pernicious influences of power, money, urgency, in-group preference, and motivated blindness as are ordinary mortals, and may interpret directors' behavior through this lens. If the company can be no better than the C-suite's perception of its board, the board must embrace without reservation its obligation to model ethical behavior.

With regard to its own members' behavior, as well as that in the C-suite, the board must consistently "repair the broken windows" of even small legal and ethical breaches that come to their attention.¹⁰⁹ The literature is replete with evidence that tolerating visible infractions breeds further infractions *of all kinds*, and leads step-by-step to

¹⁰⁵ Compliance and Ethics Leadership Counsel of the Corporate Executive Board, *Ethical Leadership: The Important Links Between Culture, Risk Management, and Business Performance*, 2010, p. 67.

¹⁰⁶ Remarks at the Practising Law Institute Corporate Compliance and Ethics program, Chicago, Illinois, May 6, 2012.

¹⁰⁷ Quoted in Adam Bryant, *If the Supervisors Respect Values, So Will Everyone Else*, THE NEW YORK TIMES, January 26, 2013.

¹⁰⁸ The principle discussed in connection with note 72, that persons in power may be more forgiving of their own transgressions while simultaneously harsher in judging the actions of others, may have special cautionary relevance to board/C-suite interactions.

¹⁰⁹ See George L. Kelling and James Q. Wilson, *Broken Windows: The Police and Neighborhood Safety*, THE ATLANTIC MONTHLY, March 1982, pp. 29–38.

continued decline in overall compliance.¹¹⁰ Deal with small problems conspicuously now, and you may not have to deal with big problems later. Of course, the response must be proportional to the infraction, but the point is that there must be a response, lest a climate of delinquency and disorder gain a foothold in the organization, at the top of a slippery slope.

In addition to ensuring that misconduct is dealt with, from a communications and modeling perspective the board should be reluctant to “let a good mistake go to waste.” The value of addressing a single violation can be multiplied if the company can get the word out about the nature of the violation and the steps taken to address it.¹¹¹ This reinforces not only the organization’s behavioral norms but also its genuine commitment to organizational justice. Nothing is more important to ethical culture than employees’ belief that if misconduct is discovered, appropriate action will follow—especially where high performers or those in senior positions are involved. How important is it? In a large-scale study, the Corporate Executive Board identified seven key drivers of employee perceptions that their organization has a culture of integrity. At the top of the list, and *three times as important as the other six factors combined*, was organizational justice: the perception that the company responds quickly and consistently to proven unethical behavior and that unethical behavior is not tolerated in their department.¹¹²

Finally, the board can also exercise leadership with respect to other cognitive traps that can lead to compliance breakdowns, such as motivated blindness, business-only framing, and tunnel vision in strategic decision-making. The board is uniquely positioned to be the voice for a broader analysis of strategic problems, one that systematically takes into account how other constituencies, such as regulators, customers, or the press, might frame a problem under consideration. And through its role in setting executive compensation, goals, incentives and the associated timelines, the board can mitigate the corrosive psychological forces at work in the crucible.

Culture and Expectations of the C-Suite

The board should also challenge senior leadership to take ownership of the organization’s ethical culture and to be accountable for results. Setting these expectations has a dual function: to benefit the overall organization by engaging the C-suite in supporting ethical culture through modeling, communications, discipline, etc., while simultaneously raising the salience of ethical behavior in the minds of the executives

¹¹⁰ See note 26 and accompanying text.

¹¹¹ For an excellent example of how this can be done effectively in a large company without identifying the participants, see the blog by Kathleen Edmond, Best Buy’s chief ethics officer, at www.kathleenedmond.com.

¹¹² Corporate Executive Board, Ethical Leadership, *supra* note 105.

themselves. A clear, explicit expectation from the board that the senior executive's duties include serving, and being accountable, as a positive role model for the rank and file can do much to focus the mind on topics that might otherwise be consigned to the back burner.

At a minimum, compliance failures should be included in executive performance reviews. Senior executives can also be invited to account for their objective actions in promoting compliance and ethical culture, such as completing required training and encouraging their staffs to do so; contributing to compliance-related newsletters and other communications; attending compliance-related functions; including “compliance moments” in presentations; making resources available for employee training; assisting with internal investigations; assisting with the design of compliance controls in their area of responsibility, etc.¹¹³ What gets measured gets done.

On a broader scale, C-suite executives can, individually or as a group, be rewarded for measurable improvements in the company's compliance in a variety of ways. Metrics of commonly recurring issues such as employment discrimination suits, safety citations, etc. can go into an evaluation.

Other facets of executive ethical leadership can best be measured through the eyes of others, for example through 360° evaluations by peers, direct and indirect reports, and the board, or via employee surveys—both emerging best practices employed by leading companies.¹¹⁴ Validated survey tools can reliably measure employees' perception of key ethical-culture variables, such as organizational justice, comfort speaking up about violations, comfort seeking advice about compliance issues, tone at the top, clarity of behavioral expectations, trust in colleagues, and the like. These cultural assessments can identify organizational weak spots and compliance danger zones, across the company as a whole or within particular locations or functions, and can serve as roadmaps for remedial action. The board can send no stronger message about the importance and priority it assigns to ethical culture than to tie part of executive compensation to improvements on these key measures.

Culture and the “Information and Reporting System”

The board's fundamental obligation with respect to compliance is to establish, and monitor, an “information and reporting system” designed to provide sufficient timely,

¹¹³ In C-SUITE EXPECTATIONS, *supra* note 97, the NACD suggests asking the CEO directly about “how the CEO is engaged in ongoing evaluation of the ethics program” and requesting examples of “how the CEO is building ethics requirements into his/her staff's objectives” and of “how the CEO is modeling ethical behaviors” (at p. 17).

¹¹⁴ See Joseph E. Murphy, Society of Corporate Compliance and Ethics, *Using Incentives in Your Compliance and Ethics Program* (2011)

accurate information to support informed judgments about the corporation's compliance.¹¹⁵ With respect to C-suite compliance, the information and reporting system includes the CCO, Internal Audit, the General Counsel and other control officers, external auditors, and the board's direct experience with senior executives. All of these represent different windows into the executive suite, and each window is limited in its own way. But few things happen in a corporation completely unwitnessed.

The final piece of a fully-developed information and reporting system is, quite simply, everyone else in the company. The effectiveness of this component depends on how comfortable employees feel in speaking to their supervisor, to a compliance officer, to in-house counsel or to an internal auditor about compliance concerns and questions; how much they trust the anonymity of the hotline service and the integrity of the investigative process that follows a report; whether they believe that the company will take appropriate action when misconduct is discovered, especially if the culprit is a high achiever, occupies a senior position, or has friends in management; and whether they believe that good-faith whistleblowers will be protected from retaliation.¹¹⁶

In a high-functioning culture, these factors operate to make rank-and-file employees the eyes and ears, the early warning system, and sometimes the conscience, of the company. A culture of "speaking up" can uncover existing or incipient violations via up-the-chain reporting and anonymous hotlines,¹¹⁷ and can identify organizational red flags and renegade microcultures via surveys or focus groups. It can also be good for earnings.¹¹⁸ As mentioned earlier, these crucial perceptions of the company's integrity and the resulting willingness of employees to speak up can be measured and, through ethical leadership at the senior executive and supervisor level, fair treatment of employees, communications, and training, can be improved.

¹¹⁵ In re Caremark International, Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996).

¹¹⁶ See generally, Michael D. Greenberg, For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd-Frank, RAND Center for Corporate Ethics and Governance, Conference Proceedings Report (2011); Ethics Resource Center, Inside the Mind of a Whistleblower, Supplemental report of the 2011 National Business Ethics Survey (2012).

¹¹⁷ See *id.*, reporting that in companies with a weak ethical culture and a weak compliance program, approximately half the employees who witness misconduct do nothing to report it, while in companies with both strong culture and a strong program, only 3% fail to report misconduct they have observed. In another Ethics Resource Center study that measured reporting-up purely as a function of culture (as opposed to culture plus compliance program), employees in a stronger culture were one-third more likely to report observed misconduct than those in a weaker culture. Ethics Resource Center, THE IMPORTANCE OF ETHICAL CULTURE: INCREASING TRUST AND DRIVING DOWN RISKS, SUPPLEMENTAL RESEARCH BRIEF OF THE 2009 NATIONAL BUSINESS ETHICS SURVEY. More generally, see also discussion in Michael D. Greenberg, CORPORATE CULTURE AND ETHICAL LEADERSHIP UNDER THE FEDERAL SENTENCING GUIDELINES: WHAT SHOULD BOARDS, MANAGEMENT AND POLICYMAKERS DO NOW? RAND CENTER FOR CORPORATE ETHICS AND GOVERNANCE, CONFERENCE PROCEEDINGS REPORT (2012).

¹¹⁸ See ETHICAL LEADERSHIP, *supra* note 105, which found a significant positive and linear relationship between employee comfort in speaking up and 10-year total shareholder return.

By investing in a robust ethics and compliance program led by an empowered CCO and committing to the long-term development of a consistent and uncompromising ethical culture, a board can ensure that its most effective “information and reporting system”—its people—will be there when most needed.

Compliance in the C-Suite

Michael Volkov, CEO
Volkov Law Group LLC

The ongoing debate whether certain executives are “too big to jail” misses the most important trend in corporate governance—namely, that criminal conduct is rising in the C-Suite. Viewed from a broad perspective, since 2000, the trend of C-Suite misconduct is unmistakable, and government prosecutors have paid greater attention while devoting more resources to the prosecution of rogue executives. At the same time, although policymakers, regulators and prosecutors have intensified their focus on internal compliance programs, the potential impact of those programs on C-Suite misconduct and culture seems to have been overlooked.

Since July 2002, the Department of Justice has convicted over 200 Chief Executive Officers and Presidents, over 120 Vice Presidents and 53 Chief Financial Officers.¹ These statistics, by themselves, paint a damning picture of ethics and compliance in the C-Suite. Meanwhile, a 2006 Compliance and Ethics Leadership Council study of major compliance scandals from 1999 to 2005 found that significant compliance violations almost always fell at the feet of a senior manager. According to CELC’s findings, in 46 percent of the incidents studied, senior managers knew about alleged improper conduct, and in another 40 percent of the incidents studied, the senior managers committed alleged improper conduct themselves. Taken together, the CELC findings suggest that more than 4 out of 5 senior managers either knew about or committed the crimes at issue.²

A subsequent study of corporate fraud conducted by KPMG found even more disturbing trends: in particular, an accelerating trend in criminal behavior perpetrated by Chief Executive Officers. From January 2008 to December 2010, KPMG found that 26 percent of observed corporate frauds involved the CEO, up from 11 percent in 2007. Among C-Suite executives, the involvement of CEOs in fraud activity was only exceeded by the involvement of senior finance executives, who were associated with 32 percent of cases.³ Board level perpetrators increased from 11 to 18 percent between 2007 and 2011.⁴ Meanwhile and in a consistent vein, FBI

¹ Corporate Fraud Task Force Report, April 2, 2008, at p. iii, available at <http://www.justice.gov/archive/dag/cftf/corporate-fraud2008.pdf>.

² Charting a New Course: Measuring and Monitoring the Effectiveness of Compliance and Ethics Programs (Corporate Executive Board—Compliance and Ethics Leadership Council 2006) p. 9

³ KPMG gathered data from fraud investigations conducted by the firms’ forensic specialists around the world from January 2008 to December 2010. In all, 348 cases from 69 countries were analyzed. http://www.kpmg.com/IS/is/utgefidefni/greinar-og-utgefidi/Documents/Who_is_the_typical_fraudster.pdf

⁴ *Id.*

Director Robert Mueller testified in 2011 that the FBI then had 667 ongoing probes into corporate fraud, and 1700 open cases of securities fraud.⁵

Although there is ample evidence to suggest an increasing enforcement focus on C-Suite executives, it is far less clear that the risks of C-Suite misconduct are being proactively addressed within companies. In too many instances, senior executives appear to have the means, the motive and the opportunity to engage in criminal fraud and other misconduct.

An important motive for accounting fraud, in particular, is manifest in executive pay structures that base incentive compensation on short-term corporate income. Multiple studies have documented the growing number of companies which structure their executive incentives in this way.⁶ Such incentives can feed the motivation of personal greed among senior executives, and amplify it through intense pressures to reach tough profit and budget targets.⁷ The KPMG survey also highlights how weakening control structures have made the opportunity to commit fraud easier.⁸ Organizations contribute to fraud when they fail to detect or respond to lapses or gaps in controls, as much as by setting overly onerous performance targets. Less robust controls, and fewer resources to monitor the controls, allow for greater exploitation by fraudsters.

In the 1980s and 1990s, prosecutors went after notorious white collar crimes and scandals, including the Wall Street criminal prosecutions with the mass arrests orchestrated by then U.S. Attorney Rudy Giuliani, and the Savings and Loans scandals of the 1980s and 1990s. Starting in 2000, however, with the fall of Enron, WorldCom, Adelphi, and continuing up until today, white collar prosecution has grown more and more recognized as a criminal enforcement priority, across both Democrat and Republican administrations. Yet the prevalence of crimes committed by top executives continues unabated. The fact that C-Suite crime continues to present a serious problem raises a question about additional measures that should be taken, beyond law enforcement, to address C-Suite misconduct and culture problems internally by corporations.

The Risks of C-Suite Misconduct: Some Recent Examples of Criminal Prosecutions

The Department of Justice's focus on corporate executives reflects public opinion and political priorities. The business community now faces a skeptical public, one with little faith in the overall ethics and social responsibility of corporations and their executives. This perception

⁵ *Statement of Robert S. Mueller, III, Director of Federal Bureau of Investigation*, before the Committee on the Judiciary, House of Representatives March 11, 2011, available at <http://www.justice.gov/ola/testimony/112-1/03-16-11-fbi-mueller-testimony-re-oversight-of-the-fbi.pdf>.

⁶ *Preliminary Executive Pay Scorecard Review*, Michelle Lamb and Greg Ruel, available at <http://GMIRatings.com>. (April 6, 2011); *Study of 2010 Incentive Design and Performance Metrics Among Top 200 SS&P 500 Companies*, James F. Reda & Associates, LLC, January 2012 available at <http://www.jfreda.com/public/pdf/PM10%20Final%20Study%20January%202012.pdf>.

⁷ KPMG, *Who is the Typical Fraudster?* (2011), http://www.kpmg.com/IS/is/utgefidefni/greinar-og-utgefidefni/Documents/Who_is_the_typical_fraudster.pdf.

⁸ *Id.*

(and reality) of corporate malfeasance has been underscored by press reports of corporate governance failures involving bribery, money laundering controls,⁹ healthcare fraud¹⁰ and LIBOR price-fixing scandals.¹¹

While history will resolve the question of whether prosecutors failed to charge financial companies and executives responsible for the financial meltdown, the Obama Administration has subsequently increased scrutiny of high-level corporate officers and employed a number of new, aggressive tools to do so, including the use of wiretaps to catch insider trading executives and the regular use of “ambush” interviews as a means to enlist the cooperation of potential defendants in government investigations.¹²

In another area of focus, the Obama Administration has recently made healthcare fraud a priority, and increased pressure against high-level executives for any whiff of misconduct. In early 2013, for example, a criminal trial against five executives from WellCare began in federal court.¹³ Sitting at the defense table were the former CEO and President (and Chairman of the Board), the CFO, two Vice Presidents and the General Counsel. The executives allegedly concocted a scheme to game the Medicaid system, and fraudulently to divert hundreds of millions of dollars. The scheme came to light when a whistleblower reported the misconduct and then agreed to wear a wire and record over 650 hours of conversations among the executives, including the general counsel.¹⁴

Corporate executives have lately been prosecuted and sentenced to significant periods of incarceration for foreign bribery, fraud, illegal cartels and other criminal offenses. Some high-profile examples include the president of one company who was sentenced to 180 months

⁹ HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution, (Department of Justice press release December 11, 2012) available at <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

¹⁰ *Health Care Fraud Prevention and Enforcement Efforts Result in Record-Breaking Recoveries Totaling \$4.1 Billion*, Department of Justice, Press Release, February 14, 2012, available at <http://www.justice.gov/opa/pr/2012/February/12-ag-213.html>.

¹¹ *Banks Looking at \$100 Billion Legal Tab*, Wall Street Journal, March 27, 2013, available at <http://online.wsj.com/article/SB10001424127887323466204578382261903001702.html>.

¹² See *United States v. Rajaratnam, No. 09 Cr. 1184(RJH)*, *United States District Court, S.D. New York*; *United States v. Gupta*, No. 11 Cr. 907(JSR); *Insider Trading: Ambiguous Statute as Warning*, Frank C. Ranzano, Pepper Hamilton LLP, Bloomberg Law Reports, July 2011, available at http://www.pepperlaw.com/pdfs/Razzano_InsiderTrading_Bloomberg0711.pdf.

¹³ *United States v. Todd Farah, et al.*, Case No. 8:11-CR-115-T-30MAP, *United States District Court, M.D. Florida, Tampa Division*; *Fraud Trial for WellCare Ex-CEO Shows Medicaid Abuse*, Bloomberg News, November 20, 2012, available at <http://www.bloomberg.com/news/2012-11-20/fraud-trial-for-wellcare-ex-ceo-shows-medicaid-program-abuse.html>; *Medicaid Fraud Trial Starts for Former WellCare Executives*, Tampa Bay Times, February 27, 2013, available at <http://www.tampabay.com/news/courts/criminal/medicaid-fraud-trial-starts-for-former-wellcare-executives/1276678>

¹⁴ *Id.*

(15 years) imprisonment for paying bribes to foreign government officials in Haiti;¹⁵ a former mortgage industry executive who was accused of masterminding one of the largest bank fraud schemes in history, and sentenced to 30 years in prison;¹⁶ 22 corporate executives who were involved in a massive antitrust cartel in the LCD-display industry, and were sentenced to terms of imprisonment totaling over 4,781 days;¹⁷ and of course, Bernie Madoff, who was sentenced to 150 years imprisonment.

The Department of Justice has dusted off the “responsible corporate officer” (RCO) doctrine to target executives in the healthcare industry, coupled with unprecedented enforcement of civil exclusion laws.¹⁸ Even those members of the C-Suite who are not actively involved in illegal conduct may be prosecuted, and incarcerated, for their roles in such cases.

Under the RCO doctrine, four corporate executives from Synthes were incarcerated for misdemeanor violations under the FDCA when they knew about illegal conduct but failed to take any steps to stop or prevent the conduct from occurring again. The company had conducted a series of non-approved clinical trials of its new bone cement used in orthopedic surgeries. The FDA warned Synthes not to promote the bone cement for certain spine surgeries, but the company, with the executives blessing, pushed ahead anyway. At least five patients who had the drug injected into their spines died on the operating-room table. The company and its executives ignored evidence of potential lethal consequences, and even went so far as to brush away scientists’ cautions that the cement could cause fatal blood clots.¹⁹ At sentencing, the federal

¹⁵ *United States v. Joel Esquenazi, et al.*, Cr. No. 09-CR-21010-JEM, S.D. Fla. Documents available at <http://www.justice.gov/criminal/fraud/fcpa/cases/esquenazij.html>; *Telecoms Exec Sentenced to Longest FCPA Sentence Ever*, Wall Street Journal Corruption Currents Blog, October 26, 2011, available at <http://blogs.wsj.com/corruption-currents/2011/10/26/telecoms-exec-receives-longest-fcpa-sentence-ever/>.

¹⁶ *United States v. Lee Farkas*, Cr. No. 1-10 cr. 200, Eastern District of Virginia, documents available at <http://www.justice.gov/criminal/vns/caseup/farkasl.html>; *Mortgage Executive Receives 30-Year Sentence*, Dealbook New York Times, June 30, 2011, available at <http://dealbook.nytimes.com/2011/06/30/mortgage-executive-receives-30-year-sentence/>.

¹⁷ *United States v. AU Optronics et al*, Cr. No. 09-110 SI, documents available at <http://www.justice.gov/atr/cases/auopt.htm>; *AU Optronics Corporation Executive Convicted for Role in LCD Price-Fixing Conspiracy*, Department of Justice Press Release, December 18, 2012, available at http://www.justice.gov/atr/public/press_releases/2012/290399.htm.

¹⁸ The “responsible corporate officer” doctrine provides that a “corporate agent, through whose act, default, or omission the corporation committed a crime” in violation of the Food, Drug, and Cosmetic Act [“FDCA”] may be held criminally liable for the wrongdoing of the corporation “whether or not the crime required ‘consciousness of wrongdoing’ “ by the agent. *United States v. Park*, 421 U.S. 658, 670 (1975). Criminal liability under the RCO doctrine extends to both the corporate agents who committed the criminal act and “those who by virtue of their managerial positions or other similar relation to the actor could be *deemed responsible* for its commission.” *Id.* (emphasis added). A corporate officer may therefore be guilty of a crime without “knowledge of, or personal participation in,” the underlying fraudulent conduct. *Id.*

¹⁹ *Bad to the Bone: A Medical Horror Story*, Fortune Blog, September 18, 2012, available at <http://features.blogs.fortune.cnn.com/2012/09/18/synthes-norian-criminal/>.

judge expressed his frustration with the conduct of each of the corporate executive defendants, and even ordered one of them “stepped-back” and sent him to jail on the day of sentencing.²⁰

In the case of Purdue Pharma, a manufacturer of the painkiller OxyContin, three of its top executives (its president, chief legal officer and former chief medical officer) pleaded guilty to charges of misleading the public about the drug’s risks. Purdue Pharma LP and the executives were fined a total of \$634 million.²¹ As part of their scheme, the executives designed and implemented a marketing strategy which was aimed at soft-pedaling the addictive risks of Oxycontin. Starting in 1996, Purdue Pharma began holding focus groups with doctors about its new long-lasting painkiller. Many of the doctors said they were reluctant to prescribe the drug because they worried about its potential for abuse. In response, the company’s sales representatives began misleading physicians about OxyContin. They said, for instance, that the drug produced no euphoric feelings for users and that users suffered no withdrawal symptoms when they stopped taking it. Within a few years, the use of the drug exploded, and led to one of the nation’s worst prescription-drug failures. The former president of Purdue Pharma was excluded from the healthcare industry for 12 years.²²

Enforcement examples like these have created an understandable climate of fear in corporate C-Suites. Corporate leaders and boards should be concerned about C-Suite misconduct and turn their attention to compliance at the highest levels of the company. The risk of failure is too great—prosecutors reaching into the corporate C-Suites handing out grand jury subpoenas, threatening indictments, and arresting corporate executives can put the future of an entire company in jeopardy.

²⁰ In December 2011, Thomas B. Higgins, the president of Synthes’ Spine Division, was sentenced to nine months in prison for violations of FCDA. *See United States v. Higgins*, 2011 WL 6088576 (E.D. Penn. 2011) Thomas B. Higgins, the president of Synthes’ Spine Division, pled guilty as a responsible corporate officer to the “introduction into interstate commerce of adulterated and misbranded medical devices.” *Id.* at *1. Higgins maintained that he did not know his actions were illegal at the time and did not intend to violate the law. *Id.* at *9. Higgins was sentenced to nine months incarceration. Richard Bohner, the Vice President of Operations, who was the senior Synthes executive with overall responsibility for regulatory compliance matters during the relevant period, also ended up pleading guilty for failing to either prevent or promptly correct Synthes’ illegal test marketing and promotion. Bohner was sentenced to eight months incarceration. *U.S. v. Bohner*, 2011 WL 6371826 (E.D. Pa. 2011). Phil Milford and Sophia Pearson, *Ex-Synthes Executive Gets Eight-Month Term in Bone-Cement Case*, Bloomberg.com, Dec. 14, 2011. In addition to Higgins and Bohner, two other Synthes executives, Michael Huggins and John Walsh were sentenced to jail for nine months and five months, respectively. *Id.* Moreover, Synthes agreed to plead guilty, sell the device, and pay a \$23.5 million fine to settle the case. *Id.*

²¹ *United States v. Purdue Frederick Co. et al.*, No 1:07-CR-00029, Western District of Virginia; *Oxycontin Maker, Execs Guilty of Deceit*, Sue Lindsey (Associated Press), USA Today, May 11, 2007, available at http://usatoday30.usatoday.com/money/economy/2007-05-10-1771944037_x.htm; *In Guilty Plea, OxyContin Maker to Pay \$600 Million*, Barry Meier, New York Time, May 11, 2007, available at http://www.nytimes.com/2007/05/11/business/11drug-web.html?_r=2&hp&.

²² *Id.*

C-Suite Compliance: An Ignored Risk and Disastrous Consequences

In this climate of fear, some companies have increased their focus on proactive compliance programs as a means to reduce risk of prosecution. Recent surveys of corporate compliance professionals show that companies are spending more money on their compliance programs.²³ This is a welcome development.

This trend, however, has not focused on compliance in the C-Suite. Broad brushstrokes of compliance programs frequently focus on creating a “culture of compliance” or communicating a “tone-at-the top” to others outside the C-Suite. There has not been a complementary focus on compliance within the C-Suite itself.

The reason for this omission is basic. It is too often simply assumed that efforts to communicate a “tone at the top” (i.e., an ethical workplace atmosphere fostered by corporate leadership) demonstrate a company’s commitment to ethical conduct at the C-Suite level. This assumption means that internal controls and compliance programs may simply ignore the C-Suite officers. In many corporate compliance programs, beyond broad statements of commitment to ethical conduct, the only meaningful detail relating to C-Suite compliance is the requirement that the company’s board and the officers participate in a one-hour training program.

The potential harm to a company which ignores C-Suite compliance risks is significant. In the same way that ethical “tone at the top” has the potential to filter down to other levels of a company, the absence of a meaningful commitment by the C-Suite to participate in a compliance program also sends a significant message throughout the organization: It suggests a fundamental contradiction, which can quickly evolve into a culture of cynicism, rather than fostering a culture of compliance.

A striking example of this contradiction occurred in a non-criminal context when Best Buy’s CEO and its Chairman were forced to resign because of the Chairman’s failure to report to the board his knowledge of the CEO’s affair with a 29 year-old subordinate. The Chairman was neither trained nor aware of the proper protocol when he learned about the CEO’s alleged affair. Instead of reporting the matter as required under the Best Buy compliance program, the Chairman went and asked the CEO whether the allegation was true. The CEO denied the matter and the Chairman let the matter drop.²⁴ The Chairman’s blatant disregard of the Best Buy compliance program occurred in an environment where Best Buy’s ethics program included many best practices: an ethicist was on its board of directors; the ethics officer, Kathleen

²³ Dow Jones 2012 State of Anti-Corruption Compliance, available at <http://www.dowjones.com/pressroom/smprs/djrcsurvey2012.html>.

²⁴ *Best Buy Founder Schulze Steps Down After Scandal*, USA Today, May 14, 2012, available at <http://usatoday30.usatoday.com/money/industries/retail/story/2012-05-14/best-buy-chairman-schulze-out/54952088/1>; *Experts Weigh In on How Best Buy Handled CEO Scandal*, Christa Meland, Twin Cities Business, May 15, 2012, available at http://tcbmag.blogs.com/daily_developments/2012/05/experts-weigh-in-on-how-best-buy-handled-ceo-scandal.html.

Edmond, had a website promoting her work and outlook; and the company was committed to transparency and compliance at every level except the C-Suite.

C-Suite Ethics and Compliance: A Proposed Solution

The solution to C-Suite ethics and compliance requires a multi-faceted strategy. It is easy to identify the problem, but a much greater challenge to implement an effective solution, since this requires close coordination among the board, senior management and the chief compliance officer. There are three steps which need to be addressed.

Step One: Redefine the Board's Compliance and Ethics Role

Corporate governance at the board level is coming under increasing scrutiny. No longer can a board meet a few times a year, review general documents, and relax behind the protection of minimum standards set forth under the *Caremark*²⁵ decision and the business judgment rule. Just as corporate executives need to step-up their compliance efforts, so do corporate boards.²⁶

Corporate governance standards are changing—more shareholders are focusing on deficiencies at the board level, especially in shareholder litigation for corporate misconduct. If the Board is not committed to compliance oversight (including at the C-Suite level), then neither will the company be committed.

Corporate boards need to conduct a rigorous self-examination of their own performance and the steps needed to minimize compliance risks. With a goal of ensuring compliance and ethical conduct, many boards are beginning to take protective steps: creating a strong independent board with monitoring functions, nominating and appointing independent and qualified directors, creating working committees, implementing a robust compliance and ethics program which stresses ethical conduct and is strictly enforced.

With respect to building an effective compliance and ethics program, the board needs to focus on two simple questions: (1) How can we get the information we need?; and (2) How can we oversee the compliance and ethics function within the company?

The board needs to start by setting up a “compliance committee.” The old model of layering compliance on top of the audit committee’s responsibility is a relic of the past, when financial certifications and accuracy were the focus of compliance in the Sarbanes-Oxley world. The compliance universe is a lot more expansive now than just under Sarbanes-Oxley. More companies now have implemented a stand-alone compliance committee. A specialized board committee focused on risk management, compliance and ethics is the first and most important step in building a C-Suite culture of compliance.

²⁵ In re Caremark International Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996).

²⁶ See generally, *Deloitte Board Governance*, available at <http://www.corpgov.deloitte.com/site/us/board-governance/?jsessionid=kNZWRZnf7DbSyszJGJ7TLBNkKvT1MJ3pmRtnjz2qQRy4Zc4Qv2ts!-498335892!1698926776>.

With the compliance committee in hand, the board needs to establish a working protocol with the Chief Compliance Officer (CCO) of the company. An effective working relationship will establish meaningful checks and balances in the company. Information is the key to compliance, and making sure that the CCO brings to the compliance committee important information in a timely fashion is critical. The protection of the CCO's role and ability to report directly to the board is paramount to this process. In some respects, the CCO will become a direct employee of the board, as explained in Step Two below.

A proper relationship between the board and the CCO requires the board to protect the CCO from retaliation from senior management, and to establish clear reporting expectations and requirements.

In addition to these basic tasks, the board needs to take a hard look at its CEO and the compensation for the CEO. In too many companies, CEOs are treated as superstars who are untouchable, and who are paid at rates that are disproportionate to the company's pay structure.²⁷ Corporate governance reform also means reforming CEO compensation so that it is tied to long-term results, including ethical performance, rather than short-term financial results.

Step Two: Empower an Independent Chief Compliance Officer

Many argue that prosecution of individual senior executives is the only real deterrent to corporate criminal behavior, and the only way to bring about change in corporate behavior. There is no question that prosecution of corporate executives increases incentives for corporate compliance. Companies recognize another important component of corporate compliance: an empowered C-Suite CCO.

The most significant trend in the last decade has been the increasing recognition for the importance of the CCO in a corporation. As prosecution risks have increased, so has the role of the CCO. Companies are fast recognizing the value of elevating a CCO, and protecting his independence through direct reporting authority to the board or a board committee.

The evolution of the role of CCO has been the result of a variety of forces—increased government prosecutions, adoption of specific guidance in the United States Sentencing Guidelines, requirements imposed by Health and Human Services in corporate integrity agreements, and industry education efforts.

Until the last few years, many companies added compliance oversight to the responsibility of their general counsels. A 2009 survey of companies found that nearly half of the responding companies followed this pattern.²⁸ More recently, companies have started to recognize that general counsels should not serve in this dual role of chief legal officer and chief compliance

²⁷ Charles M. Elson and Craig K. Ferrere, *Executive Superstars, Peer Groups, and Overcompensation: Cause, Effect and Solution*, The Weinberg Center for Corporate Governance, University of Delaware, October 2012.

²⁸ Association of Corporate Counsel and Corpedia, *2010 Compliance Program and Benchmarking Survey*, available at <http://request.corpedia.com/WP2010ACCCorpediaCompliance>.

officer, given the different mandates and competencies required by each position.²⁹ Many in the legal and governance communities have now endorsed the need for splitting the functions of chief legal officer and chief compliance officer.

Recent developments in the corporate world have refocused attention on effective corporate governance and the proper role of the CCO in an organization. Corporate compliance programs are continuing to evolve in response to emerging “best practices” and changes in the business environment. Back as far as 1998, the government encouraged companies to ensure the independence of chief compliance officers:

The OIG believes that there is some risk to establishing an independent compliance function if that function is subordina[te] to the hospital’s [G]eneral [C]ounsel, or comptroller or similar hospital financial officer. Freestanding compliance functions help to ensure independent and objective legal reviews and financial analyses of the institution’s compliance efforts and activities. By separating the compliance function from the key management positions of [G]eneral [C]ounsel or chief hospital financial officer (where the size and structure of the hospital make this a feasible option), a system of checks and balances is established to more effectively achieve the goals of the compliance program.³⁰

In a similar vein, in a September 5, 2003, letter to Tenet Healthcare Corporation, United States Senator Charles Grassley (R-IA) observed:

Apparently, neither Tenet nor (its General Counsel) saw any conflict in her wearing two hats as Tenet’s General Counsel and Chief Compliance Officer It doesn’t take a pig farmer from Iowa to smell the stench of conflict in that arrangement.³¹

The United States Sentencing Commission set in motion strong incentives for a company to earn credit for an “effective” corporate compliance program by implementing the organizational sentencing guidelines, and by adopting recent amendments to the guidelines in 2010 which specifically required companies to establish a senior level officer responsible for corporate compliance with direct reporting authority to the board.

Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program.
To carry out such operational responsibility, such individual(s) shall be given

²⁹ In the 2012 PWC State of Compliance Study, the number of CCOs reporting to GCs fell by 6 percent—to 35 percent from 41 percent—in the prior year.

³⁰ OIG, HHS, COMPLIANCE PROGRAM GUIDANCE FOR HOSPITALS (1998), *available at* <http://www.oig.hhs.gov/authorities/docs/cpghosp.pdf>.

³¹ *See*, Grassley Investigates Tenet Healthcare’s Use of Federal Tax Dollars, *available at* <http://www.senate.gov/~grassley/releases/2003/p03r09-08.htm>.

*adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.*³²

In addition to the Sentencing Commission's 2010 amendments to the guidelines, and in response to specific scandals and prosecutions in the healthcare industry, prosecutors demanded that companies separate the chief compliance functions from the chief legal officer.³³

Companies now are embracing the idea of a C-Suite level chief compliance officer, and empowering that officer with adequate resources and real autonomy. Among the many other reasons supporting the elevated CCO, is the likelihood that a C-Suite level officer can more effectively pursue a compliance agenda within the C-Suite, and identify and communicate at that level any related lapses, escalating those to the board where necessary. For example, recently in response to governance failures and legal violations, HSBC and J. P Morgan re-energized their compliance programs by empowering independent CCOs with new reporting authorities and positioning.³⁴ These innovative solutions to real governance problems reflect a growing trend across many industry sectors: namely, to empower a chief compliance officer as a check and balance against the potential for future C-Suite level misconduct.

Step Three: Assess C-Suite Compliance Risks and Respond

An independent chief compliance officer requires adequate resources to operate. Recent FCPA settlements have incorporated compliance program resourcing as an explicit requirement. A similar requirement is also included in the Sentencing Guidelines definition of an "effective" compliance program.

This requirement should be expanded to include resources needed to focus on C-Suite compliance programs and controls. An independent chief compliance officer ought to have the authority and the ability to turn his or her attention to compliance in C-Suite.

Chief Compliance officers are well-suited to this task. They can employ the well-known tools of their profession, starting with an overall risk assessment. The recent FCPA Guidance issued by the Department of Justice and the Securities and Exchange Commission underscored the importance of risk assessment in tailoring an "effective" corporate compliance program.

C-Suite compliance, in particular, requires an independent risk assessment. In response to identified risks, a chief compliance officer can then develop specific policies and procedures and

³² Section 8B2.1 (b) (2) (C), United States Sentencing Guidelines.

³³ Association of Corporate Counsel and Corpedia, *2010 Compliance Program and Benchmarking Survey*, available at <http://request.corpedia.com/WP2010ACCCorpediaCompliance>.

³⁴ Donna Boehme and Michael Volkov, *J.P. Morgan Chase Takes a Giant Step on CCO Independence*, Corporate Counsel, January 29, 2013, available at http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202586012597&JPMorgan_Chase_Takes_a_Giant_Step_on_CCO_Independence&slreturn=20130302204109; Donna Boehme, DOJ Tells HSBC and Corporate America: Reform Your Compliance Departments, Corporate Counsel, December 20, 2012, available at http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202582054989&DOJ_Tells_HSBC_and_Corporate_America_Reform_Your_Compliance_Departments.

controls, coupled with appropriate training programs, certification requirements and notifications of compliance obligations. Given the gravity of the risks associated with C-Suite misconduct, the compliance officer needs to employ appropriate tools which can reduce the risk and demonstrate the company's commitment to ethical conduct.

In completing this task, the independence and seniority of the chief compliance officer is fundamental to success. It is unrealistic to expect a CCO who is subordinate to the C-Suite hierarchy (and particularly if buried several levels down in management) to be able to influence C-Suite practices, to become aware of C-Suite improprieties, or to be insulated from reprisal in the event that such improprieties manifest. For all of these reasons, the chief compliance officer should report directly to the board on the C-Suite compliance program, preferably through a specific board-level compliance committee which is created at the same time that the board formally undertakes to ensure CCO empowerment and independence. The board committee would then play an active role in the supervision and monitoring of the C-Suite compliance program, to ensure that the program is "effective."

The independence and empowerment of the chief compliance officer is significant factor in contributing to the overall corporate culture. Where the chief compliance officer is responsible for a meaningful and visible C-Suite compliance program, then employees throughout the company will quickly understand that the commitment to compliance is real, and that no one within the company is really above the law.

The key to corporate integrity is a uniform cultural commitment to justice and ethical conduct. Such culture is more likely to emerge when employees believe that tone at the top is matched by meaningful controls and consistent enforcement, at all levels of the organization.

Conclusion

C-Suite risks can have catastrophic consequences to a company. Government prosecutors continue to rack up convictions of C-Suite corporate officers. Yet corporate boards and senior management have too often paid little attention to this issue. Corporate boards can address the issue by ensuring that an empowered and independent CCO heads the compliance function within their organizations. In turn, the role of the CCO should be to advise and assure the board on the design, implementation and monitoring of the company's compliance program, with a special focus on C-Suite compliance. Given this new focus, corporate boards can demonstrate to senior management, employees and the general public that a company's commitment to an "ethical culture" is real, and supported by the instrumentality of meaningful controls, an active champion within senior management, and much more effective board oversight.

References

- Boehme, Donna C., “Dear Tiger: Does Winning Really Take Care of Everything?” *Corporate Compliance Insights*, April 18, 2013. As of August 8, 2013:
<http://www.corporatecomplianceinsights.com/dear-tiger-does-winning-really-take-care-of-everything-winning-is-easy-compliance-is-hard/>
- Bonine-Blanc, Andrea, and Jacqueline E. Brevard, *Ethics and the Board: Integrating Integrity into Business Strategy*, New York: Conference Board, 2009.
- Bray, Chad, “Judge Approves HSBC Deferred Prosecution Agreement in Money Laundering Probe,” *Wall Street Journal*, July 2, 2013. As of September 5, 2013:
<http://online.wsj.com/article/SB10001424127887323936404578582451462472318.html>
- Cassin, Richard L., “Kaplan’s Top Ten Corporate Criminal Fines,” *The FCPA Blog*, January 4, 2013. As of August 8, 2013:
<http://www.fcpcb.com/blog/2013/1/4/kaplans-top-ten-corporate-criminal-fines.html#>
- Corporate Executive Board, *Charting a New Course: Measuring and Monitoring the Effectiveness of Compliance and Ethics Programs*, New York: Compliance and Ethics Leadership Council, 2006.
- Dalberg, John Emerich Edward, Lord Acton, *Historical Essays and Studies*, John Neville Figgis and Reginald Vere Laurence, eds., London: Macmillan, 1907.
- Greenberg, Michael D., *Perspectives of Chief Ethics and Compliance Officers on the Detection and Prevention of Corporate Misdeeds: What the Policy Community Should Know*, Santa Monica, Calif.: RAND Corporation, CF-258-RC, 2009. As of September 5, 2013:
http://www.rand.org/pubs/conf_proceedings/CF258.html
- , *Directors as Guardians of Compliance and Ethics Within the Corporate Citadel: What the Policy Community Should Know*, Santa Monica, Calif.: RAND Corporation, CF-277-CCEG, 2010. As of September 5, 2013:
http://www.rand.org/pubs/conf_proceedings/CF277.html
- , *For Whom the Whistle Blows: Advancing Corporate Compliance and Integrity Efforts in the Era of Dodd-Frank*, Santa Monica, Calif.: RAND Corporation, CF-290-CCEG, 2011. As of September 5, 2013:
http://www.rand.org/pubs/conf_proceedings/CF290.html

- , *Corporate Culture and Ethical Leadership Under the Federal Sentencing Guidelines: What Should Boards, Management, and Policymakers Do Now?* Santa Monica, Calif.: RAND Corporation, CF-305-CCEG, 2012. As of September 5, 2013:
http://www.rand.org/pubs/conf_proceedings/CF305.html
- Jacobs, Jack B., “‘Patient Capital’: Can Delaware Corporate Law Help Revive It?” *Washington and Lee Law Review*, Vol. 68, No. 4, September 1, 2011, pp. 1645–1664. As of September 5, 2013:
<http://scholarlycommons.law.wlu.edu/wlulr/vol68/iss4/2/>
- Karpoff, Jonathan M., D. Scott Lee, and Gerald S. Martin, “The Cost to Firms of Cooking the Books,” *Journal of Financial and Qualitative Analysis*, Vol. 43, No. 3, September 2008, pp. 581–612.
- Killingsworth, Scott, “Modeling the Message: Communicating Compliance Through Organizational Values and Culture,” *Georgetown Journal of Legal Ethics*, Vol. 25, No. 4, Fall 2012, pp. 961–987.
- Kossofsky, Nir, *Reputation, Stock Price, and You: Why the Market Rewards Some Companies and Punishes Others*, New York: Springer-Verlag, 2012.
- Murphy, Joseph E., *Using Incentives in Your Compliance and Ethics Program*, Minneapolis, Minn.: Society of Corporate Compliance and Ethics, November 2011.
- National Commission on Fraudulent Financial Reporting, *Report of the National Commission on Fraudulent Financial Reporting*, 1987. As of August 7, 2013:
<http://www.coso.org/publications/ncffr.pdf>
- Public Law 75-717, Federal Food, Drug, and Cosmetic Act, June 25, 1938.
- Public Law 95-213, Foreign Corrupt Practices Act, December 19, 1977.
- Schaefer, Steve, “Barclays to Pay \$450 Million for Trying to Manipulate LIBOR,” *Forbes*, June 27, 2012. As of August 8, 2013:
<http://www.forbes.com/sites/steveschaefer/2012/06/27/cftc-says-barclays-manipulated-libor-to-boost-derivative-trades-protect-reputation/>

On May 2, 2013, the RAND Corporation convened a symposium, "Culture, Compliance and the C-Suite: How Executives, Boards and Policy-Makers Can Better Safeguard Against Misconduct at the Top," to stimulate a broad conversation about the challenges posed by executive misconduct (e.g., episodes of fraud, malfeasance, unethical behavior) at the level of the chief executive, financial, and other officers (sometimes called the C-suite). The symposium conversation also focused on the risk factors that contribute to executive misconduct and on practical steps that could be taken to strengthen compliance and ethical tone at the C-suite level and the unique roles of directors, top executives, chief ethics and compliance officers (CECOs), and government regulators and policymakers in pursuing those steps. Prior to the symposium, several of the invited participants were asked to prepare and present formal remarks on corporate culture, compliance, and the C-suite. Their white papers, distributed in advance of the event, represent varied perspectives on law enforcement, organizational behavior, and compliance activity, all relating to instances of C-suite misconduct. The speakers presented their remarks during the first session of the symposium. The second and third sessions engaged the symposium participants in interactive discussions, launching from the foundational remarks initially offered by the white-paper authors. These proceedings summarize the discussion and include the white papers.



Center for Corporate Ethics and Governance

www.rand.org

\$24.95

ISBN 978-0-8330-8214-5

