9-24-2019

# The Reverse Agency Problem in the Age of Compliance

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# THE REVERSE AGENCY PROBLEM IN THE AGE OF COMPLIANCE

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## ABSTRACT

*The agency problem, the idea that corporate directors and officers are motivated to prioritize their self-interest over the interest of their corporation, has had long-lasting impact on corporate law theory and practice. In recent years, however, as federal agencies have stepped up enforcement efforts against corporations, a new problem that is the mirror image of the agency problem has surfaced—the reverse agency problem. The surge in criminal investigations against corporations, combined with the rising popularity of settlement mechanisms including Pretrial Diversion Agreements (PDAs), and corporate plea agreements, has led corporations to sacrifice directors and officers in order to reach settlements with law enforcement authorities as expeditiously as possible.*

*While such settlements are in the best interest of companies and shareholders, they have devastating effects for individual directors and officers. When settling through agreements, suspect companies usually attribute wrongdoing to a large group of directors and managers, without distinguishing among guilty and innocent individuals, and surrender all their information. As a result, directors and officers implicated in settlements may suffer severe reputational loss and face legal battles brought by corporations. Furthermore, the wrongdoing attributed to directors and officers in settlements expose them to derivative lawsuits for breach of their fiduciary duties. Unfortunately, extant law does not provide directors and officers with a means to prove their innocence or clear their name. In fact, it does not even give them a voice in the negotiations leading to the drafting of settlements. Thus, it dooms many directors and officers who have done no wrong to live with the mark of Cain and endure the economic consequences thereof.*

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*To remedy the plight of individual directors and officers, we suggest three possible legal reforms. The first seeks to amplify the voice of individual corporate officers in settlement negotiations by giving them a right to a hearing prior to the finalization of a settlement. The second is to give directors and officers implicated in settlements the right to bring an action for a declaratory judgment that could clear their name and preempt derivative actions against them. The third solution is to recognize a horizontal fiduciary duty between directors and officers, thereby allowing innocent directors and officers the right to sue their guilty colleagues for breaching such duty.*

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# I. INTRODUCTION

In this Article, we seek to unveil a new phenomenon that increasingly permeates the corporate world: the reverse agency problem. To introduce this problem, we first need to introduce its more famous cousin: the agency problem. In their seminal book, Berle and Means coined the term agency problem, which refers to the ability of directors and officers to shirk their duties and to divert value from corporations, i.e., extract private benefits from corporations with dispersed ownership.[1] The article has had an immediate and long-lasting effect on corporate law theory and practice. Indeed, no other scholarly contribution had the same impact on the field. The idea that directors and officers are willing to sacrifice the interest of the corporation to promote their narrow self-interest is both intuitive and correct. It would not be an exaggeration to say that since the book was published in 1932, the agency problem has been the focal point of corporate law theory.[2]

Oddly, in recent years we are witnessing a mirror image of the agency problem: corporations are willing to sacrifice their directors and officers (i.e., their agents) at the altar of the corporations' best interests. We term this trend "the reverse agency problem."[3] It is not an accident that this problem has gone unnoticed so far: it is a relatively new phenomenon that did not exist in the past. Yet, it is significant and ubiquitous and it is only likely to grow in the future. The reverse agency problem is a byproduct of the age of compliance. Since the mid-2000s, companies have been exposed to enforcement actions on the part of various federal regulatory agencies, such as the Department of Justice (DOJ), the Securities Exchange Commission (SEC), and the Internal Revenue Services (IRS), and criminal proceedings

[1] ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[2] Other very famous Articles that discuss various variations of the agency problem include: Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activists Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017) [hereinafter *Principal Cost*].

[3] There is family resemblance between the reverse agency problem and the problem of principal cost that has been pointed out by Zohar Goshen and Richard Squire in a recent important article. *See* Principal Costs, *supra* note 2. Goshen and Squire's theory focuses on the costs created by shareholders, which they divide into "competence costs" and "integrity costs" and argue that the law should minimize the sum of agency and principal costs. As we will explain the reverse agency problem is independent of the actions or characteristics of shareholders. In fact, it is unrelated to the ownership structure. At its heart, it is a problem that arises from the rational and legitimate actions of the management and directors of firms in the face of enforcement actions.

initiated by state agencies, such as the New York State Department of Financial Services (DFS).[4]

A considerable number of these investigations do not culminate in criminal charges. Rather, they are settled outside of court in the form of "Pretrial Diversion Agreements" (PDAs),[5] which includes mainly Deferred Prosecution Agreements (DPAs) and Non Prosecution Agreements (NPAs). Many other cases are settled post-indictment through plea agreement.[6] We refer to these agreements collectively as settlement agreements.

As a part of these agreements, the corporations are required to admit to various counts of wrongdoing by their directors, managers, and other employees. These agents, many of whom are no longer employed by the relevant companies at the time the agreement is consummated, typically have little or no say in the process and will forever have to live with the admissions that their corporations have made—admissions that implicate them in wrongdoing. And although these admissions do not formally bind them, they have a profound impact on their future. These employees suffer severe reputational losses as a consequence of these agreements, which often translate to lost careers and lost income.

Worse yet, the admissions made by corporations invariably expose directors and officers to follow-up civil suits against them.[7] The admissions in settlement agreements speak of various failures by the directors and officers. They are drafted in strong language and, thus, serve as an invitation to shareholders to demand that the corporation sues its directors and officers for a breach of the duty of loyalty or a breach of the duty of care, and if the corporation refuses to do so, to initiate a derivative action against them.

And even though the admissions made by a company do not typically bind the agents and they can bring an independent action to have their name cleared, they are facing an uphill climb. At that point, the company has given up on them and sacrificed them on the altar of the wellbeing of the shareholders. Surprisingly, for many years, law enforcement authorities refrained from persecuting individual directors and officers[8] and sufficed

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[4] *See infra* Section II.A.

[5] *See* Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Non-Prosecution*, 84 U. CHI. L. REV. 323 (2017) ("In the entire period prior to issuance of the Thompson Memo in January 2003, prosecutors negotiated only thirteen PDAs [pretrial diversion agreements]. . . . By contrast, we find based on our dataset that they entered into at least 267 PDAs from 2004 through 2014 (excluding agreements involving antitrust, tax, and environmental violations)."). *See also* Section II.B.1.

[6] *See infra* Section II.B.3.

[7] *See infra* note 110.

[8] In an effort to respond to a significant criticism arguing that the DOJ fails to prosecute individuals, in September 2015, the Deputy Attorney General Sally Q. Yates issued a new policy in the form of a memorandum, entitled "Individual Accountability for Corporate

themselves with the fines they collect from firms. Following harsh criticism of this practice, in recent years, law enforcement authorities started initiating legal actions against individual employees, but to a very limited extent.[9] In the small number of cases that law enforcement authorities proceeded to bring charges against individual employees, the employees did not have the financial wherewithal or the psychological resources to continue the fight on their own. Quite surprisingly, however, the individual directors and officers who got sued have experienced success in court.[10] Yet, even if the directors and officers are ultimately acquitted in court, they still have to confront prolonged legal battles on multiple fronts as derivative actions may be filed against them while they struggle to clear their names.

At this point, one may wonder: how can this be? There are two pieces to the puzzle. The first is clear. Companies that face criminal charges have an incentive to reach a settlement at all cost. To begin with, once a criminal investigation is opened against them, companies are at a high risk of criminal indictment and conviction if they choose not to fully cooperate with the enforcement authority. As history teaches us, indictment, not to mention conviction, has a dramatic negative impact on companies.[11] The accepted lore in the corporate law world is that "no major financial services firm has ever survived a criminal indictment."[12]

Furthermore, unlike individuals who are subject to a criminal investigation, corporations who face criminal allegations have to bear the cost of the investigation. Although the enforcement authorities do not actively force suspect corporations to examine the allegations at their own expense, they condition future settlement on full cooperation, and give corporations credit for carrying out the investigation on their own and submitting their

Wrongdoing," or the "Yates Memo." *See* Memorandum from Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Justice, to All U.S. Att'ys et al., Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015), https://www.justice.gov/archives/dag/file/769036/download [hereinafter Yates Memo].

[9] Paola C. Henry, *Individual Accountability for Corporate Crimes After the Yates Memo: Deferred Prosecution Agreements & Criminal Justice Reform*, 6 AM. U. BUS. L. REV. 153, 160–161 (2016) ("After the release of the Yates Memo, the DOJ continued to use DPAs in several cases where no individual employees were charged. . . . Thus, the government's continued use of DPAs without any individual accountability undermines the Yates Memo.")

[10] *See infra* note 141.

[11] Benjamin M. Greenblum, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863, 1886 (2005) ("The adverse publicity that accompanies a prosecution can devastate a corporation…"). *See also infra* notes 91 - 97.

[12] United States v. Stein, 435 F. Supp. 2d 330, 337 (S.D.N.Y. 2006) ("*Amici* point out that no major financial services firm has ever survived a criminal indictment").

findings to the authorities.[13] Actually, as DOJ's Yates Memo stated: "in order to qualify for any cooperation credit, corporations must provide to the Department all relevant facts relating to the individuals responsible for the misconduct."[14] The cost of conducting an internal investigation runs in the tens of millions of dollars and can often reach hundreds of millions of dollars and it comes on top of standard defense costs.[15]

To make matters worse, the uncertainty that comes with a criminal investigation imposes an almost insurmountable drag on the corporation and its ability to raise money.[16] It constitutes a serious diversion of managerial resources, forcing the corporation to focus on the criminal investigation, instead of its core business activity.[17] From the vantage point of the company, dragging out the investigation is tantamount to a death by a thousand cuts as the costs mount with every day that passes.

On top of it, a criminal investigation harms the company's reputation and makes it difficult for the corporation to do business with other companies as long as the investigation is ongoing. Potential and actual business partners become suspicious once they learn of the investigation and demand constant clarifications and assurances from the suspect company. This is especially true for suspicious financial institutions that inherently rely on business ties with correspondent banks.[18] Naturally, if the clarifications and assurances are

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[13] Department of Justice, Principles of Federal Prosecution of Business Organizations, U.S. Attorneys' Manual (USAM) 9-28.700—The Value of Cooperation, https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations#_ftnref1 ("Cooperation is a mitigating factor, by which a corporation—just like any other subject of criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution.").

[14] Yates Memo, *supra* note 8, at 2.

[15] Samuel Rubinfeld, *Costly Corporate Investigations Have No Natural End-Point*, WALL ST. J. (Oct. 10, 2017) ("The numbers, in some cases, are eye-popping. Wall Mart Stores, which is still under investigation, has spent $865 million since 2013, according to a review of its quarterly disclosures; the company says it's cooperating with U.S. authorities amid discussions of a potential resolution. Avon Products spent about $350 million on investigation-related costs before agreeing to pay U.S. authorities $135 million to settle its foreign-bribery probe. Siemens reported spending more than $1 billion on legal costs before its FCPA resolution in 2008."). *See also* Peter J. Henning, *The Mounting Costs of Internal Investigations,* N.Y. TIMES (March 5, 2012) ("When a corporation is caught in a government investigation, the legal fees can quickly exceed $100 million").

[16] Mike Koehler, *Measuring the Impact of Non-Prosecution and Deferred Prosecution Agreements on Foreign Corrupt Practices Act Enforcement*, 49 U.C. DAVIS L. REV. 497, 509 (2015) ("Legal practitioners stated: The reality is that few public or regulated companies can withstand the uncertainties and consequences that flow from an unresolved federal criminal indictment . . . .")

[17] *Infra* note 84.

[18] Greenblum, *supra* note 11, at 1886 ("The adverse publicity that accompanies a prosecution can devastate a corporation…, particularly one that relies heavily on its

not satisfactory, valuable business relationships will be lost. Hence, corporations will be readily willing to admit to wrongdoing by their agents to put an end to the investigation and hopefully sweeten the bitter pill by receiving a reduced fine.[19] In many ways, this is the same dynamic that undergirds plea bargains.

The second piece of the puzzle is less obvious. It concentrates on the question of how it is possible that companies are guilty of breaking the law—and let us be clear: they are—while their agents may be innocent. To get a handle on the answer to this question, it is necessary to comprehend that the requirements for imposing criminal liability on corporations differ from those necessary for imposing criminal liability on individuals. It is significantly more difficult to impose criminal liability on individuals than on a corporation.[20] In the case of corporations, the elements of an offence, both the actus reus and the mens rea can be satisfied by conducts and mental states of different executives and employees, aggregated and imputed to the firm. In contrast, to impose personal liability, all elements must be satisfied by the same individual. Hence, it is often impossible to derive the guilt of individual agents from the admissions made by a corporation.[21] At the same time, the relative ease of finding corporations criminally liable constitutes additional inducement for them to settle with law enforcement agencies even when it requires admitting to wrongdoing by their agents.

The desire of firms to enter settlements with law enforcement authority is perfectly rational. Moreover, they are obligated to do so by law. Presiding directors and officers, who are required to decide whether to enter into a settlement with the enforcement authority, owe a fiduciary duty to the corporation, not to their predecessors. For the reasons we explained, closing criminal investigations and receiving credit for cooperating with law enforcement authorities are in the best interest of the firm. Hence, the law, by requiring directors and officers to put the firm’s interests above all other considerations, exacerbates the plight of past employees.

To address the harsh consequences of the reverse agency problem, we propose three mechanisms that can alleviate the plight of innocent directors and officers. The first mechanism seeks to amplify the voice of individual corporate officers in settlement negotiations by giving them a right to a hearing prior to the finalization of a settlement. This mechanism would enable individual directors and officers to review settlements and propose changes before they are signed. The second mechanism we contemplate is to

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reputation in the marketplace, because of the effect on relationship with customers, creditors, and the public at large.”).

[19] *See infra* note 85.

[20] *See infra* note 83.

[21] *See infra* notes 80–83.

give individual directors and officers who were implicated in settlements the right to bring an action for a declaratory judgment that could clear them of liability. Doing so will grant innocent directors and officers the power to initiate legal actions in order to dispel the suspicions surrounding them and preempt derivative actions against them. Our third, and the most far-reaching mechanism, is to allow innocent directors and officers the right to sue their colleagues who went astray and precipitated a cascade of harms on the corporation and its employees.

Structurally, the Article unfolds in three parts. In Part II, we will discuss the rise in enforcement actions against corporations and PDAs, and explain how they drive a wedge between the interests of the corporation and its directors and officers, mainly former directors and officers. In Part III, we will introduce the reverse agency problem and position it within the rich conceptual framework of principal-agent conflicts that has been developed by corporate law theorists. In part IV, we will advance our proposed solutions to the reverse agency problem. A short conclusion will ensue.

## II. THE COMPLIANCE AGE

We commence our discussion of the reverse agency problem by turning the spotlight on a recent trend that changes the face of the corporate world: a dramatic increase in the rate and intensity of criminal enforcement actions against corporations. Clearly, criminal actions against corporations have been with us for a long time. In the last two decades, however, law enforcement authorities have stepped up their enforcement efforts against corporations, taking them to unprecedented levels. An important corollary of this trend is the emergence of vast settlements, running in hundreds of millions of dollars, that were struck between corporations and law enforcement agencies.

These settlements have generated large amounts of money that went into the pubic fisc and was used in part to continue the enforcement campaign. The enforcement efforts have intensified in the aftermath of the financial crisis of 2008 and the government bailout of the financial sector.[22] In this Part

[22] Official statements show that there was an increase in enforcement efforts following the financial crisis. *See, e.g.*, Eric Holder, Attorney General of the United States, Dep't of Just., Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 17, 2014) ("Our record demonstrates that when the evidence and the law support it, we do not hesitate to bring charges against *anyone*. Between 2009 and 2013, the Justice Department charged more white-collar defendants than during any previous five-year period going back to at least 1994."). However, some studies cast doubt on the accuracy of such statements. *See* JUSTICE DEPARTMENT DATA REVEAL 29 PERCENT DROP IN CRIMINAL PROSECUTIONS OF CORPORATIONS, https://trac.syr.edu/tracreports/crim/406/#figure1 (last visited July 9, 2019) (suggesting that "the decline in corporate prosecutions" cannot be fully explained by the increase in the use of PDAs and may "reflect a general decline in federal prosecution efforts"). It is difficult, if

we will discuss the increase in enforcement actions against corporations and explain how they transformed the corporate landscape.

### *A. The Rise of Enforcement Actions*

Recent years have witnessed a sea change in enforcement actions against corporations. The DOJ, SEC and IRS have invested considerable efforts and resources in criminal investigations against companies. This trend has grown in the aftermath of the 2008 financial crisis, with some commentators speculating that criminal enforcement against corporations provides a cost-effective method to bring money into the public fisc, and thereby defray, at least to some extent, the cost of the bailout.

The tidal wave of enforcement actions centered on violations of the Foreign Corruption Practices Act (FCPA), False Claims Act (FCA), Bank Secrecy Act[23] has exposed companies to an unprecedented level of liability and risk. In the proceeding paragraphs, we will discuss these changes in detail. We begin with the FCPA.

Congress enacted the Foreign Corrupt Practices Act (FCPA) in 1977 to combat the spread of corruption in international business transactions.[24] Until 1998, the FCPA had very little effect on the ground: investigations and prosecutions were rare.[25] Everything changed in 2005 when FCPA enforcement began in earnest.[26] Nearly seventy percent of DOJ and SEC cases involving the FCPA were commenced between 2005-2013.[27] The renewed focus of the enforcement authorities on FCPA

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not impossible, to evaluate which side is correct because doing so requires an examination of the cases declined by federal prosecutors and "[w]e simply do not have good data on such cases." Brandon L. Garrett, Too Big to Jail—How Prosecutors Compromise with Corporations 254 (2014).

[23] DOJ also increasingly enforces laws and regulations aimed at preventing money laundering, environmental and antitrust violations.

[24] Foreign Corrupt Practices Act (FCPA) of 1977, Pub. L. No. 95-213, Stat. 1494 ("to make it unlawful for an issuer of securities registered pursuant to section 12 of [the Securities Exchange Act of 1934] or an issuer required to file reports pursuant to section 15(d) of such Act to make certain payments to foreign officials and other foreign persons, to require such issuers to maintain accurate records, and for other purposes.")

[25] For historical background of FCPA enforcement until the 2000s, see, e.g., Barbara Black, *The SEC and the Foreign Corruption Practices Act: Fighting Global Corruption Is Not Part of the SEC's Mission*, 73 OHIO ST. L. J. 1093 (2012). *See also* Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775, 1829 (2011).

[26] *See generally* Amy Deen Westbrook, *Double Trouble, Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO ST. L. J. 1217 (2012); Roger M. Witten et al., *Prescriptions for Compliance with the Foreign Corrupt Practices Act: Identifying Bribery Risks and Implementing Anti-Bribery Controls in Pharmaceutical and Life Sciences Companies*, 64(3) THE BUSINESS LAWYER 691 (2009); Joel M. Cohen et al., *Under the FCPA, Who Is a Foreign Official Anyway?*, 63(4) THE BUSINESS LAWYER 1243 (2008).

[27] THE FOREIGN CORRUPT PRACTICES ACT: ECONOMIC IMPACT ON TARGETED FIRMS 1 (Law & Economics Center of George Mason University School of Law, June 2014).

enforcement has led to the voluntary payment of heavy penalties by corporations in order to settle these cases.

The harbinger of things to come is the Siemens AG case. In 2008, Siemens AG signed a plea agreement with DOJ's criminal division, as part of which it agreed to pay $800 million to settle allegations of FCPA violations in multiple countries.[28] A year later, in 2009, Kellogg Brown & Root (KBR) paid $579 million to the DOJ and SEC to resolve a broad investigation of FCPA violations via a plea agreement.[29] The two largest FCPA enforcement actions in the history came roughly a decade later. In 2017, Telia Company AB, a Swedish phone company, agreed to pay $965.8 million to settle through deferred prosecution agreement U.S. and European criminal and civil charges that it paid bribes to win business in Uzbekistan.[30] Then, in 2018, Petrobras, Brazil's state energy company, entered into a non-prosecution agreement with the DOJ that included a criminal penalty of $853.2 million,[31] in addition to a related settlement with the SEC.

These enforcement actions have been heralded in lawmakers' campaigns. For example, in 2007, Mark F. Mendelsohn, Deputy Chief of the Fraud Section of the DOJ's Criminal Division, stated in his opening address at the ACI (American Conference Institute) FCPA Conference that "2007 is by any

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[28] Press Release, U.S. Dep't of Justice, Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay $450 Million in Combined Criminal Fines (December 15, 2008), https://www.justice.gov/archive/opa/pr/2008/December/08-crm-1105.html ( "Coordinated Enforcement Actions by DOJ, SEC and German Authorities Result in Penalties of $1.6 Billion.").

[29] Press Release, U.S. Dep't of Justice, Kellogg Brown & Root LLC Pleads Guilty to Foreign Bribery Charges and Agrees to Pay $402 Million Criminal Fine (Feb. 11, 2009), http://www.justice.gov/opa/pr/2009/February/09-crm-112.html; Press Release, SEC, SEC Charges KBR and Halliburton for FCPA Violations (Feb. 11, 2009), http://www.sec.gov/news/press/2009/2009-23.htm. To gain an idea of the scope of DOJ and SEC investigations into FCPA cases, see Gibson Dunn, 2007 Year-End FCPA Update (January 4, 2008), https://www.gibsondunn.com/2007-year-end-fcpa-update/ (hereinafter: "Gibson Dunn-2007"). Gibson Dunn-2007 lists dozens of FCPA investigations in just 2007 alone.

[30] Press Release, U.S. Dep't of Justice, Telia Company AB and Its Uzbek Subsidiary Enter Into a Global Foreign Bribery Resolution of More Than $965 Million for Corrupt Payments in Uzbekistan (Sep. 21, 2017), https://www.justice.gov/opa/pr/telia-company-ab-and-its-uzbek-subsidiary-enter-global-foreign-bribery-resolution-more-965. The FCPA Top Ten List is available at the FCPA Blog at http://www.fcpablog.com/blog/2018/9/28/petrobras-smashes-the-top-ten-list-and-we-explain-why.html (last visited June 10, 2019).

[31] Press Release, U.S. Dep't of Justice, Petroleo Brasileiro S.A. – Petrobras Agrees to Pay More Than $850 Million for FCPA Violations (Sep. 27, 2018), https://www.justice.gov/opa/pr/petr-leo-brasileiro-sa-petrobras-agrees-pay-more-850-million-fcpa-violations.

measure a landmark year in the fight against foreign bribery."[32] A year later, at a speech he gave at an American Bar Association panel on foreign bribery about the dramatic increase in the number of FCPA cases, he promised that the trend will continue.[33] Mendelson's promise was echoed by Lanny Breuer, the head of the DOJ Criminal Division, who made it clear in November of 2010, that "FCPA enforcement is stronger than it's ever been — and getting stronger."[34]

These were not empty words. In 2008 the Federal Bureau of Investigation (FBI) created a unit dedicated to FCPA investigations;[35] and in 2010 the SEC also formed a specialized unit within its enforcement division to focus on these cases.[36] Finally, in November 2017, the DOJ published a new FCPA Corporate Enforcement Policy intended to encourage companies to voluntarily disclose misconduct and cooperate with enforcement authorities.[37]

Chart 1 below illustrates this point regarding enforcement actions made by the DOJ and the SEC of the Foreign Corrupt Practices Act, between 1978 and 2017:[38]

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[32] Gibson Dunn-2007, supra note 29 (describing that Frederic D. Firestone, an Associate Director in the SEC's Division of Enforcement, followed Mendelsohn's words by saying "ditto from the SEC").

[33] *Mendelsohn Says Criminal Bribery Prosecutions Doubled in 2007*, 22 CORPORATE CRIME REPORTER 36(1) (September 16, 2008).

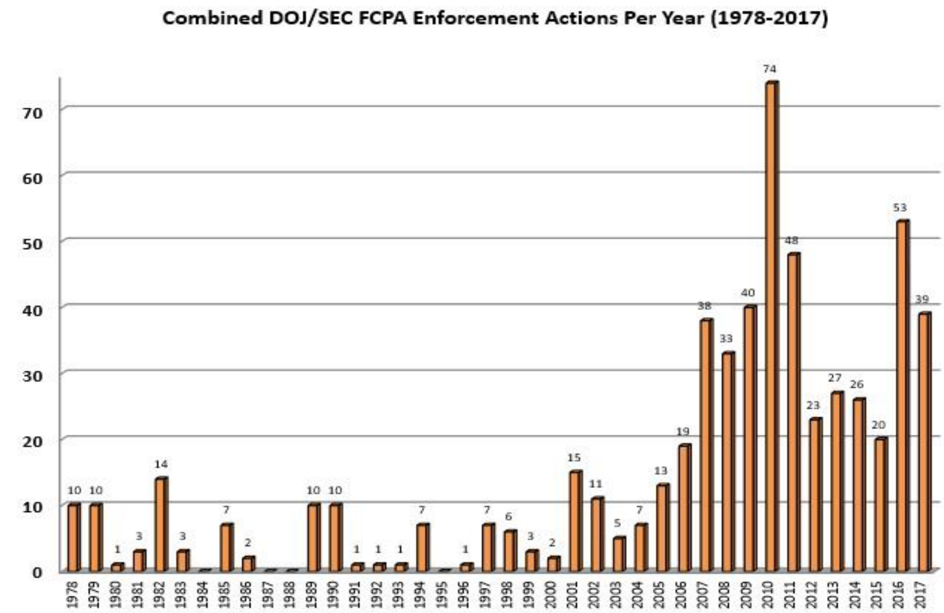
[34] Assistant Attorney General Lanny A. Breuer, Address at the 24th National Conference on the Foreign Corrupt Practices Act (Nov. 16, 2010), www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html ("We are in a new era of FCPA enforcement; and we are here to stay.").

[35] FBI, *Public Corruption*, https://www.fbi.gov/investigate/public-corruption.

[36] Andrew Ceresney, *Keynote Address at the International Conference on the Foreign Corrupt Practices Act* (Nov. 19, 2013), https://www.sec.gov/news/speech/2013-spch111913ac.

[37] United States Attorney's Manual 9-47.120 FCPA Corporate Enforcement Policy, https://www.justice.gov/criminal-fraud/file/838416/download.

[38] Gibson Dunn, 2017 Year-End FCPA Update (January 2, 2018), https://www.gibsondunn.com/2017-year-end-fcpa-update/ (hereinafter: "Gibson Dunn-2017").




A similar dynamic can be traced in the enforcement of the False Claims Act (FCA).[39] Recently, the FCA has become a major weapon in the arsenal of the enforcement authorities.[40] The act prohibits any person or organization from defrauding the government on the material terms of its receipt of government money or certification. FCA enforcement actions received public attention, when, in 2009, the pharmaceutical giant Pfizer agreed to pay $2.3 billion to settle FCA civil and criminal allegations after Pfizer was accused of promoting the sale of certain drugs that the US Food and Drug Administration (FDA) refused to approve due to safety concerns.[41] In emphasizing the magnitude of the penalties FCA infringers should expect to face, Assistant Attorney General Tony West said, "[t]his civil settlement and plea agreement by Pfizer represent yet another example of what penalties will be faced when a pharmaceutical company puts profits ahead of patient welfare."[42] In the same year, global pharma company Eli Lilly paid $1.4 billion under the FCA to resolve a DOJ claim that it had violated the FCA by

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[39] False Claims Act, 31 U.S.C. § 3729-3733 (2012).

[40] As Benjamin C. Mizer, the head of the Justice Department's Civil Division announced in December 2016, "Congress amended the False Claims Act 30 years ago to give the government a more effective tool against false and fraudulent claims against federal programs [and] [a]n astonishing 60 percent of those recoveries were obtained in the last eight years." Press Release, U.S. Dep't Just., Justice Department Recovers Over $4.7 Billion from False Claims Act Cases in Fiscal Year 2016 (December 14, 2016).

[41] Press Release, U.S. Dep't Just., Justice Department Announces Largest Health Care Fraud Settlement in Its History: Pfizer To Pay $2.3 Billion For Fraudulent Marketing (Sept. 2, 2009).

[42] *Id.*

illegally promoting one of its drugs for non-FDA uses, such as for treating dementia, aggression, and generalized sleep disorder.[43] Companies from the healthcare sector remained the focus of the DOJ and in 2012, Abbott Laboratories paid $1.5 billion to resolve criminal and civil FCA investigations arising from its unlawful promotion of one of its drugs for non-FDA approved uses.[44] Finally, in 2013, Johnson & Johnson agreed to pay $2.2 billion to settle FCA allegations that J&J promoted drugs for uses not approved as safe and effective by the FDA.[45] The rise in FCA enforcement actions continues, as is evident from the fact that in 2017 alone the DOJ recovered over $3.7 billion from FCA related investigations,[46] and in 2018 alone the DOJ recovered over $2.8 billion.[47] We do not expect this trend to wane in the foreseeable future.

The Bank Secrecy Act, together with Anti-Money Laundering (AML) laws, also provide a launching pad for enforcement actions. In this context, the U.S. regulators have raised their efforts to ensure the compliance of financial institutions with the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act of 1970[48] (commonly referred to as the Bank Secrecy Act (BSA)) and Anti-Money Laundering (AML) laws. This campaign is led by the Financial Crimes Enforcement Network (FinCEN)—the Treasury's lead agency for combatting money laundering. The SEC and the Financial Industry Regulatory Authority (FINRA) have also indicated their intent to focus their resources on AML violations.[49] Naturally, the primary targets of the aforementioned authorities are banks and depository institutions. The enforcement actions were quick to come with large settlements. In December 2012, HSBC Holdings plc entered into a deferred

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[43] Press Release, U.S. Dep't Just., Eli Lilly Company Agrees to Pay $1.415 Billion to Resolve Allegations of Off-Label Promotion of Zyprexa (Jan. 15, 2009).

[44] Press Release, U.S. Dep't Just., Abbott Labs to Pay $1.5 Billion to Resolve Criminal & Civil Investigations of Off-label Promotion of Depakote (May 7, 2012).

[45] Press Release, U.S. Dep't Just., Johnson & Johnson to Pay More Than $2.2 Billion to Resolve Criminal and Civil Investigations (Nov 4, 2013).

[46] Press Release, U.S. Dep't Just., Justice Department Recovers Over $3.7 Billion from False Claims Act Cases in Fiscal Year 2017 (Dec. 21, 2017).

[47] Press Release, U.S. Dep't Just., Justice Department Recovers Over $2.8 Billion from False Claims Act Cases in Fiscal Year 2018 (Dec. 21, 2018).

[48] 31 U.S.C. § 5311 *et seg.*

[49] *See* SEC, Office of Compliance Inspections and Examinations, Examination Priorities for 2017 (Jan. 2017), https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf, at 4 ("Money laundering and terrorist financing continue to be risk areas that are considered in our examination program."); FINRA, 2017 Annual Regulatory and Examination Priorities Letter (Jan. 2017), http://www.finra.org/sites/default/files/2017-regulatory-and-examination-priorities-letter.pdf, at 8 ("In 2017, FINRA will continue to focus on firms' anti-money laundering programs, especially those areas where we have observed shortcomings.").

prosecution agreement, under which it agreed to pay a total amount of $1.2 billion, in addition to $665 million civil penalties, to regulators including the Office of the Comptroller of the Currency, the Federal Reserve, and the Treasury Department.

On February 12, 2018, U.S. Bancorp ("USB") and the Office of the U.S. Attorney for the Southern District of New York entered into a DPA.[50] The DPA resolved criminal charges against USB, consisting of two alleged violations of the Bank Secrecy Act ("BSA") by USB's subsidiary, U.S. Bank National Association, for willfully failing to maintain an adequate anti-money laundering program and willfully failing to file a Suspicious Activity Report. The DPA specified that USB would pay the United States $528 million.

Between January 2002 and December 2015, 76.3% of AML/BSA enforcement cases were directed at banks and depository institutions.[51] In the years since the financial crisis of 2008, the world's biggest banks have been fined $321 billion.[52]

It certainly appears as if AML/BSA enforcement is going to remain at the forefront of the U.S. legislative and regulatory priorities in coming years. Recently, Congress has shown interest in updating AML laws by proposing multiple new bills[53] and engaging in a number of discussions.[54] Similar to the examples of the Foreign Corrupt Practices Act and the False Claims Act discussed above, the Bank Secrecy Act and Anti-Money Laundering are classic examples of a law and regulation that are focused on specific industries.

### B. *Pretrial Diversion Agreements*

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[50] Deferred Prosecution Agreement, *United States v. U.S. Bancorp*, No. 18-cr-150 (S.D.N.Y. Feb. 12, 2018), [hereinafter U.S. Bancorp DPA]; *see also* Press Release, U.S. Dep't of Justice, Manhattan U.S. Attorney Announces Criminal Charges Against U.S. Bancorp for Violations of the Bank Secrecy Act (Feb. 15, 2017), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-criminal-charges-against-us-bancorp-violations-bank.

[51] Dr. Sharon Brown-Hruska, *Developments in Bank Secrecy Act and Anti-Money Laundering Enforcement and Litigation*, NERA Economic Consulting 4 (June 2016), http://www.nera.com/content/dam/nera/publications/2016/PUB_Developments_BSA_AML_Lit-06.16.pdf,

[52] Gavin Finch, *World's Biggest Banks Fined $321 Billion Since Financial Crisis*, BLOOMBERG (March 2, 2017).

[53] *See, e.g.*, H.R. 4373, 115th Cong. (2017), https://www.congress.gov/115/bills/hr4373/BILLS-115hr4373ih.pdf; S. 1241, 115th Cong. (2017), https://www.congress.gov/115/bills/s1241/BILLS-115s1241is.pdf.

[54] *See, e.g.*, *Combating Money Laundering and Other Forms of Illicit Finance: Opportunities to Reform and Strengthen BSA Enforcement: Hearing Before the Comm. on Banking, Housing & Urban Affairs*, 115th Cong. (Jan. 9, 2018), *https://www.banking.senate.gov/hearings/combating-money-laundering-and-other-forms-of-illicit-finance-opportunities-to-reform-and-strengthen-bsa-enforcement.*

### 1. The Growth in the Use of PDAs

As explained above, over the last two decades, the number of corporate criminal investigations has increased exponentially. As noted by Jennifer Arlen and Marcel Kahan, "corporate criminal enforcement in the United States has undergone a dramatic transformation,"[55] and the enhanced enforcement efforts brought about a corresponding increase in the number of PDAs.[56] A related explanation for the rise in the use of the PDAs focuses on the Thompson Memo released by the DOJ in 2003, which instructed federal prosecutions to defer prosecution if corporations agreeing to cooperate fully with investigations led by the DOJ, or its agents, "including, if necessary, the waiver of corporate attorney-client and work product protection."[57]

Lastly, the collapse of Arthur Andersen in 2005, as a consequence of the criminal legal proceedings against it,[58] also explains how PDAs have "skyrocketed" since 2005.[59] Chart 2 below illustrates the growing use of PDAs over the last decade:[60]

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[55] Arlen & Kahan, *supra* note 5, at 324.

[56] Recall, that PDAs include both Non Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs). The main difference between them is that whereas a DPA involves the filing of charges in federal court, a NPA does not. *See* Cindy R. Alexander & Mark A. Cohen, *The Evolution of Corporate Criminal Settlements: An Empirical Perspective on Non-Prosecution, and Plea Agreements*, 52 AM. CRIM. L. REV. 537, 545 (2015).

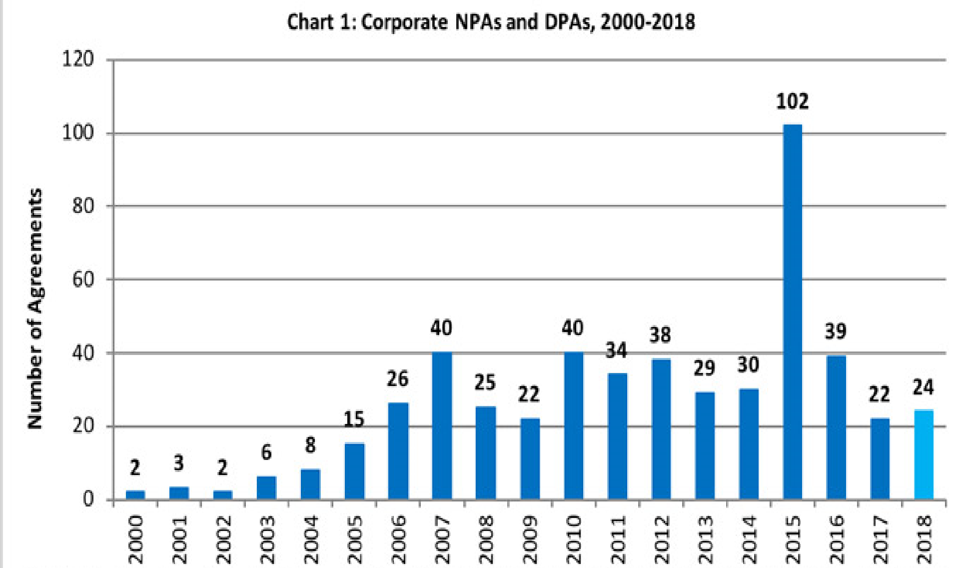
[57] *See* Memorandum from Dep. Atty. Gen. Larry Thompson to United States Attorneys: Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003). *See also infra* notes 129–130.

[58] *See infra* notes 95–97.

[59] Adam S. Zimmerman & David M. Jaros, *The Criminal Class Action*, 159 U. PA. L. REV. 1385, 1407 (2011).

[60] Gibson Dunn, 2018 Year-End update on Corporate Non-Prosecution Agreements and Deferred Prosecution Agreements (Jan. 10, 2019), https://www.gibsondunn.com/2018-year-end-npa-dpa-update/ (hereinafter: "Gibson Dunn-2018"). *See also* Gideon Mark, *Private FCPA Enforcement*, 49 AM. BUS. L. J. 419, 434-5 (2012) ("[I]n the 21st century the use of DPAs 'has evolved rapidly to the point that they are now the primary tool in DOJ's efforts to combat corporate crime.'").

This trend is not unique to the U.S. *See* Peter Reilly, *Sweetheart Deals, Deferred Prosecution, and Making a Mockery of the Criminal Justice System: U.S Corporate DPAs Rejected on Many Fronts*, 50 ARIZ. ST. L.J. 1113, 1140 (2019) (describing the growing use of PDA in other countries, such as Australia, Canada, and the United Kingdom). *See also* Samuel Rubenfeld, *U.K. to Move Forward with Deferred-Prosecution Agreements*, WALL ST. J. (Oct. 23, 2012, 3:14 PM), http://blogs.wsj.com/corruptioncurrents/2012/10/23/uk-to-move-forward-with-deferred-prosecution-agreements/.




*Note: The SEC entered into 10 NPAs and DPAs: 2010 (1), 2011 (3), 2012 (1), 2013 (1), 2014 (1), 2015(1), and 2016 (2).*
*Note: 2015 is an outlier year because of Swiss Bank Program Category 2 agreements.*

Instead of prosecuting cases to a final judgment, enforcement authorities have displayed a preference to enter into PDAs with public companies.[61] Under these pretrial agreements, corporations agree to admit to wrongdoing, pay considerable amounts, sometimes hundreds of millions of dollars,[62] undertake various corrective measures to prevent future lapses in compliance, and in exchange, have the prosecution against them deferred for a certain period of time. If the agreement was performed at the end of that period, the prosecution will be dropped.[63]

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[61] Former head of the DOJ Lanny A. Breuer stated that DPAs had "become a mainstay of white collar criminal law enforcement." Lanny A. Breuer, Assistant Attorney Gen., Dep't of Justice, Address at the New York City Bar Association (Sept. 13, 2012), https://www.justice.gov/opa/speech/assistant-attorney-general-lanny-breuer-speaks-new-york-city-bar-association (last visited June 22, 2019). *See also* Koehler, *supra* note 16, at 515-527 (describing the dominant use of DPAs and NPAs in FCPA enforcement); Julie R. O'Sullivan, *How Prosecutors Apply the "Federal Prosecutions of Corporations" Charging Policy in the Era of Deferred Prosecutions, and What That Means for the Purposes of the Federal Criminal Sanction*, 51 AM. CRIM. L. REV. 29, 77 (2014) ("The biggest change in corporate law enforcement policy in the last ten years has been the plunge in criminal convictions of large organizations, and the DOJ's consistent use of [deferred prosecution] agreements to dispose of criminal wrongdoing."); Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 855 (2007).

[62] Gibson Dunn-2018, supra note 60 (showing how in 2018, in the U.S., "the monetary recoveries skyrocketed to nearly $8.1 billion").

[63] Rachel Delaney, *Congressional Legislation: The Next Step for Corporate Deferred Prosecution Agreements*, 93 MARQ. L. REV. 875, 878 (2009).

The company under investigation and the enforcement authority, typically the DOJ, usually enter into the agreement following an internal investigation led by the company itself with the assistance of a leading audit firm[64] approved by the DOJ, which makes a forensic examination to validate the data obtained from the company's sources. In some cases, the DOJ forces the company to nominate an external monitor to supervise the collection and analysis of the data. This process includes the collection and review of thousands of documents and emails, and, in some cases, millions of pages of documents produced and submitted to the DOJ. Within this process, the company must collect and translate multiple documents, conduct internal interviews, and make representations reflecting the result of the internal investigation to the DOJ. After completing the negotiation, a PDA will be signed.

PDAs characteristically impose burdensome requirements on companies, including the establishment of a sophisticated and comprehensive compliance program,[65] high-level personnel changes such as termination of high, mid, and low level officers,[66] business changes,[67] and the appointment of an external corporate monitor approved by the enforcement authority for the probation period (usually 24 to 36 months).[68]

Also, PDAs include a statement of facts in which the company admits to the offence that it is accused of in a very detailed manner.[69] The admissions included in agreements are described by Richard Epstein as "confessions of

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[64] Typically, the audit company will be one of the "big four," namely, Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers (PwC).

[65] Arlen & Kahan, *supra* note 5, at 342 (pointing out that "from 2008 to 2014, approximately 82 percent of the PDAs entered into by the DOJ Criminal Division or the US Attorneys' Offices imposed compliance program mandates . . . .").

[66] Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993-2013*, 70 BUS. LAW. 1, 34 (2014) (found that out of 271 PDAs executed between 1993 and 2013, 30 percent mandated changes in senior management).

[67] *Id* (found that out of 271 PDAs executed between 1993 and 2013, 30 percent mandated business changes).

[68] Arlen & Kahan, *supra* note 5, at 342 (showing that "from 2008 to 2014 . . . more than 30 percent [of the PDAs entered into by the DOJ Criminal Division or the US Attorneys' Offices] imposed outside monitors . . . ."). *See also* Alexander & Cohen, supra note 56, at 545; Court E. Golumbic & Albert D. Lichy, *The "Too Big to Jail Effect" and the Impact on the Justice Department's Corporate Charging Policy*, 65 HASTINGS L.J. 1293, 1311–12, 1320 (2014); Garrett, *Structural Reform Prosecution*, supra note 61, at 898; Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH L. REV. 1713, 1720-26 (2007); Veronica Root, *The Monitor-"Client" Relationship*, 100 VA. L. REV. 523 (2014).

[69] Arlen & Kahan, *supra* note 5, at 334.

a Stalinist purge trial."[70] The company must state that the facts set forth in the statement of facts are "true" and "accurate" and agree that it shall not, through its attorneys, employees or other agents, make any public statement, in litigation or otherwise, contradicting the statement of facts, as long as they speak on behalf of the company.[71]

The consequences for the directors and officers implicated in the investigation are far reaching and dire. Naturally, the admissions made by the company affect them. To be sure, the admissions of the company do not formally bind the directors and officers, but the attribution of wrongful actions and omissions to corporate officers have profound implications for their career. If the investigation focuses on the acts and omissions of current directors and officers, they can affect to some degree the admissions made by the corporation about their actions or omissions. If, however, the investigation concentrates on the actions and omissions of past directors and officers, they have absolutely no influence on the admissions made by the company. They are not directly involved in the negotiations leading to the PDA and have no say in the process. We will discuss the ramifications of this reality to corporate law and theory in Part III.A.

### 2. The Pressure to Settle

At this point, readers may wonder why powerful corporations sign PDAs. PDAs are essentially plea bargains.[72] There exists a voluminous literature that explains the motivation of individuals to enter plea bargains. Many individual defendants simply do not have the financial resources to fight the charges facing them. Corporations, especially public ones, clearly do not have this problem. So why sign? Although it is true that in the typical case corporations have superior financial resources to individuals, one cannot infer from this fact that corporations can afford a prolonged legal battle against the state or that it is in their best interest to do so. For the reasons we will explain below, corporations, too, have a very strong incentive to settle. It is no accident that a considerable number of criminal investigations against corporations end in an agreement.

Corporations have a clear preference to enter into a PDA with the enforcement authorities due to a combination of legal and economic reasons.

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[70] Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J. Nov. 28, 2006 ("The agreements often read like the confessions of a Stalinist purge trial, as battered corporations recant their past sins and submit to punishments wildly in excess of any underlying offense. . . . [Their use] erodes the most elementary protections of the criminal law, by turning the prosecutor into judge and jury, thus undermining our principles of separation of powers.").

[71] Brandon L. Garrett, *Corporate Confessions*, 30 CARDOZO L. REV. 917, 925 (2009).

[72] For a detailed discussion of the differences between PDAs and plea agreements, *see* Section II.B.3.

Begin with the *legal reasons*, imposing criminal liability on a corporation is easier than successfully prosecuting individuals. Unlike the case with individuals where all elements of the offense must be performed by one individual, in the case of corporations, the elements may be provided by different corporate agents. As a consequence, a corporation can be charged with a criminal offense even if none of its employees can be accused of the offense. The law employs two doctrines to create this result. First and foremost, when the DOJ chooses to charge a company with a violation of a federal statute, it is going to largely rely on the doctrine of *respondeat superior*. Under this doctrine, the company may be found liable for acts of its employees if they were acting within the scope of their authority at least in part for the benefit of the corporation.[73]

This doctrine has been construed in a very broad manner by the courts. First, the *respondeat superior* doctrine enables the imposition of liability on the company, regardless of the position of the employee who violated the law.[74] Second, under this doctrine, a company may be held liable "even if an employee is violating express corporate policy."[75] Third, the requirement that the employee acted within the scope of his authority has been "defined to mean 'in the corporation's behalf in performance of the agent's general line of work,' including 'not only that which has been authorized by the corporation, but also that which outsiders could reasonably assume the agent would have authority to do.'"[76] Fourth, when examining whether the employee acted with the intent to benefit the company, it is the intent that matters, rather than the actual benefit for the company.[77] Interestingly, it is no defense that the employee acted primarily for his personal benefit,[78] except when it could be proven that the employee acted exclusively for his own benefit.[79]

The second doctrine that may be used by the DOJ is the collective knowledge doctrine. This doctrine makes it possible to impose criminal

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[73] New York Central & Hudson River Railroad v. United States, 212 U.S. 481 (1909); United States v. Singh, 518 F. 3d 236, 249-50 (4th Cir. 2008); United States v. Potter, 463 F.3d 9, 25 (1st Cir. 2006); Unites States v. Jorgensen, 144 F.3d 550, 560 (8th Cir. 1998); Unites States v. Sun Diamond Growers, 138 F.3d 961 (D.C. Cir. 1998).

[74] Standard Oil Co. of Tex. v. United States, 307 F.2d 120, 127 (5th Cir. 1962) ("[C]orporation may be criminally bound by the acts of subordinate, even menial, employees."). *See also* U.S. v. Dye Const. Co., 510 F.2d 78, 82 (10th Cir. 1975); U.S. v. Ionia Management S.A., 555 F.3d 303, 309–310 (2d Cir. 2009).

[75] City of Vernon v. S. California Edison Co., 955 F.2d 1361, 1369–70 (9th Cir. 1992).

[76] U.S. v. Hilton Hotels Corp., 467 F.2d 1000, 1004 (9th Cir. 1972); U.S. v. Automated Medical Laboratories, Inc., 770 F.2d 399, 407 (4th Cir. 1985).

[77] U.S. v. Automated Medical Laboratories, Inc., 770 F.2d 399, 407 (4th Cir. 1985).

[78] U.S. v. Sun-Diamond Growers of California, 138 F.3d 961, 970–71 (D.C. Cir. 1998).

[79] Standard Oil Co. of Tex. V. United States, 307 F.2d 120, 129 (5th Cir. 1962); U.S. v. Automated Medical Laboratories, Inc., 770 F.2d 399, 407 (4th Cir. 1985).

liability on corporations, even in cases where no individual has committed all the components of the offense.[80] Under this doctrine, the knowledge and conduct of multiple employees can be imputed, in aggregation, to the company.[81] In this way, courts can impose criminal liability on the company even if no individual employee had the mens rea necessary to prove the offense.[82] Taken together, the *responeat superior* doctrine and the collective knowledge doctrine make companies much more vulnerable to criminal convictions, compared to individuals.[83]

*The business reasons* to sign a PDA are even weightier. Once the company is accused of violating the law, not to mention convicted, it must invariably expend valuable resources on the investigation and incur significant losses. The expenses accumulate as the investigation continues. Hence, the company has an inherent incentive to close the investigation.
The opening of an investigation requires the firm to allocate managerial and legal resources to the matter. The investigation comes on top of the company's standard business, which means that the company must employ its human capital in a different way to address the exigencies posed by the investigation.[84] But this is only the beginning of the company's ordeal.

Because enforcement authorities condition entering into a settlement on full cooperation on the part of the company, and give companies credit for cooperating with the investigating authorities, which comes in the form of a reduced fine, corporations have a strong incentive to pay law firms to conduct

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[80] United States v. Bank of New Eng., N.A., 821 F.2d 844, 855–856 (1st Cir. 1987); United States v. T.I.M.E.-D.C., Inc., 381 F. Supp. 730, 738 (W.D. W.Va. 1974).

[81] *Id.* ("Corporations compartmentalize knowledge, subdividing the elements of specific duties and operations into smaller components. The aggregate of those components constitutes the corporation's knowledge of a particular operation. It is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation.").

[82] Patricia S. Abril & Ann Morales Olazabal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81, 114–115 (2006).

[83] *Developments in the Law, Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1248 (1979) ("Thus, proving that a corporate defendant committed the illegal act is in practice substantially easier than an individual prosecution. Courts have also found the requirement of corporate criminal intent satisfied where no agent's criminal intent has been shown. Corporations have been convicted of crimes requiring knowledge on the basis of the 'collective knowledge' of the employees as a group, even though no single employee possessed sufficient information to know that the crime was being committed.").

[84] *See, e.g.*, Olaf Storbeck, *Deutche Bank Investors Fear Criminal Probe Will Hinder Turnaround*, FINANCIAL TIMES (December 3, 2018), https://www.ft.com/content/03d9685c-f632-11e8-af46-2022a0b02a6c ("Investors in Deutche Bank are concerned that the criminal investigation into the suspected money laundering activities of the lender's wealth management unit will make it harder for chief executive Christian Sewing to execute his crucial turnaround agenda.").

an internal investigation within the firm and report the findings to the DOJ or SEC.[85] Since firms are under enhanced scrutiny at this point, they must ensure that the internal investigation is comprehensive and uncompromising. Firms are expected to provide full access to privileged materials, even those that come under the attorney-client privilege,[86] and align "their interests with those of" DOJ or SEC's attorneys.[87]

In global companies, the cost of conducting the said investigation runs in hundreds of millions of dollars.[88] If ultimately no agreement is reached with the enforcement authorities, the resources spent on the investigation will be wasted. Hence, once a decision on an internal investigation is made, the company will try its best to sign a PDA.

In addition to the direct costs of the investigation, criminal enforcement inflicts indirect costs on firms in the form of reputational harm,[89] loss of

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[85] *See, e.g.*, MIKE KOEHLER, THE FOREIGN CORRUPT PRACTICES ACT IN A NEW ERA 183 (2014) ("The above general framework best demonstrates the 'carrots' embedded in the [Sentencing] Guidelines . . . In short, a company subject to FCPA scrutiny will receive a lower culpability score based on voluntary disclosure, cooperation and acceptance of responsibility, which then yields a lower multipliers, which then yields a lower fine range."). The dynamic described by Professor Koehler is relevant not just related to FCPA investigations but to all investigations. *See also* Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 316–18 (2007) (describing the approach of enforcement authorities, which leads to a very tight relationship between calculation of fines and the level of cooperation provided by companies, as "carrots" and "sticks").

[86] *Infra* notes 129–130.

[87] *See* Lawrence A. Cunningham, *Deferred Prosecutions and Corporate Governance: An Integrated Approach to Investigation and Reform*, 66 FLA. L. REV. 1, 33 (2015) (explaining how AIG cooperated with the then New York Attorney General Mr. Eliot Spitzer).

[88] *See supra* note 15.

[89] *See* Brandon L. Garrett, *Structural Reform Prosecution*, supra note 61, at 855 ("Organizations feared the catastrophic punitive fines and severe reputational consequences of a conviction—what one court described as a 'matter of life and death'"). *See also* Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. QUANT. ANAL. 581 (2008) (examining 585 companies that were targeted by the SEC enforcement actions for financial misrepresentation from 1978 through 2002 and revealing that these companies lose 38 percent of their market value after news of their misconduct was reported); Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, J. L. & Econ. 757, 759 (1993) (using data on 132 cases of corporate fraud between 1978 and 1987 to find that the loss in value of common stock of affected companies after "initial press reports of allegations or investigations of corporate fraud against . . . government agencies . . . is 5.05 percent, or $40.0 million."); David M. Uhlmann, *Deferred Prosecution and Non-Prosecution Agreements and the Erosion of Corporate Criminal Liability*, 72 MARYLAND L. REV. 1295, 1335–6 (2013) (". . . Perhaps most significantly of all, criminal prosecution has a stigmatizing effect . . . ." ).

business opportunities and an increased civil litigation risk.[90] The first two costs are distinct, but related. A criminal investigation can irreversibly tarnish the reputation of a firm, causing it to lose much of its hard-earned goodwill. It creates a cloud of doubt that hovers over the operation of the firm, making it difficult for the firm to attract new capital and to maintain its client base.[91]

The constant press coverage that accompanies the investigation often augments the concerns about the stability of the company and casts doubt on its future.[92] This, in turn, makes it harder for the company to pursue new business opportunities. It also forces the company to funnel resources into the maintenance of business relationships. Once word of the investigation goes out, financial institutions, suppliers, employees and business partners that depend on the suspect firm will seek additional information about its future and may demand assurances of its long-term sustainability.[93] In parallel, they may pursue other business opportunities that they deem safer.[94]

An often-cited example that demonstrates these threats is the case of Arthur Andersen.[95] The story began in 2002, when Andersen was charged

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[90] *See* Greenblum, supra note 11, at 1885 ("Collateral consequences facing corporations convicted of a felony are perhaps just as diverse, though more detrimental, than those that attach to individuals. Corporations can be debarred from government contracting and have their professional license revoked."). *See also* Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution In a Post-Enron World: The Thompson Memo In Theory and Practice*, 43 AM. CRIM. L. REV. 1095, 1165 (2006) ("'For health care providers . . . who rely extensively on federal programs for reimbursement, exclusion is the equivalent of a corporate death penalty.' The authority to impose this powerful sanction lies with the U.S. Department of Health & Human Services' Office of Inspector General . . . . Because a number of health care convictions trigger mandatory exclusion, companies facing criminal investigation in this [healthcare] industry necessarily focus on this derivative danger.").

[91] *See* Uhlmann, *supra* note 89, at 1264 ("Reputational harm can discourage investment in a company").

[92] *See* Jamie L. Gustafson, Cracking Down on White-Collar Crime: An Analysis of the Recent Trend of Severe Sentences for Corporate Officers, 40 SUFFOLK U. L. REV. 685, 697 (2007) ("[P]ublic interest in corporate scandal spiked as a result of the media coverage."). Moreover, such an increase in public attention has been translated into an "understanding, thoughtful outcry against white-collar crime." Jonathan D. Glater, *Mad as Hell: Hard Time for White-Collar Crime*, N.Y. TIMES (July 28, 2002) https://www.nytimes.com/2002/07/28/weekinreview/ideas-trends-mad-as-hell-hard-time-for-white-collar-crime.html?mtrref=www.google.com&gwh=5A73D4320BBB42965489EFA5A8070E28&gwt=pay.

[93] Koehler, *supra* note 16, at 510 ("A criminal investigation and indictment alone could have enormous adverse consequences even if a company were ultimately acquitted at trial.")

[94] *See id.*, at 1264-65 ("Reputational harm also can hamper relationships in the broader business community.")

[95] *See* Cindy A. Schipani, *The Future of the Attorney-Client Privilege in Corporate Criminal Investigations*, 34 DEL. J. CORP. 921, 925-927 (2009). *See also* Elizabeth K. Ainslie, *Indicting Corporation Revisited: Lessons of the Arthur Andersen Prosecution*, 43

with a count of obstruction of justice, related to its auditing of Enron. Andersen was accused of destroying documents in order to impede the investigation of Enron, which was led by the Securities and Exchange Commission (SEC). The district court convicted Andersen and the Court of Appeals for the Fifth Circuit affirmed the conviction. Finally, in 2005 the Supreme Court of the United States reversed Andersen's conviction, but it was too late. In 2002, Andersen lost its Certified Public Accountants' license (since the SEC does not accept audits from convicted firms), and in 2005, although the Supreme Court reversed the conviction, Andersen had no chance to reclaim its title of one of the "big five" accounting firms.[96] The dire consequences of the investigation and conviction were described in 2002 by Eric Holder, who served as the Attorney General of the United States between 2009 and 2015:

> "Nevertheless, for a firm that trades on its reputation, and that was already facing an exodus of clients, the effect of the indictment and conviction was close to a death sentence. Thousands of innocent employees now find themselves out of jobs and, for no good reason, their professional reputations scarred. The survival of Andersen itself is in great doubt. Is this an appropriate outcome? I'm not sure."[97]

The story of Arthur Anderson demonstrates why entering into a PDA with the enforcement authorities as quickly as possible is the top priority of firms. Companies under a criminal investigation must strive to reach a settlement at all cost; waiting is simply not a viable option for most firms, even if it can ultimately lead to acquittal. The market reaction to a criminal investigation against a firm can be harsher than any legal punishment it may face. Dragging out the investigation is a losing strategy from every aspect. The longer the investigation, the higher the price for a company in terms of lost business opportunities. All the while, the legal expenses continue to add up. Hence,

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AM. CRIM. L. REV. 107, 109 (2006); Golumbic & Lichy, *supra* note 68, at 1306-8; Peter J. Henning, *The Organizational Guidelines: R.I.P.?*, 116 YALE L. J. POCKET PART 312, 314 (2007); Lawrence D. Finder & Ryan D. McConnell, *Devolution of Authority: The Department of Justice's Corporate Charging Policies*, 51 ST. LOUIS U. L.J. 1, 14-15 (2006).

[96] *Id*.

[97] Eric Holder, *Don't Indict WorldCom*, WALL ST. J., July 30, 2002, at A14. *See also* Alex B. Heller, *Corporate Death Penalty: Prosecutorial Discretion and the Indictment of SAC Capital*, 22 GEO. MASON. L. REV. 763, 763-64 ("In Andersen's case, the indictment alone was a corporate death sentence, even before adjudication. The Anderson case and the lessons learned in its aftermath have been regarded as a turning point in government decisions to charge corporate offenders, especially in the financial services industry.").

the company faces a reality in which its resources are dwindling, while its expenses are mounting.

From both perspectives, the best response to a criminal investigation is to strive to settle it expeditiously, almost at all cost. The alternative, as the story of Arthur Anderson reminds us, may be the demise of the corporation. The desire to settle makes perfect sense for the company, but for the reasons we will explain in Section III below, it comes at a dear price for the individual directors and officers.

### 3. Plea Agreements

Similar dynamics that characterize PDAs also arise, albeit to a lesser extent, in the context of plea agreements.[98] In parallel to the increase in the use of PDAs, classic corporate plea agreements continue to be a useful tool for enforcement authorities.[99] The main difference between PDAs and plea agreements is that under a plea agreement the defendant is convicted of a crime, whereas under a DPA or an NPA, the defendant is not convicted of any crime.[100]

Furthermore, there are additional differences, as well. First, courts have a potentially more significant role in overseeing plea agreements. Granted, both plea agreements and DPAs may require court approval. Yet, there is a difference between a court's role in reviewing DPAs and its role in evaluating plea agreements. As stated by Judge Srinivasan of the D.C. Circuit in the famous case of Fokker: "the context of a DPA is markedly different. Unlike a plea agreement—and more like a dismissal under Rule 48(a)—a DPA involves no formal judicial action imposing or adopting its terms."[101] It should be added that unlike

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[98] Alexander & Cohen, *supra* note 56, at 538.

[99] *Id*., at 562 (reporting that 486 corporate criminal settlements were signed between 1997 and 2011 by the DOJ and public companies (or their affiliates), and 329 of these settlements were plea agreements). *See also* Data & Documents, CORPORATE PROSECUTION REGISTRY, http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/browse/browse.html (set "U.S. Public Company?" field as "Yes" and then search Disposition Type field for "DP," "NP," and "plea.") (reporting that 361 corporate criminal settlements were signed between 1992 and 2019 by federal agencies and public companies, among which 167 are plea agreements).

[100] *See* Greenblum, *supra* note 11, at 1869 ("A guilty plea [in plea bargaining] results in a conviction and collateral consequences attach no differently than if the offender had been convicted in a trial." (citation omitted)); Cindy R. Alexander & Jennifer Arlen, *Does Conviction Matter? The Reputational and Collateral Effects of Corporate Crime*, *in* RESEARCH HANDBOOKS IN CORPORATE LAW AND GOVERNANCE SERIES (Jennifer Arlen eds., 2018), ("DPAs lack the stigmatizing effect of a corporate conviction"); Cindy R. Alexander & Yoon-Ho Alex Lee, *Non-Prosecution of Corporations: Toward a Model of Cooperation and Leniency*, 96 N.C. L. REV. 859, 862 (2018) ("Because neither the NPA nor the DPA entails the corporate defendant pleading guilty, we refer to them as non-plea settlements.")

[101] United States v. Fokker Services B.V., 818 F.3d 733, 746 (D.C. Cir. 2016). *See also*, *Id.* at 744-5 ("Whatever may be the precise contours of that authority of a court to confirm

DPAs, NPAs, the other type of PDAs, do not require court approval and do not come under judicial scrutiny at all, even though they too contain broad admissions of guilt by firms. The weakened role of judicial oversight in PDA takes away some of the bargaining power wielded by law enforcement authorities in negotiations of plea agreements.[102]

Second, in the case of plea agreements, some or much of the fact finding is done by the court, depending on the stage at which the plea agreement is entered. This may ameliorate the tendency of enforcement agencies to attribute blame to a large group of directors and officers collectively and indiscriminately, without even referring to them by name.

Third, indeed, both plea agreements and PDAs include factual admissions and waiver of rights. Still, as reported by Cindy R. Alexander and Mark A. Cohen in their empirical study, PDAs are more likely than plea agreements to include requirements to waive privilege.[103] Finally, "over 91% of DPAs and 79% of NPAs are found to require an agreement to the admissibility of a statement of facts and prior testimony or statements, compared to 38% of all plea agreements."[104]

Despite these differences, PDAs and plea agreements put companies under enormous pressure to please the relevant enforcement authorities in order to avoid a catastrophic result for the company. Toward this end, corporations are willing to disregard the interests of present, especially past employees, making them scapegoats for the company's failure and not going into the trouble of distinguishing among those who sinned and those who did not. This gives rise to the reverse agency problem.

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that a DPA's conditions are aimed to assure the defendant's good conduct, it does not permit the court to impose its own views about the adequacy of the underlying criminal charges."); *Criminal Law—Separation of Powers—D.C. Circuit Holds That Courts May Not Reject Deferred Prosecution Agreements Based on the Inadequacy of Charging Decisions or Agreement Conditions*, 130 HARV. L. REV. 1048, 1055 (2017); James M. Anderson & Ivan Waggoner, *The Changing Role of Criminal Law in Controlling Corporate Behavior*, THE RAND CORPORATION 62 (2014), https://www.rand.org/pubs/research_reports/RR412.html ("But because DPAs and NPAs are typically negotiated and executed prior to the indictment, there is no judicial oversight over the terms of such agreements, so prosecutors do not have to worry about the risk of a judge rejecting a plea agreement or the terms of probation."); Epstein, *supra* note 70 ("[DPA agreements can] turn[] the prosecutor into judge and jury, thus undermining our principles of separation of powers."); Peter R. Reilly, *Corporate Deferred Prosecution as Discretionary Injustice*, UTAH. L. REV. 839, 871 (2017) ("district courts have a long history of competently reviewing plea agreements."). *But see* Darryl Brown, *The Judicial Role in Criminal Charging and Plea Bargaining*, 46 HOFSTRA L. REV. 63 (2017) (explaining how judge play a passive role in approving plea agreements).

[102] Reilley, *supra* note 101, at 869 ("in the context of a DPA, the prosecutor gets to control all those checks and balances that in trials or plea agreements would be controlled by judges, juries, and the watching public").

[103] Alexander & Cohen, *supra* note 56, at 587.

[104] *Id*.

## III. THE REVERSE AGENCY PROBLEM

Companies' desire to reach a settlement with enforcement authorities gives rise to a hitherto unobserved phenomenon, which we call "the reverse agency problem." For the reasons we detailed in Part II, companies under a criminal investigation are willing to sacrifice their directors and officers in order to reach a quick settlement that will bring the investigation to a close. The reverse agency problem is the mirror image of the famous managerial agency problem identified by Berle and Means. Berle and Means observed that the structure of public corporations allow directors and officers to promote their narrow self-interest at the expense of the shareholders.[105] This insight has had an unparallel impact on corporate law scholarship and it is undeniably correct for corporations in the ordinary course of business.

The opening of a criminal investigation against the firm gives rise to a new agency problem. In order to save the corporation and its shareholders from a long criminal prosecution process and a severe sanction at the end of it, corporations are willing to admit to wrongdoing in order to cut their losses and put the investigation behind them.[106] En route to this result, corporations are willing to attribute various acts and omissions to their directors and officers, as required by the law enforcement agencies. We do not criticize this behavior. It is perfectly rational. More importantly, settlements maximize value for the shareholders.[107] Yet, it comes at hefty price for the directors and officers, and often other employees, who are expected to take one for the team and live with the consequences of the settlement.

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[105] *See* discussion, *infra*, text accompanying note 114.

[106] *See* Richard Cassin, *What's Wrong With Corporate Criminal Liability?*, THE FCPA BLOG (Jan. 7, 2009, 7:02 PM), http://www.fcpablog.com/blog/2009/1/8/whats-wrong-with-corporate-criminal-liability.html ("That way, organizations threatened with criminal prosecution might feel less compelled to rush into settlements with the DOJ that 'sell out individuals within the company.'"); Paul J. Larkin, Jr. & John-Michael Seibler, *All Stick and No Carrot: The Yates Memorandum and Corporate Criminal Liability*, 46 STETSON L. REV. 7, 31 (2016) ("[C]orporations have gone along with the government's proposal because the alternative—a conviction—can amount 'to a virtual death sentence for business entities.'").

[107] *Compare* Cunningham, *supra* note 87, at 20 (explaining how "[f]rom the perspective of economic theory, the adverse collateral consequences [of corporate conviction] are essentially negative externalities, and DPAs are designed to avoid those."), *with* the argument that settlement under pressure may harm shareholders, such as Jenny Anderson, *A.I.G. Is Expected to Offer $1.6 Billion to Settle With Regulators*, THE N.Y. TIMES (Feb. 6, 2006) (last visited June 20, 2019) (providing the statement of Howard Opinsky, a spokesman for Maurice R. Greenberg, who served as the Chairman and CEO of AIG that settled in 2005 with the SEC for $1.6 Billion: "Shareholders lose when companies choose to settle investigations motivated by political ambition, fueled by threats and settled out of fear … Even if all the allegations were to be believed, a settlement of this magnitude is merely a political trophy for the attorney general and totally disproportionate to the impact of the alleged misconduct.").

As we will show, these consequences are severe. Critically, the admissions implicating corporate officers should not be presumed to be accurate. They are merely a means to secure a settlement with the law enforcement authorities.[108] The directors and officers who are subject to the agreement and its statement of facts, often do not have a say in the negotiation process and even when they do, their voices get muffled.[109] The interest of the shareholders takes precedence over the directors' and officers'. For this reason, we decided to dub this conflict of interest "the reverse agency problem." In the paragraphs to come, we will explore the effects of criminal investigations, in general, and settlements, in particular, on corporate agents and highlight the dynamics and costs resulting therefrom.

If the investigation results in an agreement or an indictment, the company involved is likely to face demands from shareholders to file civil actions against the directors and officers implicated in the investigation.[110] The facts stated in the agreement or in the indictment provide a fertile ground for the filing of derivative suits against the directors and officers. After all, they contain long and detailed descriptions of wrongdoing by the company's employees and managers, and oversight failure by the directors.

The company can respond to such demands in one of three ways. First, it can accept them — at least in part — and bring actions against the relevant directors and officers for breaching their fiduciary duties. Second, it can set up a special litigation committee to investigate the matter and make recommendations to the board of directors.[111] Finally, it can refuse to take any legal action against the directors and officers. Refusal to concede to these demands invariably leads to the filing of derivative actions against the said directors and officers.[112]

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[108] Section II.B.2.

[109] Recall, again, how Professor Richard Epstein described the PDAs as "confessions of a Stalinist purge trial." *Supra* note 70.

[110] *See* Westbrook, *supra* note 26, at 1227. *See also* Mark, *supra* note 60, at 446 ("Beginning in 2006 or so, the stepped-up enforcement of the FCPA by the DOJ and SEC has sparked a corresponding increase in collateral civil litigation predicated on facts alleged by the federal government in enforcement actions."). It should be noted that sometimes the mere announcement of a criminal investigation can trigger the filing of derivative actions.

[111] *See, generally*, Minor Myers, *The Decision of the Corporate Special Litigation Committees: An Empirical Investigation*, 84 IND. L.J. 1309 (2009); C. N. V. Krishnan, Steven Davidoff Solomon & Randall S. Thomas, *An Empirical Study of Special Litigation Committees* (Mar. 2019),https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3053449.

[112] Of course, there are also costs for the firm. Although the main target of derivative actions are the directors and officers, not the company itself, they represent an unwelcome development for the company. It must be understood that the filing of a derivative action constitutes a serious distraction from the perspective of the company. If it is filed against present directors and officers, it prevents them from focusing exclusively on the affairs of the company. *See supra* note 84. Furthermore, since directors and officers are typically

### *A. When Directors and Officers Come Second*

It is impossible to overestimate the role of agency problems in corporate law.[113] There exists a broad consensus among theorists and lawmakers that a principal goal of corporate law is to mitigate agency problems, first and foremost those exist between shareholders and managers. In a landmark contribution, Berle and Means noted that the separation between ownership and management, the hallmark of modern corporations, presents many advantages, but it also has a downside: it raises a risk that management would transfer wealth from the shareholders to its members.[114]

Subsequently, scholars have pointed out the existence of other types of agency problem, i.e., conflicts of interest that are endemic to corporations. Another type of agency problem noted by corporate scholars is the tension between shareholders and creditors, with the former who are residual value claimants willing to take risks to maximize reward, while the latter who have a fixed claim preferring a much lower level of risk, if any.[115] Then, scholars observed a third type of agency problem that exists between majority shareholders and minority shareholders. [116] This problem focuses on the ability of majority shareholders to enrich themselves at the minority's expense by forcing management to play along with this plan. Finally, Ronald Gilson and Jeffrey Gordon have identified yet another type of agency problem that arises between institutional investors and standard shareholders. In this case, the misalignment of interests arises from the different investment strategies of the two groups and their willingness to actively engage the management of companies in which they invest.[117]

Our goal is to add to the canon of agency problems by drawing attention to the reverse agency problem that is gaining prominence in the compliance age. The reverse agency problem arises in the context of the enforcement actions against corporations. To reach an expedient resolution, corporations are willing to accede to the demands of the law enforcement authorities. Reaching a settlement is in the best interest of all parties involved. From the vantage point of the law enforcement authorities, settlements save scarce

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entitled to reimbursement of their legal expenses, it is the company that ends up footing the legal bills. Finally, the filing of derivative actions further harms the reputation of the company and hobbles its ability to do business.

[113] *See, e.g.*, Goshen & Squire, supra note 2, at 769 ("For the last forty years, the problem of agency costs has dominated the study of corporate law and governance.").

[114] *See* references in *supra* notes 1–2.

[115] John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29-30 (Reinier Kraakman et al. eds., 3rd. ed., 2017).

[116] *Id.*, at 29-30. *See also* Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22 (2000).

[117] *See* Gilson & Gordon, *supra* note 2.

resources and allow the initiation of additional enforcement actions against other firms.[118] From the perspective of firms, the sooner an investigation ends, the better.

Settling the case means dramatic cost savings for the firm, relative to the option of indictment.[119] It also frees up the company's human resources, allowing the company to focus exclusively on its business.[120] Finally, it removes a cloud of uncertainty from the firm,[121] and signals to the market that the company has gotten back on track.[122]

The consequences of a settlement are very different for the company's employees and officers who were implicated in the investigation. The opening of a criminal investigation is like the opening of a Pandora's box: it will certainly change the lives of the individual directors, officers and employees implicated for the worse, by imposing two major costs on them.

First, their correspondence, documents and actions will be scrutinized and analyzed for evidence of wrongdoing. Although this is a necessary measure, it exposes the inner world of business organizations and the materials that were presumed to be private.

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[118] United States Attorneys' Manual § 9-22.010. ("The major objectives of pretrial diversion are . . . [T]o save prosecutive and judicial resources for concentration on major cases"). *See also* Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?,* 105 MICH L. REV. 1713, 1730 (2007); Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 901 (2007); Christie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?* 34 J. CORP. L. 679, 680-1 (2009).

[119] As Judge Kaplan stated in the case of KPMG: "Many companies faced with allegations of wrongdoing and under intense pressure to avoid indictment, as an indictment—especially of a financial services firm—threatens to destroy the business regardless of whether the firm ultimately is convicted or acquitted." U.S. v. Stein, 440 F. Supp. 2d 315, 338 (S.D.N.Y. 2006).

[120] *See, e.g.*, Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 272 & n. 27 (1986); A.F. Conard, *Winnowing Derivative Suits Through Attorneys Fees*, 47 L. CONT. PROB. 269, 271 ("A less conspicuous but equally immediate cost of the derivative suit will be consumption of the time of the corporate officers and directors and their staffs and their consequent diversion of their best efforts from production and distribution."). Interestingly, courts permit boards of public companies and special litigation committees appointed by the boards to take into account, when considering a demand for a derivative suit, also the time that corporate managers and directors will spend if participate in a trial. *See, e.g.*, Joy v. North, 692 F.2d 880 (2d Cir. 1980).

[121] It is worth noting that "[I]n reality, it would almost never be possible to predict lost business from reputational damage . . . ." David M. Uhlmann, *The Pendulum Swings, Reconsidering Corporate Criminal Prosecution*, 49 UC DAVIS L. REV. 1235, 1254-5 (2016).

[122] *See* Brandon Garett, *International Corporate Prosecutions*, *in* THE OXFORD HANDBOOK OF CRIMINAL PROCESS (Darryl K. Brown, Jenia I. Turner & Bettina Weisser eds. 2019) ("[R]epresentatives of companies sometimes also prefer a swifter conclusion to a case to minimise the reputational risks to their corporation.").

The famous case of KPMG [123] is illustrative. In 2003, the DOJ launched a criminal investigation against KPMG and many of its employees concerning the designing, marketing and implementing of illegal tax shelters. The DOJ took full advantage of KPMG's vulnerability, pitting the company against its own employees, as described at length in Judge Kaplan's decision:

> "The government took full advantage. It sought interviews with many KPMG employees and encouraged KPMG to press the employees to cooperate. Indeed, it urged KPMG to tell employees to disclose any personal criminal wrongdoing. When individuals balked, the prosecutors told KPMG. In each case, KPMG reiterated its threat to cut off payment of legal fees unless the government were satisfied with the individual's cooperation. In some cases, it told the employees to cooperate with prosecutors or be fired. The government obtained statements, commonly known as proffers, from nine KPMG employees who now are defendants here (the 'Moving Defendants'). . . Having considered the evidence, the Court is persuaded that the government is responsible for the pressure that KPMG put on its employees. It threatened KPMG with the corporate equivalent of capital punishment. KPMG took the only course open to it."[124]

Judge Kaplan proceeded to state that the use of the Thompson Memo by prosecutors has produced "the exertion of enormous economic power by the employer upon its employees to sacrifice their constitutional rights." [125] Ultimately, the court suppressed many of the statements made by the individual employees of the KPMG, finding that they were obtained in violation of the Fifth Amendment.[126]

The case of KPMG is not an outlier or an isolated example; on the contrary, it is highly representative of the DOJ's policy. Eastern District of New York Judge John Gleeson noted in the oft-cited case of HSBC that:

> "Recent history is replete with instance where the requirements of such cooperation have been alleged and/or held to violate a company's attorney-client

[123] U.S. v. Stein, 440 F. Supp. 2d 315 (S.D.N.Y. 2006).
[124] *Id*., at 318 – 319.
[125] *Id*., at 337.
[126] *Id*., at 338.

> privilege and work product protections, or its employees' Fifth or Sixth Amendments rights."[127]

This concern of violation of employees' Fifth Amendments rights in the context of criminal investigation within the firm has attracted also the attention of the academia.[128] Legal counsels also voiced serious concerns about the "culture of waiver" adopted by the DOJ.[129] The DOJ itself acknowledged that:

> "The Department's policy with respect to privilege waivers became the subject of intense lobbying of Congress by the defense bar and the business community over the next few years. The American Bar Association, the U.S. Chamber of Commerce, and the National Association of Manufacturers decried what they claimed was a 'culture of waiver,' in which prosecutors almost

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[127] United States v. HSBC Bank USA, N.A., No. 12-CR-763, 2013 WL 3306161, at *6 (E.D.N.Y. July 1, 2013). Judge Gleeson added that: "[F]or nearly ten years – from 1999 to 2008 – the Department of Justice's corporate charging policies, as articulated in the Holder, Thompson, McCallum, and McNulty Memos, emphasized the importance of corporate cooperation, including a willingness to waive the attorney-client and work product protections[;]" that "The DOJ's corporate charging policies, as articulated in the Holder and Thompson Memos, also instructed federal prosecutors to consider the extent to which a cooperating company makes witnesses available to the government [;]" and that "the DOJ's corporate charging policies, as articulated in the Holder and Thompson Memos, also instructed federal prosecutors to consider a company's advancing of legal fees to employees, except as required by law, as potentially indicative of an attempt to shield culpable individuals, and therefore a factor weighing in favor of indictment of the company." *Id.*, at note 10–12.

[128] *See, e.g.*, Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613, 1634-5 (2007) ("If firms are to require their agents to say what they know, some reason must be given to induce the agent to speak. The reason can only be what rests within the firm's control: denial of the compensation or employment that the firm confers upon the employee."); T.H. Waters III, *Between a Rock and a Hard Place: An Examination of a 'Costly' Right to Silence for Corporate Employees in Criminal Investigations*, 25 REV. LIT. 603, 605-6 (2006) ("The leverage gained from the corporation's compliance forces the employee to cooperate or risk losing her job.").

[129] Statement of the Coalition to Protect the Attorney-Client Privilege, Submitted to the U.S. Senate Judiciary Committee, Regarding Hearings on Coerced Waiver of the Attorney-Client Privilege: The Negative Impact for Clients, Corporate Compliance, and the American Legal System (September 12, 2006) ("Almost 75% of both inside and outside counsel who responded to this question expressed agreement (almost 40% agreeing strongly) with a statement that a 'culture of waiver' has evolved in which governmental agencies believe it is reasonable and appropriate for them to expect a company under investigation to broadly waive attorney-client privilege or work product protections.").

> immediately demanded privilege waivers upon initiation of an investigation."[130]

Second, the opening of a criminal investigation casts a heavy shadow on the integrity and reputation of the board and management of the suspect firm. This effect is unavoidable. The moment an investigation is announced, the directors and top managers have to deal with a whirlwind of rumors and suspicions that are kept alive by constant media coverage, as well as stories on blogs and social media.[131] These rumors and suspicions cannot be easily set aside or disproved.[132]

It is important to understand that the announcement of an investigation marks the beginning of the Via Dolorosa of the individuals implicated. Naturally, the investigation may lead to three possible outcomes: a finding of no wrongdoing, a settlement, or an indictment. Needless to say, the best

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[130] James McMahon, *Attorney-Client Privilege in the Corporate Setting*, 64 UNITED STATES ATTORNEY'S BULLETIN 1, 3 (July 2016). As the bulletin explains, "[w]ith the August 2008 release of the Principles of Federal Prosecution of Business Organizations—known informally as the Filip Memo—federal prosecutors, under most circumstances, are no longer permitted to ask a cooperating corporation or entity to waive its attorney-client or work product privileges as part of its cooperation." *Id.*, at 1. However, in 2015, the DOJ issued the Yates Memo, which requires a company to disclose "all relevant facts relating to the individuals responsible for the misconduct" for the company "to be eligible for any cooperation credit." Yates Memo, *supra* note 8. *See also* Gideon Mark, *The Yates Memorandum*, 51 UC DAVIS 1589, 1602 (2018) ("Nevertheless, the consensus of the defense bar was that the Filip Memorandum did not cure the waiver problem created by prior Memoranda, with the result that counsel would often be forced to risk waiver in order to avoid an adverse DOJ action.").

[131] Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 INDIANA L. J. 473, 501 (2006) ("Upon observing an instance of entity fault for criminality, persons may be less willing to contract with, employ, and rely upon individuals known to have contributed, in some way at least, to the formation of institutional conditions that produced that criminality."). *See also Id.*, at 502 ("The extent of both of these effects of reputational sanction on a firm is likely to vary according to a given individual's position within the organization. The more senior and responsible a person . . . the more likely that others will conclude that the message of firm fault conveys something significant about the individual.").

[132] *See* Jonathan M. Karpoff; John R. Jr. Lott, *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON. 757, 792 (1993) (finding that companies charged with defrauding customers and other stakeholders have lower operating earnings over the following five years). In fact, practitioners have designed complicated strategies to the difficulty of dealing with potential reputational loss following the announcement of an investigation. *See, e.g.*, Kevin Bailey & Charlie Potter, Protecting Corporate Reputation in a Government Investigation, Global Investigations Review (Jan. 5, 2017), https://globalinvestigationsreview.com/chapter/1079418/protecting-corporate-reputation-in-a-government-investigation.

possible option from the vantage point of the company and its employees is the first one. Unfortunately, very few investigations have a happy ending.[133] Hence, a settlement or an indictment is a much more realist outcome.

For the reasons we discussed in Part I, a considerable number of investigations end in a settlement. As a part of the settlement, the company makes a series of admissions of wrongdoing, which it cannot renounce. It must also sign a statement of facts that is appended to the settlement agreement. The statement, too, contains a long and detailed enumeration of factual findings, which the firm is not allowed to dispute, deny or challenge, lest the agreement be rescinded. Frequently, the statements of facts describe the wrongdoing of the company, its managers, and its directors in very strong language stating that they "knowingly" and "willfully" violated the law, or "knowingly" failed to implement and maintain controls to address known risks.

Critically, since firms are artificial entities, they cannot commit the elements of the criminal offenses attributed to them on their own; they must operate through human agents. It is the actions and mindsets of the corporation's employees that establish the actus reus and mens rea of the offenses of which the corporation is accused. Accordingly, settlement agreements and statement of facts attribute various illegal actions, omissions, states of minds and intents to various agents of the firm.[134] At the end of the process, the DOJ issues a press release describing in great detail the terms of the agreements and the confession made by the corporation.

It must be emphasized at this point that the number of individual employees involved in a criminal investigation can be very high. When striving to finalize an agreement and collect a significant fine, law enforcement authorities do not typically dwell on the wording. Nor does the company under investigations.[135] Both parties are interested in a quick

[133] Based on data retrieved from the Corporate Prosecution Registry, a database that provides comprehensive and up-to-date information on federal organizational prosecutions in the United States, out of the 3429 criminal investigations conducted on corporations (among which 383 were on public corporations) between 1992 and 2019, only 179 resulted in acquittal, dismissal, or declination (among which 19 were on public corporations). Data & Documents, CORPORATE PROSECUTION REGISTRY, http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/browse/browse.html (search Disposition Type field for "All," "acquittal," "dismissal," and "declination.").

[134] *See* Gibson Dunn-2017, supra note 38, at 3 ("Most NPAs and DPAs require a clear acknowledgement by the company that the statement of facts is 'true and accurate,' and that the company bears responsibility for the actions of officers, directors, employees and agents acting on its behalf.").

[135] Koehler, *supra* note 16, at 554 ("Prosecutors have far less leverage over individuals. People, unlike corporations, often face the prospect of incarceration and financial ruin in the event of a criminal conviction. As a result, individuals are more likely to test the government's legal theories and version of the facts. . . . [P]rosecutors know from their

resolution.[136] The directors, officers and other employees get caught in the middle.

Although corporations are willing to sacrifice both former and present employees to reach a settlement, there is an important difference between its treatments of the two groups. While present employees can have an indirect and limited input on the negotiations leading to the agreement, former employees are excluded from the process altogether. A clarification is in order here. As we discussed, the investigation is often conducted by external law firms and consultants that are hired for this purpose. Past and present employees, who are relevant to the investigation, are interviewed in the course of the investigations. Hence, they receive an opportunity to share their versions of what happened. Thereafter, they leave the floor to the attorneys to negotiate and draft the terms of the settlement agreement, including the exact wording of the statement of facts. Present directors and officers must approve the agreement on behalf of the corporation. Hence, they have an opportunity to review the draft and introduce very marginal changes to the wording, but they cannot realistically achieve more than this as the bargaining power lies with the law enforcement authorities.

This is especially true given that although the final version of the agreement is provided to the board of directors for review only a few days before the date of signing. Although directors review the agreement before its approval, they are not involved, in any way, in the preparation of the agreement. Furthermore, when a settlement is presented to the board, the board faces a *binary choice*: approve or else the DOJ will reopen the case and even broaden the investigation to cover larger time periods and additional countries in which the company did business.

Past employees are in worse shape. Their approval of the agreement is not required. They do not get a chance to review the agreement, nor do they receive an opportunity to comment on it. Worse yet, the present directors and officers have a strong economic motivation to settle expeditiously regardless of the ramifications for past employees. After all, they are eager to put the criminal investigation behind them and they owe a fiduciary duty to the corporation, not to their predecessors.[137]

At this point, one might wonder: why is all this problematic? if an employee, current or former, committed a criminal offense, they should live with the consequences, whether or not she was given a fair hearing. But

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interactions with lawyers for individuals that, unlike with the corporation, they are likely to have a fight on their hands if they bring charges.").

[136] Reilly, *Sweetheart Deals*, *supra* note 60, at 1120 (explaining how the DPAs "can be a means to: speedy and efficient dispute resolution").

[137] Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("Corporate officers and directors . . . stand in a fiduciary relation *to the corporation and its stockholders*.").

therein lies the rub: many individual directors and officers have not violated the law and cannot be assumed to have done so. It is critical to understand that even though the liability of a corporation is based on the acts, omissions, intent and mental states of its officers and employees, it is much easier to assign criminal liability to a corporation than to its individual employees.[138]

As we explained earlier, a corporation may be found guilty of criminal misbehavior even when none of its employees committed a criminal offense on her own. While in the case of individual liability, all the elements of a criminal offense must be performed by one person, in the case of corporate liability it is possible to collect elements from different employees and attribute them to the corporation.

Two important doctrines that are routinely used by law enforcement authorities are responsible for this difference: the *respondeat superior* doctrine and the collective knowledge doctrine.

The *reponsdeat superior* doctrine allows law enforcement authorities to attribute the acts, omissions and intents of various individual employees, including even low-level employees, to the corporation itself. On this theory, the corporation is deemed vicariously liable for the misdeeds of its agents; all individual wrongs, even if they do not suffice to establish personal liability, are channeled to the corporation, and, in the aggregate, they often suffice to impose liability upon it.[139]

The collective knowledge doctrine enables law enforcement authorities to rely on the collective knowledge of all the employees of a corporation in order to find it guilty of a crime. Based on this doctrine, corporations have been found to be criminally guilty in cases in which no single agent satisfied the knowledge requirements necessary for a criminal conviction, but several agents collectively satisfied these requirements.[140]

Accordingly, it is impossible to derive personal liability from the liability of the firm. This is not merely a theoretical point: attempts by law enforcement authorities to prosecute officers of corporations that admitted to wrongdoing often result in acquittals. Furthermore, in many cases, it is not even possible to impose civil liability on directors and officers pursuant to settlements.[141] There is a gulf between corporate liability and personal

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[138] *See supra* note 83.

[139] *See supra* notes 73-79.

[140] *See supra* notes 80-82.

[141] One famous example is the case of the oil and gas services company Tidewater Inc. After the company resolved the FCPA investigation by signing a PDA, a derivative suit was filed against Tidewater's directors. The district court in Louisiana dismissed the suit, with a conclusion that: "While Plaintiff's allegations are sufficient to show that Tidewater was evidently violating both the FCPA and the Exchange Act, nowhere in the Complaint do Plaintiff's allegations meet the specificity to show that the Individual defendants were acting with the intent to violate these laws. The mere fact that the violation occurred does not

liability. Yet, settlements are not sensitive to this fact. They are drafted in a sweeping manner that pays no heed to the consequences for the individual employees.

Indeed, from a purely legal perspective, the admissions and statements made by corporations do not bind individual directors, officers and employees. They do not constitute res judicata as far as personal liability is concerned. However, from a practical perspective, the consequences for individual employees are severe.

Employees who are covered by the PDAs do not have an opportunity to disagree with the statements that were made about them. They cannot initiate a legal proceeding to clear their name or even challenge the factual accuracy of the statements that pertain to them. Their only chance to do so is when a personal investigation is opened or if shareholders decided to bring derivative actions against them. But even this opportunity is more illusory than real.

The broad and unequivocal admissions that are found in settlement and statements of facts practically invite the filing of derivative actions against the individuals who are mentioned in them. The signing of a settlement is almost invariably a prelude to civil litigation that comes on its heels.[142] Plaintiffs in derivative actions base their prima facie case on the admissions made by a company in its settlement with DOJ or other law enforcement authorities.[143]

Plaintiffs often quote extensively from the admissions and findings in settlement agreements which do not go to the trouble of carefully addressing the potential personal liability of each individual director and officer, and the claims made by derivative plaintiffs. The admissions and findings list all directors, officers and other employees whose names were mentioned in the annual reports of the company during the years described in the settlement agreement as defendants and treat them as a monolithic group.

We will elaborate on this point later. Here, it is worth noting that private plaintiffs have neither the capabilities nor the incentives to distinguish between good directors and officers and bad ones. Private plaintiffs, who are individual shareholders, have a very limited access to information about the company and its officers and directors.[144] Furthermore, the plaintiffs are frequently shareholders with a miniscule stake in the company, and therefore

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demonstrate that the board acted in bad faith" Strong v. Taylor, 877 F. Supp. 2d 433 (E.D. La. 2012). As Professor Mike Koehler, a compliance expert, put it: "Not only was the Tidewater derivative claim, representative of the type of derivative claims frequently brought in the FCPA context, it was also representative of the outcome." Mike Koehler, *Foreign Corrupt Practices Act Ripples*, 3 AM. U. BUS. L. REV. 391, 437 (2014).

[142] *See supra* note 110.

[143] *Id.*

[144] ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE 85–87 (Oxford U. Press, 2007).

"ha[ve] very little incentive to consider the effect of the action on the other shareholders" and the company as a whole.[145]

The directors and officers, who are listed as defendants, do not get a real opportunity to exonerate themselves. As Professor Amy Westbrook puts it more generally: "the majority of the recent shareholder derivative suits filed in the wake of FCPA actions have been dismissed, a handful have settled, and none have been fully litigated on the merits."[146]

Thus, at the end of the day, the directors and officers who were implicated in settlements do not have a real way to vindicate themselves. They have to live with the admissions and statements of facts made by their corporations. The ramifications for these individuals, who have done no wrong, are dire and far-reaching. Their reputation is irremediably harmed, as is their future employability and earning capacity.[147] They have to deal with the financial and emotional consequences of a long criminal investigation that is often followed by civil litigation. All the while, they are being featured in uncomplimentary media reports. Worst of all, no extant law gives them an opportunity to set the record straight.

The population of top corporate executives can be characterized as a small community. As Edward Rock has pointed out, "the senior managers and directors of large, publicly held corporations, and the lawyers who advise them form a surprisingly small and close-knit community. The directors of large, publicly held corporations number roughly four to five thousand."[148] Jayne Bernard further observed that "[i]n such a community, information travels, impressions are formed and hardened, loyalties are tested, and reputations are built and dismantled, extremely efficiently, often with just a few phone calls. In a rarefied community such as this, the role of reputation is significant."[149]

Finally, the allegations of wrongdoing made with respect to directors and other top officers may cause institutional investors to vote against the

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[145] Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 271 (1986).

[146] Westbrook, *supra* note 26, at 1228. *See also* Kevin LaCroix, *FCPA Follow-On Civil Actions: Frequently Filed, Less Frequently Successful* (June 18, 2017), https://www.dandodiary.com/2017/06/articles/foreign-corrupt-practices-act/fcpa-follow-civil-actions-frequently-filed-less-frequently-successful/

[147] *See* Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1919 (1998) (noting that "while litigation is unlikely to cost [corporate managers and directors] their jobs, liability can damage their reputations and future careers").

[148] Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1013 (1997).

[149] Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959, 966 (1999).

directors' reelection[150] or to act in order to fire other senior executives. Large institutional investors have become involved in monitoring the compliance of public companies, in which they invest, to laws and regulations.

### *B. The Pooling Effect*

A root cause of the reverse agency problem is the collective treatment of directors and officers in settlements and the insinuation and the attribution of various elements of wrongdoing to them in order to establish the guilt of the corporation on which they serve. A typical agreement begins with a statement that the Company admits, accepts, and acknowledges that it is responsible under Unites States law for the acts of its officers, directors, employees, and agents. Later, the agreement describes in great detail how the company, via the actions and omission of its managers and employees, broke the law on during the time period covered by the agreement. The Agreement also describes how directors failed to adopt and implement any adequate compliance program, and how this failure enabled the wrongdoing.

As such, the agreement does not distinguish between law abiding and diligent officers, directors and employees and their peers who broke the law or breached their fiduciary duties. Moreover, no names are mentioned in agreements; managers and directors are treated as an indistinguishable group. Thus, a pooling equilibrium is created. To illustrate this point, we revisit some of the largest agreements signed during the past few years, discussed in Section II.A.

For instance, the plea agreement signed with Kellogg Brown & Root (KBR) states that "Kellogg Brown & Root LLC admits, accepts, and acknowledges that it is responsible for the acts of its predecessor companies' officers, employees, and agents as set forth below."[151] Likewise, the DPA that HSBC entered into, in the context of the Bank Secrecy Act, proclaims that "The HSBC Parties admit, accept and acknowledge that they are responsible for the acts of their officers, directors, employees, and agents . . . ."[152] Similar statements can be found in the agreements signed with Telia,[153]

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[150] Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 IOWA L. REV. (forthcoming 2020), at 42–44.

[151] Plea Agreement at 33, United States v. Kellogg Brown & Root, 161 F. Supp. 3d 423 (E.D. Tex. 2015) (No. H-09-071) [hereinafter *KBR Plea Agreement*].

[152] Deferred Prosecution Agreement at 3, United States v. HSBC No. 12-CR-763, 2013 WL 3306161 (E.D.N.Y. July 1, 2013) [hereinafter *HSBC DPA*].

[153] Deferred Prosecution Agreement at 2, United States v. Telia Company AB, No. 1:17-CR-00581-GBD (S.D.N.Y. 2017) https://www.justice.gov/criminal-fraud/file/998601/download ("The Company admits, accepts, and acknowledges that it is responsible under Unites States law for the acts of its officers, directors, employees, and agents as charged in the Information, and as set forth in the attached Statement of Facts, and that the allegations described in the Information and the facts described in the attached Statement of Facts are true and accurate.").

Petrobras,[154] and USB. [155]These examples are representative. The drafters of the agreements intentionally keep the language broad and vague, imputing potential responsibility to large groups of executives without distinguishing among them.

It is noteworthy that some agreements contain language suggesting that had the matter been litigated, the consequences for the company would have been dire. For example, the agreement with KBR contains the following clause: "Had this matter proceeded to trial, the United States would have proven beyond a reasonable doubt, by admissible evidence, the facts alleged in the Information."[156] The use of such statements sends a strongly negative signal about the parties involved, suggesting that they managed to avoid a sure criminal conviction.

As a matter of fact, the pooling effect discussed above takes place not only in the agreements themselves. It begins much earlier at the moment an investigation is announced. Once an investigation has been initiated, the suspect company must issue an immediate report to notify the public of this development. In addition, the company is legally obliged to mention the ongoing investigation against it in quarterly and annual reports. These reports persist over a long period of time. In 2016, the median duration of FCPA enforcement actions was 4.25 years.[157] During this time period, a gray cloud hangs over all of the company's directors and officers,[158] and a statute of

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[154] Non Prosecution Agreement Re: Petroleo Brasileiro S.A. – Petrobras (Sept. 26, 2018) ("The Company admits, accepts, and acknowledges that it is responsible under Unites States law for the acts of its officers, directors, employees, and agents as set forth in the attached Statement of Facts, and that the facts described therein are true and accurate.").

[155] U.S. Bancorp DPA (Feb. 12, 2018), available at https://www.justice.gov/usao-sdny/press-release/file/1035081/download ("USB stipulates that the facts set forth in the Statement of Facts, attached hereto as Exhibit C and incorporated herein, are true and accurate, and admits, accepts and acknowledges that it is responsible under United States law for the acts of its current and former officers and employees as set forth in the Statement of Facts").

[156] *See, e.g.*, KBR Plea Agreement, *supra* note 151, at 33. *See also* HSBC DPA, *supra* note 144 at 1 ("If this matter were to proceed to trial, the Department would prove beyond a reasonable doubt, by admissible evidence, the facts alleged below and set forth in the criminal Information attached to this Agreement.").

[157] THE GRAY CLOUD OF FCPA SCRUTINY LASTED TOO LONG IN 2016, http://fcpaprofessor.com/gray-cloud-fcpa-scrutiny-lasted-long-2016/ (last visited July 11, 2019) [hereinafter *THE GRAY CLOUD OF FCPA SCRUTINY*].

[158] Richard Cassin, *The FCPA's Long Shadow*, THE FCPA BLOG (August 6, 2012), http://www.fcpablog.com/blog/2012/8/6/the-fcpas-long-shadow.html ("The threat of FCPA enforcement after a company self reports casts a long shadow. It darkens the future for management, shareholders, lenders, customers, and suppliers. Exactly the problem the statute of limitations was supposed to fix.").

limitations is not going to help here.[159] The public reports of the company describe how the company is subject to a criminal investigation, and, in some cases, reveal that the investigation identified certain practices and transactions that likely constitute violations of law.

Finally, the pooling effect continues in formal publications made by enforcement authorities. Typically, after an agreement is signed, the enforcement authorities issue a press release that describes it in great detail. The content of the publications resembles the language used in the agreements and statements of facts. The enforcement authorities, for their part, have no incentive to soften the harsh language of the agreements; on the contrary, they want to send a clear and unequivocal message about the harsh consequences of breaking the law to the rest of the market.

News about the agreement spreads fast. Publications made by authorities focus on the large fines the companies agreed to pay, and the companies' admissions. The large penalties draw enormous public attention to the publications and readers are inevitably exposed to the admissions of guilt referencing the management and board of the relevant companies, who are once again referred to as a guilty group.

These publications aggravate the plight of innocent directors and officers, adding an element of public shaming to their ordeal. This effect is accentuated by the motivation of enforcement agents to aggrandize their own achievements [160] in order to bolster their statutory enforcement powers.[161] This concern is exacerbated owing to the fact that publications by enforcement agencies are subject to very few procedural safeguards, if any.[162] When issuing a publication, enforcement authorities are generally not required to give prior notice or an opportunity to the company or its agents to be heard.[163] At bottom, from the beginning of the investigation process until

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[159] As one commentator explained: "Statute of limitations are ordinarily the remedy the law provides for legal gray clouds. Yet in corporate FCPA enforcement actions, the fundamental black-letter legal principle of statute of limitations seems not to matter because cooperation is the name of the game and to raise bona fide legal arguments such as statute of limitations is not cooperating in an investigation. Given the 'carrots' and 'sticks' relevant to resolving corporate FCPA enforcement actions, one of the first steps a company the subject of FCPA scrutiny often does to demonstrate its cooperation is agree to toll the statute of limitations or waive any statute of limitations defenses." THE GRAY CLOUD OF FCPA SCRUTINY, *supra* note 157.

[160] *See* Nathan Cortez, *Adverse Publicity by Administrative Agencies in the Internet Era*, 211 BYU L. REV. 1371, 1378 (2011).

[161] *See* Ernest Gellhorn, *Adverse Publicity by Administrative Agencies*, 86 HARV. L. REV. 1380, 1398–1401 (1973).

[162] Cortez, *supra* note 160, at 1374.

[163] *Id.* at 1383. *See also* Gellhorn, *supra* note 161, at 1420 ("[U]sually no protection other than the common sense and good will of the administrator prevents unreasonable use of coercive publicity.").

its end, the executives of the suspect company are treated as a monolithic group. Neither the companies nor the enforcement authorities have an incentive to carefully differentiate among wrongdoers and innocent parties. Both groups are pooled together.

### *C. The Near Irrelevance of Standard Defense Mechanisms to the Reverse Agency Problem*

Thus far, we have analyzed in great detail the adverse effect of the reverse agency problem on corporate officers and employees, as is true of all agency problems. The reverse agency problem makes it harder and more expensive for corporations to hire good directors, managers and key employees. Of course, directors and officers who strayed from the right path should be held accountable for their decisions. As we emphasized time and again throughout the Article, we are in favor of meting out penalties to corporate officers who broke the law. The problem is that law enforcement authorities do not go into the trouble of assigning personal liability. In settlement agreements, all those involved are pooled together. Nor do corporations wish to expend the resources to distinguish among culpable and innocent employees. Currently, there is no way out of this pooling equilibrium.

This state of affairs adversely affects good directors and managers. In a world with perfect separation between good directors and officers and bad ones, everyone will be rewarded and punished based on their performance. However, in the age of settlements, corporate directors and officers may bear the cost of the misdeeds of others. They no longer in full control of their own fate.[164] Enforcement actions, and the settlements signed in their wake, create inter-dependencies among corporate agents. In the age of compliance, one bad apple can upset the applecart. Sometimes, one director or corporate officers who took matters into his own hands and broke the law can get an entire corporation and its top personnel in trouble.

Over the years, corporate law has adopted several mechanisms to protect directors and officers from legal liability and thereby lower operation costs for firms. Standard theorizing assumes that higher exposure to legal liability must be offset by higher compensation. Hence, if directors and officers face a high risk of legal liability, they would require higher pay to offset this risk.[165] The central mechanisms that were developed to shelter directors and

[164] *Id*.

[165] *See, e.g.*, Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857 (1984) (explaining how corporate liability imposes legal risks on corporate decisionmakers, and accordingly, how "competent corporate decisionmakers will either demand insulation from them or require compensation for bearing them.") *See also* John E. Core, *On the Corporate Demand for Directors' and Officers' Insurance*, 64(1) J. RISK & INSURANCE 63, 66-67 (1997) ("The director will not serve unless the package offered meets his or her reservation utility . . . level of other pay necessary to compensate the director

officers from liability are the business judgment rule, exculpation clauses, directors and officers' (D&O) liability insurance, and indemnification clauses.

The business judgement rule immunizes directors and corporate officers against liability for harms arising from mistaken business decisions, as long as a decision was informed, made in good faith and without conflict of interest.[166] Exculpatory clauses are implemented contractually and have the effect of relieving high level employees from liability arising from a breach of a duty of care owed to the corporation.[167] D&O liability insurance protects the directors and officers of a corporation against personal losses resulting from a suit against them for violating a duty to the firm.[168] Indemnification clauses guarantee directors and officers reimbursement for attorneys' fees, legal expenditures and even judgment.[169]

Although each of these mechanisms operate differently they share a common purpose: they aim to relieve directors and officers of the need to incur costs of pay damages for negligent breaches of the duty of care owed to the corporation. Corporations, for their part, are willing to limit the legal liability of their directors and managers since it lowers executive compensation.

Critically, though, two of the aforementioned mechanisms—business judgement rule and exculpation—are not relevant in the context of criminal investigations. They are only available in the internal relationship between directors and officers and their firms. The other two mechanisms—indemnification and insurance—are subject to mandatory "boundaries" and depend on the company's willingness to provide them, its governing documents, and its insurance policy. [170] At any rate, none of these mechanisms can compensate directors and officers for the reputational and

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for his or her [] any uninsured risk. Thus, other forms of director compensation are hypothesized to be substitutes for D&O insurance, for a decrease in the level of D&O insurance results in an increase in the amount of other pay required by the director as a compensation for the additional risk (the 'risk premium').").

[166] *See, e.g.*, Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[167] DEL. CODE ANN. tit. § 102(b)(7) (2007).

[168] Tom Baker & Sean Griffith, *Predicating Corporate Governance Risk: Evidence from the Directors' and Officers' Liability Insurance Market*, 74 U. CHI. L. REV. 487, 487 (2007) (arguing that "[n]early all public corporations purchase D&O policies").

[169] DEL. CODE ANN. tit. § 145(a) (2007).

[170] *Id.* Furthermore, it is worth noting that that insurance coverage is not unlimited. *See, e.g.*, Tom Baker & Sean J. Griffith, *How the Merits Matter: Directors and Officers' Insurance and Securities Settlements*, 157 U. PA. L. REV. 155, 805 (2009) ("If, as is generally the case, D&O insurance limits are significantly lower than potential investor losses.") *See also Id.*, at 798 ("The insurer will have two principal case-specific interests: first, and most obviously, to reduce settlement payouts; and second, to maximize investment returns by delaying the payout of invested capital.").

economic harms they suffer as a result of criminal investigations and settlements. These harms lie outside the ken of the sphere of protection firms can provide.[171]

Since companies cannot offer directors and officers adequate protection against the reverse agency problem, they would have to pay them higher compensation that reflects the increased risk to which they are exposed.[172] Given that it is impossible to know in advance which directors and officers would be affected by the higher risk—after all, enforcement actions can be random—firms would have to increase managerial compensation across the board. In some cases, the promise of higher compensation would suffice to persuade competent directors and managers to assume the risk. In others, potential directors and officers may decide to pursue different career opportunities. On the margin, the reverse agency problem would drive capable candidates away from the corporate world.[173] This effect should be especially high among risk averse individuals, who would require very high compensation to take on extra risk. Indeed, there is already some evidence suggesting this effect is felt in the corporate world.[174]

## IV. POTENTIAL SOLUTIONS

In this Part, we consider possible mechanisms to address the reverse agency problem. As we explained, a root cause of the reverse agency problem is the collective treatment of directors and officers in settlements and the insinuation and the attribution of various elements of wrongdoing to them in order to establish the guilt of the corporation on which they serve.

The sweeping statements that are made about directors, officers and other employees without giving them a way to clear their names are neither fair nor efficient. Hence, the mechanisms we propose in this Part aim at allowing

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[171] David A. Skeel, JR., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1833 (2001) (describing how defenses that the company provide to its directors and managers, such as insurance and indemnification, cannot protect them from reputational consequences). *See also* JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 52 (2008) ("[T]he prevailing norms of director behavior are stricter and less forgiving than the liability rules by which directors are evaluated.").

[172] *Supra* note 165.

[173] Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1140 (2006) (arguing that "[a] significantly higher level of risk for outside directors could well deter good candidates from serving . . . ."). *See also* Financier Worldwide Magazine, Risks Facing Directors & Officers (August 2016) ("the potential to unfairly blame individuals when not warranted under the circumstances will only serve to deter qualified people from seeking out and taking director and officer positions.")

[174] *See* Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 CRIM. L. & PHIL. 471, 488 (2018) ("No wonder, then, that corporate managers, whenever they get a chance, express vocal complaints and fears about the potential ''death knell'' represented by the imposition of criminal liability on their firms.").

directors and officers who were involved in criminal investigations to prove that they are neither guilty of a criminal offense nor that of a breach of a fiduciary duty to the corporation. In other words, our proposals are intended to break the pooling effect created by settlements and allow innocent and diligent directors and officers to distinguish themselves from their peers who broke the law. To this end, we propose three specific legal mechanisms that can ameliorate the reverse agency problem.

The first mechanism seeks to amplify the voice of individual corporate officers in settlement negotiations by giving them a right to a hearing prior to the finalization of a settlement. This mechanism would enable individual directors and officers to review settlements and offer changes before they are signed. The second mechanism we contemplate is to give individual directors and officers who were implicated in settlements the right to bring an action for a declaratory judgment that could clear them of liability. Doing so will grant innocent directors and officers the power to initiate legal action in order to dispel the suspicions that surround them and preempt derivative actions against them. Our third, and most far reaching mechanism, is to allow innocent directors and officers the right to sue their colleagues who went astray and precipitated a cascade of harms on the corporation and its employees.

### *A. A Right to a Hearing*

One way to address the reverse agency problem is by providing interested corporate directors and officers the right to demand a hearing prior to the signing of a settlement. The hearing will be held by the relevant law enforcement agency at the end of the investigation after a detailed draft had been produced, but before the settlement is finalized. The reason for holding the hearing at this time is to give directors and officers an opportunity to review the statements made about them, consider their accuracy and propose amendments to the draft. It is noteworthy that small changes in the language of the settlement agreement may have a significant impact on the future of the directors and officers involved.[175]

The holding of a hearing will give the employees who are covered in the settlement agreement an opportunity to set the record straight by correcting potential misstatements about them and other factual errors. It appears to be the simplest and the most cost-effective solution to the reverse agency

[175] To illustrate, there is a huge difference whether a DPA describes a felony as committed by “employees” or by “certain low level employees; similarly, there is a huge difference if a DPA states that the admission of the company is being made under the *respondeat superior* doctrine; finally, there is a huge difference between a DPA that states that the company and its officers “knowingly” and “willfully” committed the offence and a DPA that lacks such descriptions.

problem. True, the introduction of hearings will prolong investigations and increase their cost. Yet, reducing costs and shortening investigations are not goals in their own right; rather, they are important side constraints. The main goal is to improve accuracy in fact-finding and to further justice by giving directors and officers a final chance to exonerate themselves of wrongdoing. Hence, as long as the additional cost of holding hearings is not unreasonably high, it may be in society's best interest to do this.

The solution of hearings, while promising on its face, has an obvious downside. The effectiveness of this solution critically depends on the willingness of the enforcement agencies to receive input from individual directors and officers and change their recommendations accordingly. In other words, the success of hearings depends on the good faith and openness of the relevant administrative agencies.

In our case, it is questionable that law enforcement agents would adopt the requisite mindset to make the hearings work. It must be born in mind that the hearings would come at the end of a long investigation involving interviews with all the relevant parties and careful legal analysis that yielded certain findings. At this point, the focus of the law enforcement agencies is on the large penalty that is about to be collected from the firm. Also, they may be facing pressures from the firm to bring the investigation to an end. Finally, inertia, a common phenomenon in administrative agencies,[176] may limit the effectiveness of the proposed hearing.

If law enforcement agencies cannot hold the hearings with an open mind and an open heart, the hearings will be counterproductive. Not only will the hearings be costly, but also in their aftermath, it will be nearly impossible for individual directors and officers to prove their innocence. After all, they were granted an opportunity to vindicate themselves and failed. At the end of the day, therefore, hearings should be adopted as a solution to the reverse agency problem only if lawmakers are convinced that the enforcement agents that administer them are open to persuasion.

### *B. Declaratory Judgement*

Our second solution to the reverse agency problem relies on the courts. It harnesses the judicial system to help directors and officers. Specifically, we propose granting directors and officers who were implicated in investigations and settlements the right to seek a declaratory judgment in court to their name

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[176] *See, generally*, STEPHEN BREYER, REGULATION AND ITS REFORM 365 (Harvard U. Press, 2009) ("Thus, it will not be difficult for agencies to reach a decision and then to write whatever impact statement is needed to justify it. The temptation for the agency to do so will be great, because of its staff, through inertia, will tend to favor existing regulatory directions. And in many agencies it is common practice first to reach a decision and then to have a special opinion-writing section compose a statement in justification.").

of wrongdoing. If successful, directors and officers should be able to receive indemnification from their companies for the legal fees and judicial costs they incurred. A declaratory judgment that clears individual agents of wrongdoing will dispel the uncertainty that hovers over them, prevent the automatic filing of derivative actions against them, and allow them to restore their reputation[177] and carry on with their careers.[178]

Giving directors and officers the right to sue for a declaratory judgement has several advantages over the option of granting them a right to a hearing with an enforcement agency. Judges, unlike law enforcement agents, are impartial, independent, and immune from market pressures. Judges are much more likely to consider the claims of directors and officers without prejudice and grant them the declaratory relief, when appropriate. Judges, of course, have no personal stake in the outcome of the case and will be guided by their sense of justice.

Although we believe that the solution of declaratory judgments can help alleviate the plight of individual directors and officers, as well other corporate employees, it is not clear that they have standing to sue. It should be remembered that individual directors and officers are not a formal party to settlement agreements. Settlements are struck between corporations and law enforcement authorities. Hence, even though the findings of fact specified in settlement have a profound effect on the directors and officers, they do not legally bind the directors and officers. Thus, it is unclear that individual directors and officers have standing to sue.

We believe that individual directors and officers should not be barred from suing. We therefore call on courts to open their doors to directors and officers who seek to exonerate themselves from allegations of wrongdoing. It must be realized that individual employees of corporations cannot challenge the content of settlements, nor do they have a meaningful way to correct the statements made about them by their corporations. Under these circumstances, courts should lend them a helping hand and allow them to initiate legal action to clear themselves. Leaving them to live with the negative implications of settlements to which they were not a party and could not meaningfully influence is a highly unjust result.

[177] In this regard, it is interesting to note that the Supreme Court suggested a constitutional right to protect one's reputation. *See* Rosenblatt v. Baer, 383 U.S. 75, 92 (1966) ("The right of a man to the protection of his own reputation from unjustified invasion and wrongful hurt reflects no more than our basic concept of the essential dignity and worth of every human being—a concept at the root of any decent system of ordered liberty.").

[178] *See* e.g., Fredrick Lawrence, *Declaring Innocence: Use of Declaratory Judgements to Vindicate the Wrongly Convicted*, 18 PUBLIC INTEREST L.J. 391, 397 (2009) ("As a remedy to the stigma suffered by persons wrongfully accused or convicted of criminal acts, this Article proposes that persons wrongfully accused of criminal acts have a right to sue for a declaration of innocence.").

### *C. An Action against Other Directors and Officers*

Our third solution to the reverse agency problem is to give innocent directors and officers legal recourse against their colleagues who broke the law and brought about the criminal investigation. After all, the criminal investigation against the firm was commenced for a reason and the admissions of guilt by the corporation are not groundless. In a typical case, the acts or omissions of those employees trigger the criminal investigation that will result in the attribution of illicit behavior to their colleagues, who have done no wrong. Under our proposal, directors and corporate officers who suffered losses as a consequence of the decisions or behaviors of their peers would be allowed to sue the peers to recover compensation for their losses.

It should be emphasized that we will not allow suits against the corporation itself, but only against individual directors and officers who strayed from the path. Thus, neither the corporation nor its shareholders would be affected by our proposal. The implementation of our proposal requires the law to recognize a new fiduciary duty that will apply among directors and officers inter se. Under current law, directors and officers owe a duty of care and a duty of loyalty to their corporations, but not to one another.[179] At present, therefore, fiduciary duties apply only vertically, in the relationship between corporations and their top agents.

Elsewhere, we argued that the modern business world has become so complex and specialized that directors and corporate officers have become dependent on one another. Each of them brings a unique set of skills and backgrounds to the table. No individual director or officer can be expected to perform all the tasks that are necessary for the successful functioning of the corporation on her own. Hence, directors and managers have no choice but to rely on each other. Failure by one board member or manager can doom the entire board or management team. For this reason, we suggested recognizing a new fiduciary duty that would apply horizontally among directors and officers in their inner relations.[180] A breach of the duty by a director or officer will enable other directors and officers who were harmed by the breach to seek damages from the delinquent actor.

Allowing directors and officers to seek compensation from peers who harmed them will provide them with a way to recover for the losses that befell them. Unlike an administrative hearing or a declaratory judgment that does not address past harms, a suit for a breach of a horizontal fiduciary duty, if successful, would make the plaintiff whole. Furthermore, the introduction of

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[179] Asaf Eckstein & Gideon Parchomovsky, *Toward a Horizontal Fiduciary Duty in Corporate Law*, 104 CORNELL L. REV. 803 (forthcoming 2019).

[180] *Id*.

momentary damages will allow courts to apportion liability among defendants or reduce compensation awards in cases in which plaintiffs are found contributorily negligent. In other words, the use of monetary damages will allow courts to go beyond all or nothing solutions.

### *D. A Lawsuit against the Company?*

A fourth possible solution to the reverse agency problem is to give directors and corporate officers a cause of action against the corporation for unnecessarily implicating them in wrongdoing.[181] On its face, this appears like a straightforward response to the reverse agency problem. After all, it is the company that chose to enter into the agreement and did not go into the trouble of carefully distinguishing between culpable executives and innocent ones. A closer examination reveals that the matter is not nearly as simple as it may appear on first blush. As we explained throughout the Article, the decision to enter into an agreement with the enforcement authorities and do so expeditiously is in the best interest of the company. Furthermore, the board, in deciding to negotiate and approve a settlement, acts within its fiduciary duty to the company. At present it owes no fiduciary duty to past executives and directors, or even to the serving ones. Neither does the company.[182]

In order to allow executives to sue the firm, it is necessary to create a new legal duty, not necessarily a fiduciary duty, that obliges the company to treat its agents fairly and not sacrifice or even jeopardize their reputation to promote the interest of the firm. It is, of course, possible to recognize such a duty, but doing so will engender a problem of split loyalties. Presently, at least under the predominant view, corporate agents have a single goal: maximizing shareholders' profits. As we impose additional duties on corporate officers and directors, we put them in very difficult situations, requiring them to favor one group of stakeholders over another.

Furthermore, in the case of settlements, companies do not have a lot of leeway. They face a take it or leave it situation. It is the enforcement authorities who are in the driver's seat. Companies do not have any real bargaining power. Therefore, allowing individual executives to file suits against their company under these circumstances strikes us an extreme measure. After all, one might wonder: why not let executives sue law enforcement authorities? We clearly do not support this option. Law enforcement authorities should be able to do their job undeterred. As for the possibility of allowing executives to sue companies, we believe it should be reserved, if at all, to extreme cases in which companies were reckless or grossly negligent. This standard would require plaintiffs to prove that

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[181] We are grateful to Zohar Goshen for pointing out this possibility to us.
[182] *Supra* note 137.

companies could easily distinguish between them and their guilty peers, but elected recklessly not to do so.

## V. CONCLUSION

In this Article we demonstrated that the agency problem in corporate law is not one directional as conventional theory suggests, but rather bidirectional. Since the seminal article of Berle and Means, a central tenet of corporate law scholarship and policy has been that corporate officers and directors would sacrifice the interests of their companies and shareholders to promote their own narrow self-interest. We showed that the reverse phenomenon also exists. Companies facing criminal and regulatory investigations are willing to sacrifice their top officials, indeed all of their employees, in order to appease the investigating authorities and strike a favorable settlement with them. We dubbed this phenomenon: the reverse agency problem.

Like its more famous kin, the reverse agency problem arises from perfectly rational motivation: the desire of firms to avoid criminal indictment and bring criminal investigation to a rapid close is perfectly sensible. The fact that to achieve this goal firms are willing to attribute wrongdoing to a large group of directors and managers, without distinguishing among guilty and innocent individuals, is consistent with the wealth maximization goal of the firm and its shareholders.

Yet, the rush of companies to settle imposes a dear cost on innocent corporate officers by implicating them in various forms of wrongdoing without giving them any opportunity to clear their name. These officers are left to bear the mark of Cain for the rest of their career as extant law does not afford them with any procedural or substantive means of clearing themselves. Worse yet, the allegations of guilt made about them in settlement agreements expose directors and officers to subsequent derivative suits from shareholders. In the compliance age, as the number of enforcement actions continues to increase, so will the scope and severity of the reverse agency problem.

As we emphasized time and again throughout the Article, we do not excoriate the increase in criminal enforcement against corporations and their employees. On the contrary, we fully support this trend. It is not criminal enforcement per se that is the root cause of the reverse agency problem, but rather the zeal of corporations and enforcement authorities to consummate settlements expeditiously while attributing guilt indiscriminately to large numbers of individual employees and grouping together guilty and innocent corporate officers in the process. In addition to unveiling the reverse agency problem and analyzing its causes and effects, we proposed three mechanisms that could ameliorate the problem. Our first proposal was to hold special hearings that would give directors and officers an opportunity to set the record straight prior to the finalization of settlements. Our second suggestion was to allow directors and officers the right to seek a declaratory judgment clearing them of wrongdoing. Our third and final mechanism was to enable corporate officers who suffered reputational harms on account of wrongful actions or omissions by their peers to seek recourse from the latter by bringing civil actions against them. It is our hope that by unveiling the reverse agency problem, our article brings about a fuller and more nuanced understanding of the complex interaction between firms and their officers.