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The Agent's Problem

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THE AGENT'S PROBLEM

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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 a 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 has surfaced: what we call the "reverse agency problem." The surge in criminal investigations against corporations, combined with the rising popularity of settlement mechanisms, including pretrial diversion agreements 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. This phenomenon is the mirror image of the agency problem—the agent's problem.

Although such settlements are in the best interests of companies and shareholders, they can have devastating effects on individual directors and officers. When they agree to settle a criminal prosecution, suspect companies collectively attribute wrongdoing to a large group of

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directors and managers without distinguishing between the guilty and the innocent. As a result, directors and officers implicated in settlements often suffer severe reputational losses, regardless of their culpability. Furthermore, the wrongdoing attributed to directors and officers in settlements exposes them to derivative lawsuits for breaches of their fiduciary duties. Unfortunately, extant law does not provide directors and officers with a means to prove their innocence or clear their names. 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.

Four legal reforms could remedy the plight of nonculpable individual officers and directors. The first seeks to amplify the voices of individual corporate officers in settlement negotiations by giving them the right to a hearing prior to the completion of a settlement. The second gives directors and officers implicated in settlements the right to bring an action for a declaration of innocence that would clear their names and preempt derivative actions against them. The third solution recognizes 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. The fourth, which should only become available in rare cases, is to let directors and officers sue the corporation for which they worked for the harms they suffered as a consequence of the corporation's actions and admissions.

TABLE OF CONTENTS

INTRODUCTION

This Article unveils a new phenomenon that increasingly permeates the corporate world. To date, corporate scholarship has focused predominately on the agency problem, the ability of directors and officers to shirk their duties and extract private benefits from corporations with dispersed ownership.[1] We, however, present an entirely new problem, originating in law enforcement initiatives against corporations: what we call the "reverse agency problem." This phenomenon is the mirror image of the agency problem—the agent's problem.

The term "agency problem" as a general phenomenon was coined by Professor Adolf Berle and economist Gardiner Means in their seminal book, *The Modern Corporation and Private Property*.[2] The concept has had an immediate and long-lasting effect on corporate-law theory and practice. Indeed, no other scholarly contribution has had such a significant impact on corporate law. 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 is not an exaggeration to say that since the book was published in 1932, the agency problem has been the focal point of corporate-law theory.[3]

In recent years, however, the agency problem's mirror image has emerged: corporations are increasingly willing to sacrifice their directors and officers[4]—namely, their agents—to further the corpor-

1. ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119–23 (1932).

2. *See id.* (describing the "[d]ivergence of [i]nterest between [o]wnership and [c]ontrol" and explaining that when corporations have dispersed ownership, "profits at the expense of the corporation become practically clear gain to the persons in control and the interests of a profit-seeking control run directly counter to the interests of the owners").

3. Other significant articles that address the agency problem include: 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); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

4. This Article focuses on the reverse agency problem's consequences for directors and officers because they are the primary targets of derivative actions. However, lower-level employees of the company can also be harmed by the reverse agency problem. For an example of

ations' own interests.[5] It is not an accident that this problem has gone unnoticed given that it is a relatively new phenomenon that did not exist in the past. Yet, it is significant and ubiquitous, and it is likely to grow in the future.

The reverse agency problem is a by-product of the age of compliance. Since the mid-2000s, publicly held companies have increasingly been exposed to enforcement actions on the part of various federal regulatory agencies, such as the Department of Justice ("DOJ"), the Securities and Exchange Commission ("SEC"), and the Internal Revenue Service ("IRS").[6] State agencies, such as the New York State Department of Financial Services ("DFS"), have also subjected them to criminal proceedings.[7]

Most of these investigations do not culminate in criminal charges. Rather, they are settled outside of court in the form of "pretrial diversion agreements" ("PDAs"),[8] which include deferred prosecution agreements ("DPAs") and non-prosecution agreements ("NPAs"). Many other cases are settled postindictment through plea agreements.[9]

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a lower-level manager alleging harm by the reverse agency problem, see *Yeatts v. Zimmer Biomet Holdings, Inc.*, 940 F.3d 354, 357–58 (7th Cir. 2019).

5. There is family resemblance between the reverse agency problem and the problem of principal cost that Professors Zohar Goshen and Richard Squire point out in a recent article. *See* Goshen & Squire, *supra* note 3, at 770. Goshen and Squire's theory focuses on the costs created by shareholders, which they divide into "competence costs" and "conflict costs," and they argue that the law should minimize the sum of agency and principal costs. *Id.* at 770, 828 (emphasis omitted). As this Article explains, 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 firms' management and directors in the face of enforcement actions.

6. *See infra* Part I.A (discussing federal enforcement).

7. As for the state agencies, see, for example, Courtney Dankworth, Eric Dinallo, Greg Lyons, David Sewell & Brenna Rae Sooy, *Debevoise & Plimpton Expects More New York Regulatory Enforcement of Banking and Financial Services*, CLS BLUE SKY BLOG (Sept. 10, 2020), https://clsbluesky.law.columbia.edu/2020/09/10/debevoise-plimpton-expects-more-new-york-regulatory-enforcement-of-banking-and-financial-services [https://perma.cc/7BQN-CDSN] ("Similarly to the Office of the Attorney General, DFS has increased enforcement action during the Trump Administration.").

8. *See* Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Non-Prosecution*, 84 U. CHI. L. REV. 323, 334 n.32 (2017) ("In the entire period prior to issuance of the Thompson Memo in January 2003, prosecutors negotiated only thirteen PDAs . . . . 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 infra* Part I.B.1 (discussing the increased use of PDAs).

9. *See infra* Part I.B.3.

This Article refers to these agreements collectively as "settlement agreements."

As a part of these agreements, corporate defendants must admit to various counts of wrongdoing by their directors and managers. 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, yet 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 directors and managers suffer severe reputational losses, often translating to lost careers and lost income, as a consequence of these agreements.

Worse yet, corporations' admissions invariably expose directors and officers to follow-up civil suits against them.[10] 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 sue 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, these shareholders themselves may initiate a derivative action against the directors and officers.

Even though admissions made by a company do not formally bind the agents and the agents can bring an independent action to have their names cleared, they face an uphill climb. At that point, the company has given up on them and sacrificed them on the altar of the shareholders' wellbeing. Surprisingly, for many years, law enforcement authorities largely refrained from prosecuting individual directors and officers,[11] focusing instead on the large payments they collect from firms. In light of the financial crisis and following harsh criticisms of this practice,[12] law enforcement authorities in recent years have started

10. *See infra* note 119 and accompanying text.

11. *See, e.g.*, Peter R. 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, 1135 & n.114 (2018) [hereinafter Reilly, *Sweetheart Deals*].

12. In an effort to respond to a significant criticism that the DOJ fails to prosecute individuals, then-Deputy Attorney General Sally Yates issued a new policy in September 2015 in the form of a memorandum entitled "Individual Accountability for Corporate Wrongdoing," or the "Yates Memo." *See* Memorandum from Sally Quillian Yates, Deputy Att'y Gen., U.S. Dep't of Just., to All U.S. Att'ys et al., Individual Accountability for Corporate Wrongdoing (Sept. 9, 2015) [hereinafter

initiating legal actions against individual employees, but only to a very limited extent.[13] In the small number of cases that resulted in charges against individual employees, the employees did not have the financial wherewithal or the psychological resources to continue the fight on their own. By contrast, directors and officers have often mounted successful defenses against such actions.[14] Yet even directors and officers who are ultimately acquitted in court must still confront prolonged legal battles on multiple fronts, as derivative actions may be brought 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 costs. To begin with, once a criminal investigation is launched against them, companies are at a high risk of criminal indictment and conviction if they choose not to cooperate fully with the enforcement authority. History teaches that indictment, not to mention conviction, has a dramatic negative impact on companies.[15] The accepted lore in the corporate-law world is that "no major financial services firm has ever survived a criminal indictment."[16]

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

Yates Memo], https://www.justice.gov/archives/dag/file/769036/download [https://perma.cc/2AE9-UE9Y].

13. *See* 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, 157–58, 160–61 (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.").

14. *See infra* note 149 and accompanying text.

15. Benjamin M. Greenblum, Note, *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 infra* notes 99–105 and accompanying text.

16. United States v. Stein, 435 F. Supp. 2d 330, 337 n.11 (S.D.N.Y. 2006).

authorities.[17] As the DOJ's Yates Memo stated: "[I]n order to qualify for any cooperation credit, corporations must provide to the Department all relevant facts relating to the individuals responsible for the misconduct."[18] The cost of conducting an internal investigation typically runs in the tens of millions of dollars and can sometimes reach hundreds of millions of dollars, which comes on top of standard defense costs.[19]

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.[20] It constitutes a serious diversion of managerial resources, forcing the corporation to focus on the criminal investigation instead of its core business activity.[21] 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.

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17. U.S. Dep't of Just., Justice Manual § 9-28.700 (2018) [hereinafter Justice Manual], https://www.justice.gov/jm/jm-9-28000-principles-federal-prosecution-business-organizations#9-28.700 [https://perma.cc/P8VS-Q4KM] ("Cooperation is a mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution.").

18. Yates Memo, *supra* note 12, at 2.

19. As Samuel Rubenfeld describes,

> The numbers, in some cases, are eye-popping. Wal Mart Stores Inc., 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 Inc. spent about $350 million on investigation-related costs before agreeing to pay U.S. authorities $135 million to settle its foreign-bribery probe. Siemens AG reported spending more than $1 billion on legal costs before its FCPA resolution in 2008.

Samuel Rubenfeld, *Costly Corporate Investigations Have No Natural End-Point*, WALL ST. J. (Oct. 10, 2017, 6:00 AM), https://www.wsj.com/articles/costly-corporate-investigations-have-no-natural-end-point-1507630214 [https://perma.cc/BF7Z-GVNX]; *see also* Peter J. Henning, *The Mounting Costs of Internal Investigations*, N.Y. TIMES: DEALBOOK (Mar. 5, 2012, 11:07 AM), https://dealbook.nytimes.com/2012/03/05/the-mounting-costs-of-internal-investigations [https://perma.cc/JTS7-G8Q6] ("When a corporation is caught in a government investigation, the legal fees can quickly exceed $100 million . . . .").

20. 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 . . . .'" (quoting Scott A. Resnik & Keir N. Dougall, *The Rise of Deferred Prosecution Agreements*, N.Y. L.J. (Dec. 18, 2006), https://dougallpc.com/pdf/The_Rise_of_Deferred_Prosecution_Agreements.pdf [https://perma.cc/Y3V5-W3SS])).

21. *See infra* note 92 and accompanying text.

On top of that, a criminal investigation harms the company's reputation and makes it difficult for the corporation to do business while 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 financial institutions that inherently rely on business ties with correspondent banks.[22] Naturally, if the clarifications and assurances are not satisfactory, valuable business relationships will be lost. Hence, corporations will readily admit to wrongdoing by their agents to put an end to the investigation and hopefully sweeten the bitter pill with a reduced fine.[23]

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 to be clear, they are—while their agents may be innocent. To start, the requirements for imposing criminal liability on corporations are much lower than those necessary for imposing criminal liability on individuals.[24] In the case of corporations, the elements of an offense, both the actus reus and the mens rea, can be satisfied by the conduct 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 any particular individual agent from a corporation's admissions.[25] 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.

Firms' desire to enter settlements with law enforcement 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. Again, closing criminal investigations and receiving credit for cooperating with law enforcement authorities are in the best interest of the firm. Hence, by

22. Greenblum, *supra* note 15, at 1886 ("The adverse publicity that accompanies a prosecution can devastate a corporation, particularly one that relies heavily on its reputation in the marketplace, because of the effect on relationships with customers, creditors, and the public at large.").

23. *See infra* note 93 and accompanying text.

24. *See infra* note 91 and accompanying text.

25. *See infra* notes 88–91 and accompanying text.

requiring directors and officers to put the firm's interests above all other considerations, the law exacerbates the plight of past directors and officers.

This Article proposes four mechanisms to address the harsh consequences of the reverse agency problem and alleviate the plight of innocent directors and officers. The first mechanism amplifies the voices of individual corporate officers in settlement negotiations by giving them a right to a hearing prior to the finalization of a settlement. This would enable individual directors and officers to review settlements and propose changes before they are signed. Second, individual directors and officers implicated in settlements should have the right to bring an action for a declaration of innocence that could clear them of liability. This would grant innocent directors and officers the power to initiate legal actions to dispel the suspicions surrounding them and preempt derivative actions against them. The third proposal 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 directors and officers. The fourth, and arguably most extreme, way to address the problem is to allow directors and corporate officers to bring suits against the corporation for which they worked to redress the harm they suffered as a consequence of actions and admissions made by the corporation in the course of the criminal investigation against it. Because it is drastic, this option should be reserved for cases involving recklessness or gross negligence in harming former board members and managers.

The Article unfolds in three parts. Part I discusses the rise in enforcement actions against corporations and the resulting PDAs, and explains how they drive a wedge between the interests of the corporation and its directors and officers, mainly former directors and officers. Part II introduces the reverse agency problem and positions it within the rich conceptual framework of principal–agent conflicts developed by corporate-law theorists. Part III advances proposed solutions to the reverse agency problem.

I. THE COMPLIANCE AGE

The backdrop and driving force behind the reverse agency problem is a dramatic increase in the rate and intensity of criminal enforcement actions against corporations. Criminal actions against corporations have existed 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. In particular, enforcement efforts intensified in the aftermath of the 2008 financial crisis and the government bailout of the financial sector.[26]

An important corollary of this trend is the emergence of vast settlements, running in the hundreds of millions of dollars, that are struck between corporations and law enforcement agencies. The money from these settlements has gone into the public fisc and has been used, in part, to continue the enforcement campaign. This Part discusses the increase in enforcement actions against corporations and explains how they have 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.[27]

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26. Official statements show there was an increase in enforcement efforts following the financial crisis. *See, e.g.*, Eric Holder, Att'y Gen., U.S. Dep't of Just., Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 17, 2014), https://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law [https://perma.cc/3FXT-QEYK] ("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, e.g.*, *Justice Department Data Reveal 29 Percent Drop in Criminal Prosecutions of Corporations*, TRAC REPS. (Oct. 13, 2015), https://trac.syr.edu/tracreports/crim/406 [https://perma.cc/7T7S-QSR5] (suggesting "the decline in corporate prosecutions" cannot be fully explained by the increase in the use of DPAs and may "reflect a general decline in federal prosecution efforts"). It is difficult, if 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).

27. *See, e.g.*, Benjamin Bathke, *Financial Crisis Bank Fines Hit Record 10 Years After Market Collapse*, DEUTSCHE WELLE (Aug. 10, 2017), https://www.dw.com/en/financial-crisis-bank-fines-hit-record-10-years-after-market-collapse/a-40044540 [https://perma.cc/EJQ3-RP6F] ("In fact, the US has not only gotten back every dime it used to rescue banks, it has recovered more than the total cumulative impact of the bailout."); *see also* FT Podcast, *Credit Crisis Fines Hit $150 Billion*, FIN. TIMES (Aug. 8, 2017), https://www.ft.com/content/d5a2cca3-803f-4866-8083-

The tidal wave of enforcement actions—centered on violations of the Foreign Corrupt Practices Act ("FCPA"), False Claims Act ("FCA"), and Bank Secrecy Act ("BSA")[28]—has exposed companies to an unprecedented level of liability and risk. This Section discusses these changes in detail, beginning with the FCPA.

Congress enacted the FCPA in 1977 to combat the spread of corruption in international business transactions.[29] Until 1998, the FCPA had very little effect on the ground—investigations and prosecutions were rare.[30] Everything changed in 2005 when FCPA enforcement began in earnest.[31] Nearly 70 percent of DOJ and SEC cases involving the FCPA were commenced between 2005–2013.[32] This renewed focus on FCPA enforcement has led companies to voluntarily pay heavy penalties to settle actions against them.

The harbinger of things to come was the Siemens AG case. In 2008, Siemens AG signed a plea agreement with the DOJ's criminal

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fa972c9d9076 [https://perma.cc/HT4N-44ZF] ("Financial institutions have paid more than $150bn in fines in the US relating to the credit crisis a decade ago.").

28. The DOJ also increasingly enforces laws and regulations aimed at preventing money-laundering, environmental, and antitrust violations.

29. The text of the FCPA declares its purpose is

> 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.

Foreign Corrupt Practices Act ("FCPA") of 1977, Pub. L. No. 95-213, 91 Stat. 1494, 1494.

30. For historical background of FCPA enforcement until the 2000s, see, for example, 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, 1093–1108 (2012) ("[T]he SEC began to enforce the FCPA in earnest in the early 2000s.") and Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775, 1829 (2011) ("While for decades FCPA prosecutions were rare, they accelerated after 1998.").

31. *See generally* Amy Deen Westbrook, *Double Trouble: Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO ST. L.J. 1217 (2012) (describing increased FCPA enforcement beginning in 2007); Roger M. Witten, Kimberly A. Parker, Jay Holtmeier & Thomas J. Koffer, *Prescriptions for Compliance with the Foreign Corrupt Practices Act: Identifying Bribery Risks and Implementing Anti-Bribery Controls in Pharmaceutical and Life Sciences Companies*, 64 BUS. LAW. 691 (2009) (noting that 2006–2008 saw more FCPA actions than the entirety of 1977–2005, and describing the impact of increased FCPA enforcement in the pharmaceutical industry). *See* Joel M. Cohen, Michael P. Holland & Adam P. Wolf, *Under the FCPA, Who Is a Foreign Official Anyway?*, 63 BUS. LAW. 1243, 1247 (2008) (noting an increase in FCPA actions and penalties from 2005–2007).

32. GERALD S. MARTIN, JONATHAN M. KARPOFF & D. SCOTT LEE, SEARLE CIV. JUST. INST., LAW & ECON. CTR, GEORGE MASON UNIV. SCH. OF LAW, THE FOREIGN CORRUPT PRACTICES ACT: ECONOMIC IMPACT ON TARGETED FIRMS 1 (2014).

division, as part of which it agreed to pay $800 million to settle allegations of FCPA violations in multiple countries.[33] As then-SEC Chairman Christopher Cox put it at that time, it was "the largest settlement in the history of the Foreign Corrupt Practices Act since it became law in 1977."[34]

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.[35] The penalties have only continued to increase. For example, in 2017, Telia Company AB, a Swedish phone company, agreed to pay $965.8 million to settle, via DPA, U.S. and European criminal and civil charges that it paid bribes to win business in Uzbekistan.[36] Then, in 2018, Petrobras, Brazil's state energy company, entered into an NPA with the DOJ that included a criminal penalty of $853.2 million,[37] in addition to a related settlement with the SEC. And in 2020, Goldman Sachs agreed to pay $3.3 billion to the DOJ and SEC to resolve an FCPA case against it.[38]

33. Press Release, U.S. Dep't of Just., Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree To Pay $450 Million in Combined Criminal Fines (Dec. 15, 2008), https://www.justice.gov/archive/opa/pr/2008/December/08-crm-1105.html [https://perma.cc/QC7B-VR9E].

34. Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Siemens AG for Engaging in Worldwide Bribery (Dec. 15, 2008), https://www.sec.gov/news/press/2008/2008-294.htm [https://perma.cc/5WP9-4DJK].

35. Press Release, U.S. Dep't of Just., Kellogg Brown & Root LLC Pleads Guilty to Foreign Bribery Charges and Agrees To Pay $402 Million Criminal Fine (Feb. 11, 2009), https://www.justice.gov/opa/pr/kellogg-brown-root-llc-pleads-guilty-foreign-bribery-charges-and-agrees-pay-402-million [https://perma.cc/CZ32-V3PH]; Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges KBR and Halliburton for FCPA Violations (Feb. 11, 2009), http://www.sec.gov/news/press/2009/2009-23.htm [https://perma.cc/K5DX-L688]. To gain an idea of the scope of DOJ and SEC investigations into FCPA cases, *see* GIBSON, DUNN & CRUTCHER, LLP, 2007 YEAR-END FCPA UPDATE (2008) [hereinafter GIBSON DUNN-2007], https://www.gibsondunn.com/2007-year-end-fcpa-update [https://perma.cc/Y9FE-BU8S] (listing dozens of FCPA investigations in 2007 alone).

36. Press Release, U.S. Dep't of Just., Telia Company AB and Its Uzbek Subsidiary Enter into a Global Foreign Bribery Resolution of More than $965 Million for Corrupt Payments in Uzbekistan (Sept. 21, 2017), https://www.justice.gov/opa/pr/telia-company-ab-and-its-uzbek-subsidiary-enter-global-foreign-bribery-resolution-more-965 [https://perma.cc/43EJ-NQJJ]. The FCPA Top Ten List is available at the FCPA Blog. Harry Cassin, *Wall Street Bank Earns Top Spot on FCPA Blog Top Ten List*, FCPA BLOG (Oct. 26, 2020, 7:58 AM), https://fcpablog.com/2020/10/26/wall-street-bank-earns-top-spot-on-fcpa-blog-top-ten-list [https://perma.cc/S6CN-99XL].

37. Press Release, U.S. Dep't of Just., Petroleo Brasileiro S.A. – Petrobras Agrees To Pay More than $850 Million for FCPA Violations (Sept. 27, 2018), https://www.justice.gov/opa/pr/petr-leo-brasileiro-sa-petrobras-agrees-pay-more-850-million-fcpa-violations [https://perma.cc/ZG3Z-VHAV].

38. *See* Cassin, *supra* note 36 (summarizing the Goldman Sachs settlement).

These enforcement actions have been heralded in public pronouncements by DOJ officials. For example, in 2007, Mark F. Mendelsohn, deputy chief of the fraud section of the DOJ Criminal Division, stated in his opening address at the American Conference Institute's FCPA Conference that "2007 is by any measure a landmark year in the fight against foreign bribery."[39] Speaking a year later at an American Bar Association panel on foreign bribery, he promised that the trend would continue.[40] Mendelsohn's promise was echoed by Lanny Breuer, the head of the DOJ Criminal Division, who made it clear in November 2010 that "FCPA enforcement is stronger than it's ever been—and getting stronger."[41]

These were not empty promises. In 2008, the Federal Bureau of Investigation created a unit dedicated to FCPA investigations;[42] and in 2010, the SEC also formed a specialized unit within its enforcement division to focus on these cases.[43] 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.[44] Figure 1 illustrates the rise in FCPA enforcement actions brought by the DOJ and the SEC between 1978 and 2019:

39. GIBSON DUNN-2007, *supra* note 35 (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").

40. *Mendelsohn Says Criminal Bribery Prosecutions Doubled in 2007*, CORP. CRIME REP. (Sept. 16, 2008), https://www.corporatecrimereporter.com/mendelsohn091608.htm [https://perma.cc/R8MS-Y3U6].

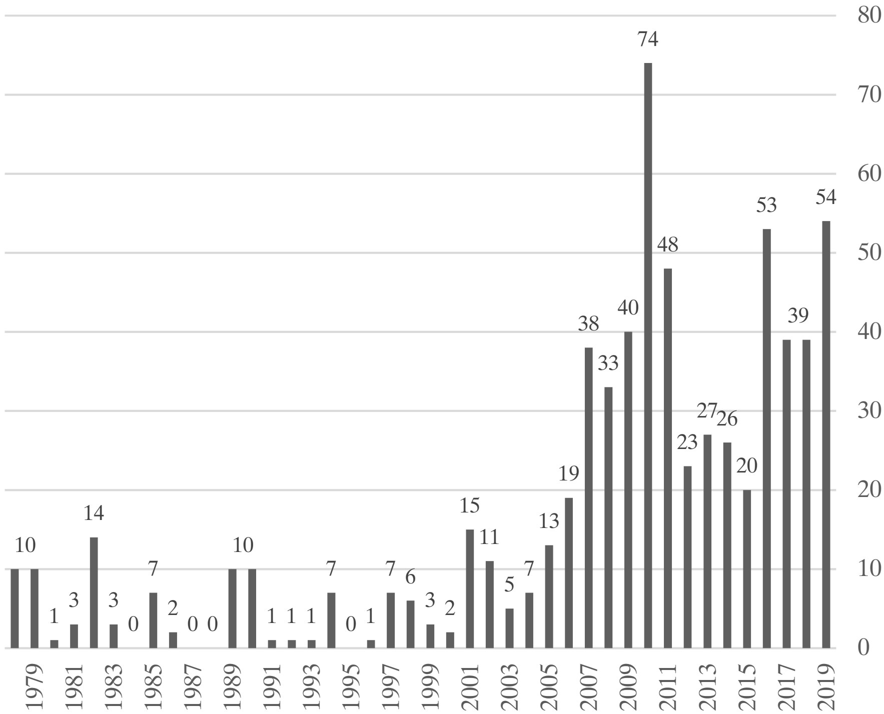
41. Lanny A. Breuer, Assistant Att'y Gen., U.S. Dep't of Just., Address at the 24th National Conference on the Foreign Corrupt Practices Act (Nov. 16, 2010), https://www.justice.gov/opa/speech/assistant-attorney-general-lanny-breuer-speaks-24th-national-conference-foreign-corrupt [https://perma.cc/3TWJ-NAN3] ("[W]e are in a new era of FCPA enforcement; and we are here to stay.").

42. *See Public Corruption*, FBI, https://www.fbi.gov/investigate/public-corruption [https://perma.cc/75ZA-PBMF].

43. Andrew Ceresney, Co-Director, Div. of Enf't, U.S. Sec. & Exch. Comm'n, Keynote Address at the International Conference on the Foreign Corrupt Practices Act (Nov. 19, 2013), https://www.sec.gov/news/speech/2013-spch111913ac [https://perma.cc/5TVT-BBVQ].

44. Justice Manual, *supra* note 17, § 9-47.120. The new policy was first published in November 2017. *See* David A. Silva, *Department of Justice Adopts New FCPA Corporate Enforcement Policy*, AM. BAR ASS'N (Dec. 21, 2017), https://www.americanbar.org/groups/litigation/committees/professional-liability/practice/2017/department-of-justice-adopts-new-fcpa-corporate-enforcement-policy [https://perma.cc/B3EM-L47G].

FIGURE 1: COMBINED DOJ/SEC FCPA ENFORCEMENT ACTIONS, 1978–2019[45]



A similar dynamic can be traced in FCA[46] enforcement, as it has recently become a major weapon in the arsenal of enforcement authorities.[47] 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

45. GIBSON DUNN & CRUTCHER LLP, 2019 YEAR-END FCPA UPDATE 2 (2020), https://www.gibsondunn.com/wp-content/uploads/2020/01/2019-year-end-fcpa-update.pdf [https://perma.cc/CFC5-A3JK]. For the data regarding the years 1979–2018, see Michael S. Diamant, Christopher W.H. Sullivan & Jason H. Smith, *FCPA Enforcement Against U.S. and Non-U.S. Companies*, 8 MICH. BUS. & ENTREPRENEURIAL L. REV. 353, 357 (2019).

46. False Claims Act, 31 U.S.C. §§ 3729–3733 (2018).

47. As Benjamin 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 . . . . An astonishing 60 percent of those recoveries were obtained in the last eight years." Press Release, U.S. Dep't of Just., Justice Department Recovers Over $4.7 Billion from False Claims Act Cases in Fiscal Year 2016 (Dec. 14, 2016), https://www.justice.gov/opa/pr/justice-department-recovers-over-47-billion-false-claims-act-cases-fiscal-year-2016 [https://perma.cc/CH3V-AB4K].

public attention when, in 2009, the pharmaceutical giant Pfizer agreed to pay $2.3 billion to settle FCA civil and criminal allegations after being accused of promoting the sale of certain drugs that the U.S. Food and Drug Administration ("FDA") refused to approve due to safety concerns.[48] In emphasizing the magnitude of the penalties FCA infringers should expect to face, Assistant Attorney General Tony West said, "This 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."[49] FCA civil and criminal investigations into the promotion of non-FDA-approved drug uses have continued, as have the large settlements to resolve them. For example, global pharma company Eli Lilly paid $1.4 billion in 2009,[50] Abbott Laboratories paid $1.5 billion in 2012,[51] and Johnson & Johnson agreed in 2013 to pay $2.2 billion to settle similar FCA allegations.[52] The rise in FCA enforcement actions continues. In 2017 alone, the DOJ recovered over $3.7 billion from FCA-related investigations,[53] and 2018's aggregate recovery was over $2.8 billion.[54] This trend is not likely to wane in the foreseeable future.

48. *See* Press Release, U.S. Dep't of Just., Justice Department Announces Largest Health Care Fraud Settlement in Its History: Pfizer To Pay $2.3 Billion for Fraudulent Marketing (Sept. 2, 2009), https://www.justice.gov/opa/pr/justice-department-announces-largest-health-care-fraud-settlement-its-history [https://perma.cc/H5VG-8LGN].

49. *Id.*

50. Press Release, U.S. Dep't of Just., Eli Lilly Company Agrees To Pay $1.415 Billion To Resolve Allegations of Off-Label Promotion of Zyprexa (Jan. 15, 2009), https://www.justice.gov/archive/opa/pr/2009/January/09-civ-038.html [https://perma.cc/W3C7-H2P2].

51. *See* Press Release, U.S. Dep't of Just., Abbott Labs To Pay $1.5 Billion To Resolve Criminal & Civil Investigations of Off-Label Promotion of Depakote (May 7, 2012), https://www.justice.gov/opa/pr/abbott-labs-pay-15-billion-resolve-criminal-civil-investigations-label-promotion-depakote [https://perma.cc/V5QM-TWBQ].

52. Press Release, U.S. Dep't of Just., Johnson & Johnson To Pay More than $2.2 Billion To Resolve Criminal and Civil Investigations (Nov. 4, 2013), https://www.justice.gov/opa/pr/johnson-johnson-pay-more-22-billion-resolve-criminal-and-civil-investigations [https://perma.cc/3QHE-QUJY].

53. Press Release, U.S. Dep't of Just., Justice Department Recovers Over $3.7 Billion from False Claims Act Cases in Fiscal Year 2017 (Dec. 21, 2017), https://www.justice.gov/opa/pr/justice-department-recovers-over-37-billion-false-claims-act-cases-fiscal-year-2017 [https://perma.cc/878K-WEHX].

54. Press Release, U.S. Dep't of Just., Justice Department Recovers Over $2.8 Billion from False Claims Act Cases in Fiscal Year 2018 (Dec. 21, 2018), https://www.justice.gov/opa/pr/justice-department-recovers-over-28-billion-false-claims-act-cases-fiscal-year-2018 [https://perma.cc/VPN7-Y7DG].

Laws designed to prevent money laundering have also provided a launching pad for enforcement actions. In this context, U.S. regulators have increased their efforts to ensure financial institutions comply with the Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act of 1970[55] (commonly referred to as the BSA) and anti-money laundering ("AML") laws. This campaign is led by the Financial Crimes Enforcement Network ("FinCEN")—the Treasury's leading agency for combatting money laundering. The SEC and the Financial Industry Regulatory Authority have also indicated their intent to focus their resources on AML violations.[56] Naturally, these authorities primarily target banks and depository institutions. And enforcement actions so far have quickly resulted in large settlements. In December 2012, HSBC Holdings admitted to AML violations and resolved them by agreeing to pay $1.2 billion as part of a DPA with the DOJ.[57] Additionally, it agreed to pay $665 million in civil penalties to the Office of the Comptroller of the Currency and the Federal Reserve.[58]

In February 2018, U.S. Bancorp ("USB") and the Office of the U.S. Attorney for the Southern District of New York entered into a DPA to resolve criminal charges against the company.[59] Those charges consisted of two alleged BSA violations by USB's subsidiary, U.S. Bank National Association, for willfully failing to maintain an adequate AML program and willfully failing to file a Suspicious

55. Financial Recordkeeping and Reporting of Currency and Foreign Transaction Act of 1970, Pub. L. No. 91-508, 84 Stat. 1118.

56. *See* U.S. SEC. & EXCH. COMM'N, OFF. OF COMPLIANCE INSPECTIONS & EXAMINATIONS, EXAMINATION PRIORITIES FOR 2017, at 4 (2017), https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf [https://perma.cc/PV85-UFSN] ("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 8 (2017), http://www.finra.org/sites/default/files/2017-regulatory-and-examination-priorities-letter.pdf [https://perma.cc/NK3G-GFBC] ("In 2017, FINRA will continue to focus on firms' anti-money laundering programs, especially those areas where we have observed shortcomings.").

57. *HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement*, U.S. DEP'T JUST. (Dec. 11, 2012), https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations [https://perma.cc/VU3S-RSLX].

58. *Id.*

59. *See* Deferred Prosecution Agreement, United States v. U.S. Bancorp, No. 18-cr-150 (S.D.N.Y. Feb. 12, 2018); *see also* Press Release, U.S. Dep't of Just., Manhattan U.S. Attorney Announces Criminal Charges Against U.S. Bancorp for Violations of the Bank Secrecy Act (Feb. 15, 2018), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-criminal-charges-against-us-bancorp-violations-bank [https://perma.cc/ZZL7-F2SN].

Activity Report. The DPA specified that USB would pay the United States $528 million.

Between January 2002 and December 2015, 76.3 percent of AML and BSA enforcement cases were directed at banks and depository institutions.[60] In the years since the financial crisis of 2008, the world's biggest banks have been fined $321 billion.[61]

It certainly appears as if AML and BSA enforcement will remain at the forefront of U.S. legislative and regulatory priorities in coming years. Recently, Congress has shown an interest in updating AML laws by proposing multiple new bills[62] and engaging in a number of discussions on the subject.[63] The next Section further explains how and why many enforcement actions end with PDAs.

B. Pretrial Diversion Agreements

1. *The Growth in the Use of PDAs.* As explained above, the number of corporate criminal investigations has increased exponentially over the last two decades. As Professors Jennifer Arlen and Marcel Kahan note, "corporate criminal enforcement in the United States has undergone a dramatic transformation,"[64] and these enhanced enforcement efforts have brought about a corresponding increase in the number of PDAs.[65] A related explanation for this trend focuses on the Thompson Memo released by the DOJ in 2003, which

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60. SHARON BROWN-HRUSKA, NERA ECON. CONSULTING, DEVELOPMENTS IN BANK SECRECY ACT AND ANTI-MONEY LAUNDERING ENFORCEMENT AND LITIGATION 4 (2016), http://www.nera.com/content/dam/nera/publications/2016/PUB_Developments_BSA_AML_Lit-06.16.pdf [https://perma.cc/FG22-MJH3].

61. Gavin Finch, *World's Biggest Banks Fined $321 Billion Since Financial Crisis*, BLOOMBERG (Mar. 2, 2017), https://www.bloomberg.com/news/articles/2017-03-02/world-s-biggest-banks-fined-321-billion-since-financial-crisis [https://perma.cc/6TL9-5BCU].

62. *See, e.g.*, AML and CTF Modernization Act, H.R. 4373, 115th Cong. (2017); Combating Money Laundering, Terrorist Financing, and Counterfeiting Act of 2017, S. 1241, 115th Cong. (2017).

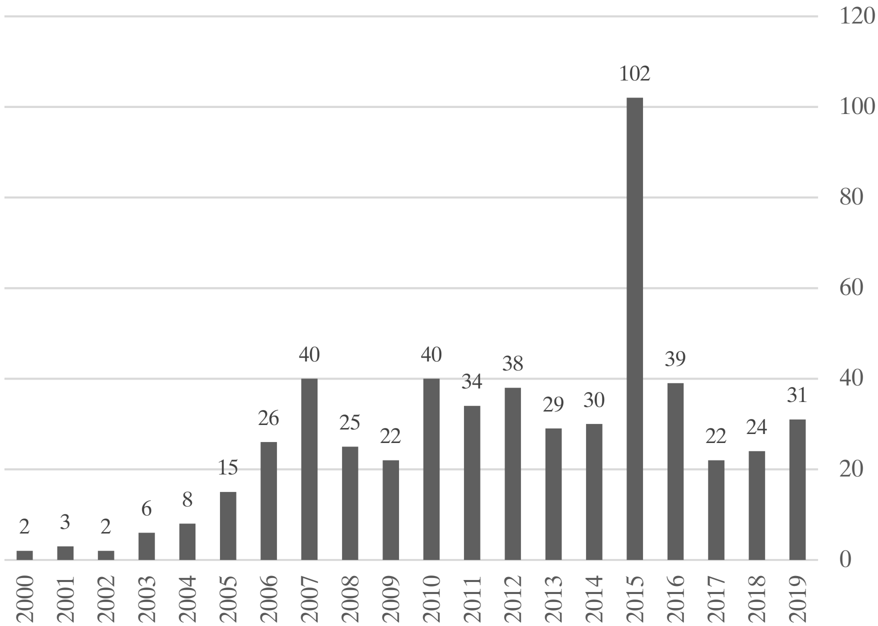
63. *See, e.g.*, *Combating Money Laundering and Other Forms of Illicit Finance: Opportunities to Reform and Strengthen BSA Enforcement: Hearing Before the Comm. on Banking, Hous. & Urb. Affs.*, 115th Cong. 1 (Jan. 9, 2018) (statement of Sen. Mike Crapo, Chairman, S. Comm. on Banking, Hous. & Urb. Affs.).

64. Arlen & Kahan, *supra* note 8, at 324.

65. 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, an NPA does not. *See* Cindy R. Alexander & Mark A. Cohen, *The Evolution of Corporate Criminal Settlements: An Empirical Perspective on Non-Prosecution, Deferred Prosecution, and Plea Agreements*, 52 AM. CRIM. L. REV. 537, 545 (2015).

instructed federal prosecutors to defer prosecution if corporations agreed 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."[66] Figure 2 illustrates the growing use of PDAs over the last decade:

FIGURE 2: CORPORATE NPAS AND DPAS, 2000–2019[67]



66. *See* Memorandum from Larry D. Thompson Deputy Att'y Gen., U.S. Dep't of Just., to Heads of Dep't Components U.S. Att'ys, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003); *see also infra* notes 138–39.

67. *See* GIBSON DUNN & CRUTCHER LLP, 2019 YEAR-END UPDATE ON CORPORATE NON-PROSECUTION AGREEMENTS AND DEFERRED PROSECUTION AGREEMENTS 2 (2020), https://www.gibsondunn.com/2019-year-end-npa-dpa-update [https://perma.cc/7EHD-K9K6]; *see also* Gideon Mark, *Private FCPA Enforcement*, 49 AM. BUS. L.J. 419, 434–35 (2012) ("In the twenty-first 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 United States. *See* Reilly, *Sweetheart Deals*, *supra* note 11, at 1140 (describing the growing use of PDAs 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), https://www.wsj.com/articles/BL-CCB-7259 [https://perma.cc/QQY4-3YFR] ("The U.K. intends moving forward with introducing deferred-prosecution agreements, a law enforcement tool extensively used by the U.S., to prosecute white-collar crime, according to a consultation paper.").

Instead of prosecuting cases to a final judgment, enforcement authorities have displayed a preference to enter into PDAs with public companies.[68] Under these pretrial agreements, corporations agree to admit to wrongdoing, pay considerable amounts—sometimes hundreds of millions of dollars[69]—and undertake various corrective measures to prevent future lapses in compliance. In exchange, the enforcement authority will defer the prosecution for a certain period of time. If the corporation has performed the agreement at the end of that period, the prosecution will be dropped.[70]

The company under investigation and the enforcement authority, typically the DOJ, usually enter into the agreement following an internal investigation. The company itself leads the investigation with the assistance of a DOJ-approved audit firm,[71] 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. The investigative process includes the collection and review of thousands of documents and emails. In some cases, the numbers are much higher,

68. Lanny A. Breuer, former head of the DOJ Criminal Division, stated that DPAs had "become a mainstay of white collar criminal law enforcement." Lanny A. Breuer, Assistant Att'y Gen., U.S. Dep't of Just., Assistant Attorney General Lanny A. Breuer Speaks 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 [https://perma.cc/CFP6-QBU8]; *see also* Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 855 (2007) [hereinafter Garrett, *Structural Reform Prosecution*] ("[T]he Department of Justice ("DOJ") adopted a novel strategy by prosecuting large organizations far more often, but leveraging the prosecutions to secure adoption of sweeping internal reforms. Without obtaining an indictment, much less a conviction, the DOJ recently prevailed on thirty-five leading corporations . . . ."); Koehler, *supra* note 20, at 515–22 (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.").

69. *See* GIBSON DUNN & CRUTCHER LLP, 2018 YEAR-END UPDATE ON CORPORATE NON-PROSECUTION AGREEMENTS AND DEFERRED PROSECUTION AGREEMENTS 1 (2019), https://www.gibsondunn.com/wp-content/uploads/2019/01/2018-year-end-npa-dpa-update.pdf [https://perma.cc/9JAC-Q2HN] (showing how in 2018, in the United States, "the monetary recoveries skyrocketed to nearly $8.1 billion").

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

71. Typically, the audit company will be one of the "big four," namely, Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers.

and millions of pages of documents are produced and submitted to the DOJ. Within this process, the company must collect and translate multiple documents, conduct internal interviews, and make representations to the DOJ reflecting the result of the internal investigation. 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;[72] high-level personnel changes, such as termination of high-, mid-, and low-level officers;[73] business changes;[74] and the appointment of an external corporate monitor approved by the enforcement authority for the probation period, which is usually twenty-four to thirty-six months.[75]

Also, PDAs include a statement of facts in which the company admits to the offenses of which it is accused in a very detailed manner.[76] Professor Richard Epstein went so far as to describe these admissions

72. *See* Arlen & Kahan, *supra* note 8, at 342 ("[F]rom 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 . . . .").

73. *See* Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993–2013*, 70 BUS. LAW. 61, 84, 92–94 (2014) (finding that out of 271 PDAs executed between 1993–2013, 30 percent mandated changes in senior management).

74. *See id.* at 84, 94 (finding that out of 271 PDAs executed between 1993–2013, 30 percent mandated business changes).

75. *See* Arlen & Kahan, *supra* note 8, at 342 ("[F]rom 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 . . . ."); Garrett, *Structural Reform Prosecution*, *supra* note 68, at 898 ("The length of monitoring is often longer than the typical eighteen months for deferral agreements and can be as long as three years. The average amount of time that these agreements last is two years. A few specify that they can be extended if needed to secure compliance."); *see also* Alexander & Cohen, *supra* note 65, at 588 ("[S]ome commentators regard DPAs and NPAs as being more likely to require far reaching governance reforms, including external monitors and compliance programs, than those typically achieved through a plea agreement."); 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) (explaining that "DPAs generally include undertakings to make significant structural and procedural reforms," and highlighting the "expansive" "corporate governance measures HSBC agreed to undertake" as part of a settlement with the Justice Department); Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713, 1720–26 (2007) (reviewing "twenty-five cases in which DPAs or NPAs required the appointment of someone with ongoing supervisory responsibility" to evaluate monitors and their powers). *See generally* Veronica Root, *The Monitor-"Client" Relationship*, 100 VA. L. REV. 523 (2014) (analyzing corporate compliance monitors).

76. *See* Arlen & Kahan, *supra* note 8, at 334.

as "confessions of a Stalinist purge trial."[77] 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.[78]

The consequences for the directors and officers implicated in the investigation are far-reaching and dire. Naturally, the company's admissions affect them. True, 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 careers. Current directors and officers can affect to some degree the admissions made by the corporation about their acts or omissions, thus lessening their impact. 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. Part III.A discusses the ramifications of this reality for corporate law and theory.

2. *The Pressure To Settle.* At this point, readers may wonder why powerful corporations sign PDAs. PDAs are essentially plea bargains.[79] A voluminous literature explains why individuals enter plea bargains.[80] Most 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 in the typical case corporations have superior financial resources to individuals, that does not mean they can afford a prolonged legal battle

77. Professor Richard Epstein argues further that

> [t]he 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.

Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J. (Nov. 28, 2006, 12:01 AM), https://www.wsj.com/articles/SB116468395737834160 [https://perma.cc/VH6T-965L].

78. *See* Brandon L. Garrett, *Corporate Confessions*, 30 CARDOZO L. REV. 917, 924–25 (2008).

79. For a detailed discussion of the differences between PDAs and plea agreements, see *infra* Part II.B.3.

80. *See, e.g.*, Jed S. Rakoff, *Why Innocent People Plead Guilty*, N.Y. REV. (Nov. 20, 2014), https://www.nybooks.com/articles/2014/11/20/why-innocent-people-plead-guilty [https://perma.cc/24NJ-87JB].

against the state or that it is in their best interest to do so. As this Section explains, 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 enter PDAs for a number of legal and economic reasons. To begin with the *legal reasons*, imposing criminal liability on a corporation is easier than successfully prosecuting individuals. Unlike in cases against individuals, where the prosecutor must prove that one individual performed all the elements of the offense, the acts and omissions of different corporate agents may be used together to prove the case against corporations. As a consequence, a corporation can be charged with a criminal offense even if none of its directors, officers, or employees individually can be accused of it.

Two doctrines create this result. First and foremost, when the DOJ chooses to charge a company with a violation of a federal statute, it largely relies 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 and were motivated, at least in part, by the desire to benefit the corporation.[81] Courts have construed this doctrine broadly. First, the *respondeat superior* doctrine enables the imposition of liability on the company, regardless of the position of the employee who violated the law.[82] Second, a company may be held liable "even if an employee is violating express corporate policy."[83] Third, the requirement that the employee acted within the scope of her 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

81. *See* N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 493–95 (1909); United States v. Singh, 518 F.3d 236, 249–51 (4th Cir. 2008); United States v. Jorgensen, 144 F.3d 550, 560 (8th Cir. 1998); United States v. Sun-Diamond Growers of Cal., 138 F.3d 961, 970 (D.C. Cir. 1998); *see also* United States v. Potter, 463 F.3d 9, 25 (1st Cir. 2006).

82. *See* Standard Oil Co. of Tex. v. United States, 307 F.2d 120, 127 (5th Cir. 1962) (stating a "corporation may be criminally bound by the acts of subordinate, even menial, employees"); *see also* United States v. Ionia Mgmt. S.A., 555 F.3d 303, 309–10 (2d Cir. 2009) (rejecting the argument "that corporate criminal liability can only stem from the actions of so-called 'managerial' employees" as "at odds with . . . precedents" (citations omitted)); United States v. Dye Constr. Co., 510 F.2d 78, 82 (10th Cir. 1975) ("The cases recognize that corporations are responsible for the acts and omissions of their authorized agents acting in the scope of their employment. There is no doubt as to the authority of the superintendent, the foreman and the back hoe operator." (citations omitted)).

83. City of Vernon v. S. Cal. Edison Co., 955 F.2d 1361, 1369 (9th Cir. 1992).

corporation, but also that which outsiders could reasonably assume the agent would have authority to do.'"[84] 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 to the company.[85] Interestingly, it is no defense that the employee acted primarily for his personal benefit,[86] but it may be one when the employee acted exclusively for his own benefit.[87]

The second doctrine that the DOJ may use is the collective-knowledge doctrine. This doctrine makes it possible to impose criminal liability on corporations, even in cases where no individual has committed all the components of the offense.[88] Under this doctrine, the knowledge and conduct of multiple employees can be imputed, in aggregation, to the company.[89] 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.[90] Taken together, the *respondeat superior* doctrine and the collective-knowledge doctrine make companies much more vulnerable to criminal convictions, compared to individuals.[91]

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84. United States v. Hilton Hotels Corp., 467 F.2d 1000, 1004 (9th Cir. 1972); *see* United States v. Automated Medic. Lab'ys, Inc., 770 F.2d 399, 407 (4th Cir. 1985).

85. *See Automated Medic. Lab'ys, Inc.*, 770 F.2d at 407.

86. *See Sun-Diamond Growers of Cal.*, 138 F.3d at 970–71.

87. *See Automated Medic. Lab'ys, Inc.*, 770 F.2d at 407; *Standard Oil Co. of Tex.*, 307 F.2d at 129.

88. The First Circuit explains:

> a corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly.

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

89. This doctrine arises because

> [c]orporations 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.

Id.

90. Patricia S. Abril & Ann Morales Olazabal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81, 114–15 (explaining generally the collective-knowledge doctrine and its relation to mens rea).

91. A note argues that

> 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

The *business reasons* to sign a PDA are even weightier. Once the company is accused of violating the law—and whether or not it is ultimately 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. An investigation requires the firm to allocate managerial and legal resources to the matter and comes on top of the company's standard business. This means the company must employ its human capital in a different way to address the exigencies posed by the investigation.[92] 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 in the form of a reduced fine for cooperating with the investigating authorities, corporations have a strong incentive to pay law firms to conduct an internal investigation within the firm and report the findings to the DOJ or SEC.[93] 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

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> 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.

Note, *Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1248 (1979).

92. *See, e.g.*, Olaf Storbeck, *Deutsche Bank Investors Fear Criminal Probe Will Hinder Turnaround*, FIN. TIMES (Dec. 3, 2018), https://www.ft.com/content/03d9685c-f632-11e8-af46-2022a0b02a6c [https://perma.cc/B8FQ-NB5Q] ("Investors in Deutsche 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.").

93. *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 Professor Mike Koehler describes is relevant not just to FCPA investigations but to all investigations. *See* 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 the calculation of fines and the level of cooperation provided by companies, as "carrots" and "sticks").

come under the attorney–client privilege,[94] and align "their interests with those of" the DOJ's or SEC's attorneys.[95]

In global companies, the cost of conducting the investigation runs into the hundreds of millions of dollars.[96] If ultimately no agreement is reached with the enforcement authorities, the resources spent on the investigation will be wasted. Hence, once a company decides to conduct an internal investigation, it 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,[97] loss of business opportunities, and an increased civil litigation risk.[98] The first two costs are distinct, but related. A criminal investigation can irreversibly tarnish the reputation of a firm, causing

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94. *Infra* notes 138–39.

95. *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 then-N.Y. Attorney General Eliot Spitzer).

96. *See generally supra* note 19 (providing examples).

97. *See* Garrett, *Structural Reform Prosecution*, *supra* note 68, 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, 581 (2008) (examining 585 companies that were targeted by SEC enforcement actions for financial misrepresentation from 1978–2002 and revealing that these companies lost 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*, 36 J.L. & ECON. 757, 758–59 (1993) (using data from 132 corporate fraud cases between 1978–1987 to find that the loss in common-stock value of the 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 MD. L. REV. 1295, 1336 (2013) ("Perhaps most significantly of all, criminal prosecution has . . . a stigmatizing effect that civil enforcement does not.").

98. *See* Greenblum, *supra* note 15, 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.").

Former DOJ attorneys Christopher Wray and Robert Hur note that for health care providers who extensively rely 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.

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) (citation omitted).

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.[99]

The constant press coverage that accompanies the investigation often augments concerns about the company's stability and casts doubt on its future.[100] This, in turn, makes it harder for the company to pursue new business opportunities. It also forces the company to funnel resources into maintaining business relationships. Once word of the investigation gets 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.[101] In parallel, they may pursue other business opportunities that they deem safer.[102]

An often-cited example that demonstrates these threats is the case of Arthur Andersen.[103] The story began in 2002, when Andersen was charged with obstruction of justice for destroying documents in order

99. *See* David M. Uhlmann, *The Pendulum Swings: Reconsidering Corporate Criminal Prosecution*, 49 U.C. DAVIS L. REV. 1235, 1264 (2016) [hereinafter Uhlmann, *The Pendulum Swings*] ("Reputational harm can discourage investment in a company.").

100. *See* Jamie L. Gustafson, Note, *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?smid=url-share [https://perma.cc/T6SF-MXEV].

101. Koehler, *supra* note 20, at 510 ("A criminal investigation and indictment alone could have enormous adverse consequences even if a company were ultimately acquitted at trial.").

102. *See* Uhlmann, *The Pendulum Swings*, *supra* note 99, at 1264–65 ("Reputational harm also can hamper relationships in the broader business community.").

103. *See* Cindy A. Schipani, *The Future of the Attorney-Client Privilege in Corporate Criminal Investigations*, 34 DEL. J. CORP. 921, 925–27 (2009) (summarizing the case and explaining the negative impacts on Arthur Andersen as a result of the prosecution); *see also* Elizabeth K. Ainslie, *Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution*, 43 AM. CRIM. L. REV. 107, 109 (2006) ("[T]he indictment, the conviction, and the consequent prohibition against appearing before the Securities and Exchange Commission were sufficient to kill the company."); 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) (explaining the devastating effects of the prosecution on Arthur Andersen); Golumbic & Lichy, *supra* note 75, at 1306–08 (summarizing the Arthur Andersen case); Peter J. Henning, *The Organizational Guidelines: R.I.P.?*, 116 YALE L.J. POCKET PART 312, 314 (2007) ("Federal prosecutors use deferred and non-prosecution agreements to accomplish the Guidelines' goals while avoiding the 'Arthur Andersen effect'—the collateral damage from a conviction in which innocent employees unconnected to the wrongdoing lose their jobs and investments in the firm.").

to impede the SEC-led investigation of Enron. The district court convicted Andersen the same year, and the Fifth Circuit affirmed. In 2005, the Supreme Court reversed Andersen's conviction, but it was too late. Andersen had already lost its Certified Public Accountant license—since the SEC does not accept audits from convicted firms—and despite the reversal, Andersen had no chance to reclaim its title as one of the "big five" accounting firms.[104] Eric Holder, who later served as the attorney general of the United States, described the dire consequences of the investigation and conviction in 2002:

> 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.[105]

The story of Arthur Andersen demonstrates why entering into a PDA with the enforcement authorities as quickly as possible is most firms' top priority once an investigation has begun. Companies under criminal investigation must strive to reach a settlement at all costs; 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 in 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, the company faces a reality in which its resources are dwindling while its expenses are mounting.

From both perspectives—the legal perspective and the business perspective—the best response to a criminal investigation is to strive to settle it expeditiously, almost regardless of the cost. The alternative, as the story of Arthur Andersen illustrates, may be the demise of the corporation. The desire to settle makes perfect sense for the company,

104. Schipani, *supra* note 103, at 926–27.

105. Eric Holder, *Don't Indict WorldCom*, WALL ST. J. (July 30, 2002, 12:01 AM), https://www.wsj.com/articles/SB1027991133930326640 [https://perma.cc/93DG-GFAX]; *see also* Alex B. Heller, Note, *Corporate Death Penalty: Prosecutorial Discretion and the Indictment of SAC Capital*, 22 GEO. MASON L. REV. 763, 763–64 (2015) ("In Andersen's case, the indictment alone was a corporate death sentence, even before adjudication. The Anders[e]n 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." (footnotes omitted)).

but for the reasons Part II explains, it comes at a dear price for the individual directors and officers.

3. *Plea Agreements.* Similar dynamics to those that characterize PDAs also arise, albeit to a lesser extent, in the context of plea agreements.[106] In parallel to the increase in the use of PDAs, classic corporate plea agreements continue to be a useful tool for enforcement authorities.[107] 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.[108]

There are additional differences as well. First, courts play a more significant role in overseeing plea agreements. Although both plea agreements and DPAs may require court approval, there is a difference between the court's role in reviewing DPAs and its role in evaluating plea agreements. As Judge Sri Srinivasan of the D.C. Circuit stated in the famous case of *Fokker*[109]: "[T]he 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."[110] And unlike DPAs, NPAs do not require court

106. Alexander & Cohen, *supra* note 65, at 538 (discussing critiques concerning the use of DPAs and NPAs).

107. *Id.* at 562 (reporting that 486 corporate criminal settlements were signed between 1997–2011 by the DOJ and public companies (or their affiliates), and 329 of these settlements were plea agreements); *see also Data & Documents*, CORP. PROSECUTION REGISTRY, http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/browse/browse.html [https://perma.cc/HJD5-9N7R] (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 1992–2019 by federal agencies and public companies, among which 167 were plea agreements).

108. *See* 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 87 (Jennifer Arlen ed., 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*."); Greenblum, *supra* note 15, 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.").

109. United States v. Fokker Servs. B.V., 818 F.3d 733 (D.C. Cir. 2016).

110. *Id.* at 746; *see also id.* at 744–45 ("Whatever may be the precise contours of that authority of a court to confirm 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."); JAMES M. ANDERSON & IVAN WAGGONER, THE CHANGING ROLE OF CRIMINAL LAW IN CONTROLLING CORPORATE BEHAVIOR 62 (2014) ("But because DPAs and NPAs are

approval and do not come under judicial scrutiny at all, notwithstanding that they too contain broad admissions of guilt. The weakened role of judicial oversight of PDAs takes away some of the bargaining power wielded by law enforcement authorities in plea-agreement negotiations.[111]

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, both plea agreements and PDAs include factual admissions and a waiver of rights. Still, as reported by research fellow Cindy Alexander and Professor Mark Cohen in their empirical study, PDAs are more likely than plea agreements to include requirements to waive privilege.[112]

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."[113]

Despite these differences, both 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. To this end, corporations are willing to disregard the interests of present and, especially, past directors and officers, treating

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."); Recent Cases, *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.*—United States v. Fokker Services B.V., *818 F.3d 733 (D.C. Cir. 2016)*, 130 HARV. L. REV. 1048, 1055 (2017); Peter R. Reilly, *Corporate Deferred Prosecution as Discretionary Injustice*, 2017 UTAH L. REV. 839, 871 (2017) [hereinafter Reilly, *Discretionary Injustice*] ("[D]istrict courts have a long history of competently reviewing plea agreements."); Epstein, *supra* note 77 ("[DPA agreements can] turn[] the prosecutor into judge and jury, thus undermining our principles of separation of powers."). *But see* Darryl Brown, *The Judicial Role in Criminal Charging and Plea Bargaining*, 46 HOFSTRA L. REV. 63, 77–82 (2017) (explaining how judges play a passive role in approving plea agreements).

111. Reilly, *Discretionary Injustice*, *supra* note 110, at 869 ("[I]n 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.").

112. Alexander & Cohen, *supra* note 65, at 587.

113. *Id*.

them as scapegoats who must bear the blame for the company's failure. Furthermore, to enter agreements as quickly as possible, firms categorically refuse to go to the trouble of distinguishing among those who sinned and those who did not. This gives rise to the reverse agency problem.

II. 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." The reverse agency problem is the mirror image of the famous managerial agency problem identified by Berle and Means. They observed that the structure of public corporations allows directors and officers to promote their narrow self-interest at the expense of the shareholders.[114] This insight has had an unparalleled impact on corporate-law scholarship, and it is undeniably correct for corporations in the ordinary course of business.

The opening of a criminal investigation into 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 its end, corporations are willing to admit to wrongdoing in order to cut their losses and put the investigation behind them.[115] En route to this result, corporations attribute various acts and omissions to their directors and officers, as required by law enforcement agencies. This behavior is perfectly rational. Settlements generally maximize value for the shareholders.[116] Yet, they come at a hefty price for the

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114. *See infra* note 123 and accompanying text.

115. *See* 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.'" (citation omitted)); Richard Cassin, *What's Wrong with Corporate Criminal Liability?*, FCPA BLOG (Jan. 7, 2009, 7:02 PM), http://www.fcpablog.com/blog/2009/1/8/whats-wrong-with-corporate-criminal-liability.html [https://perma.cc/JK8E-Z5PF] ("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.'" (citation omitted)).

116. *Compare* Cunningham, *supra* note 95, at 20 ("From the perspective of economic theory, the adverse collateral consequences [of corporate conviction] are essentially negative externalities, and DPAs are designed to avoid those."), *with* Jenny Anderson, *A.I.G. Is Expected To Offer $1.6 Billion To Settle with Regulators*, N.Y. TIMES (Feb. 6, 2006), https://www.nytimes.com/2006/02/06/business/aig-is-expected-to-offer-16-billion-to-settle-with-regulators.html [https://perma.cc/U7A9-JQCH] (providing the statement of Howard Opinsky, a spokesman for Maurice R. Greenberg, who served as the chairman and CEO of AIG that

directors and officers, and often other employees, who are expected to "take one for the team" and live with the consequences of the settlement.

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 law enforcement authorities.[117] 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.[118] The shareholders' interest takes precedence over that of the directors and officers. For this reason, we refer to this conflict of interest as "the reverse agency problem." This Part explores the effects of criminal investigations in general, and settlements in particular, on corporate agents and highlights the dynamics and costs resulting therefrom.

If the investigation results in an agreement or an indictment, the company is likely to face demands from shareholders to file civil actions against the directors and officers implicated in the investigation.[119] Further, the facts stated in the agreement or indictment provide a fertile ground for shareholders to file their own derivative suits against the directors and officers. After all, the documents 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

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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 . . . . [A] settlement of this magnitude is merely a political trophy for the attorney general and totally disproportionate to the impact of the alleged misconduct").

117. *See infra* Part II.B.2.

118. Recall, again, that Professor Epstein describes the PDAs as "confessions of a Stalinist purge trial." Epstein, *supra* note 77.

119. *See* Westbrook, *supra* note 31, at 1227 (discussing collateral suits triggered by announcements of penalties or investigations); *see also* Mark, *supra* note 67, 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."). Note that sometimes the mere announcement of a criminal investigation can trigger the filing of derivative actions.

matter and make recommendations to the board of directors.[120] 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.[121]

A. When Directors and Officers Come Second

It is impossible to overestimate the role of agency problems in corporate law.[122] 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 that 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.[123]

Subsequently, scholars have identified other types of agency problems—that is, conflicts of interest that are endemic to corporations. For one, there is a tension between shareholders and creditors. The former, who are residual value claimants, are willing to take risks to maximize reward, but the latter, who have a fixed claim, prefer a much lower level of risk, if any.[124] Further, an agency problem

120. *See generally* C.N.V. Krishnan, Steven Davidoff Solomon & Randall S. Thomas, *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees*, 60 J. CORP. FIN. 1 (2020) (providing more updated empirical data regarding the recommendations of special litigation committees); Minor Myers, *The Decision of the Corporate Special Litigation Committees: An Empirical Investigation*, 84 IND. L.J. 1309 (2009) (discussing the mechanism of the special litigation committees and providing empirical data regarding the recommendations of these committees through the years).

121. 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, derivative actions represent an unwelcome development for the company. The filing of such an 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* Storbeck, *supra* note 92 (discussing how a money-laundering investigation of Deutsche Bank would divert attention from the operative business). Furthermore, since directors and officers are typically 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.

122. *See, e.g.*, Goshen & Squire, *supra* note 3, at 769 ("For the last forty years, the problem of agency costs has dominated the study of corporate law and governance.").

123. *See* sources cited *supra* notes 1–2.

124. *See* John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL

exists between majority shareholders and minority shareholders.[125] 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, Professors 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 varying willingness to actively monitor and engage the management of companies in which they invest.[126]

This Article adds 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 of the investigations against them, corporations are willing to accede to the demands of 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 resources and allow the initiation of additional enforcement actions against other firms.[127] 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.[128] It also frees

APPROACH 30 (Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe & Edward Rock eds., 3d ed. 2017) (discussing how owners may behave opportunistically toward creditors, employees, and customers).

125. *Id.*; *see also* Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. 22, 22–23 (2000) (describing how controlling shareholders "tunnel" resources out of a company and to themselves).

126. *See generally* Gilson & Gordon, *supra* note 3, at 865 ("Record owners prefer exit to the exercise of governance rights even when a governance approach is more valuable to the beneficial owners.").

127. U.S. Dep't of Just., United States Attorneys' Manual § 9-22.010 (2011) [hereinafter Attorneys' Manual], https://www.justice.gov/jm/jm-9-22000-pretrial-diversion-program#9-22.010 [https://perma.cc/3SEQ-N4BX] ("The major objectives of pretrial diversion are . . . [t]o save prosecutive and judicial resources for concentration on major cases."); *see also* Christie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?*, 34 J. CORP. L. 679, 680–81 (2009) (discussing the argument that monitorships achieve the same effect as a conviction but without the costs); Garrett, *Structural Reform Prosecution*, *supra* note 68, at 901 (suggesting that settlements save DOJ resources); Khanna & Dickinson, *supra* note 75, at 1730 (suggesting that monitors are a means of saving government resources).

128. As Judge Kaplan stated in the case of KPMG: "Many companies faced with allegations of wrongdoing are under intense pressure to avoid indictment, as an indictment—especially of a

up the company's human resources, allowing the company to focus exclusively on its business.[129] Finally, it removes a cloud of uncertainty from the firm[130] and signals to the market that the company has gotten back on track.[131]

But the consequences of a settlement are very different for employees and officers who were implicated in the investigation than they are for the company itself. The opening of a criminal investigation is like the opening of a Pandora's box. The investigation is certain to change the lives of the individual directors, officers, and employees implicated for the worse. This is so for two reasons.

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

The famous case of KPMG[132] is illustrative. In 2003, the DOJ launched a criminal investigation against KPMG and many of its employees concerning the creation, marketing, and implementation of illegal tax shelters. The DOJ utilized KPMG's vulnerability, pitting the

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financial services firm—threatens to destroy the business regardless of whether the firm ultimately is convicted or acquitted." United States v. Stein, 440 F. Supp. 2d 315, 337 (S.D.N.Y. 2006).

129. *See, e.g.*, A. F. Conard, *Winnowing Derivative Suits Through Attorneys Fees*, 47 LAW & CONTEMP. PROBS. 269, 271 (1984) ("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 the consequent diversion of their best efforts from production and distribution."); 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). 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, the time that corporate managers and directors will spend participating in a trial. *See, e.g.*, Joy v. North, 692 F.2d 880, 892 (2d Cir. 1980) ("[T]he court can consider the degree to which key personnel may be distracted from corporate business by continuance of the litigation.").

130. Notably, "[i]n reality, it would almost never be possible to predict lost business from reputational damage." Uhlmann, *The Pendulum Swings*, *supra* note 99, at 1254–55.

131. *See* Brandon Garrett, *International Corporate Prosecutions*, *in* THE OXFORD HANDBOOK OF CRIMINAL PROCESS *11 (Darryl K. Brown, Jenia Iontcheva 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." (quoting OECD WORKING GRP. ON BRIBERY, PHASE 3 REPORT ON IMPLEMENTING THE OEOCD ANTI-BRIBERY CONTENTION IN NORWAY § 24 (June 2011), https://www.oecd.org/daf/anti-bribery/anti-briberyconvention/Norwayphase3reportEN.pdf [https://perma.cc/V77P-QWTU])).

132. *Stein*, 440 F. Supp. 2d at 315.

company against its own employees, as described at length in Judge Lewis 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.[133]

Judge Kaplan then proceeded to state that prosecutors' use of the Thompson Memo has produced "the exertion of enormous economic power by the employer upon its employees to sacrifice their constitutional rights."[134] Ultimately, the court suppressed many of the statements made by individuals within KPMG, finding that they were obtained in violation of the Fifth Amendment.[135]

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 instances where the requirements of such cooperation have been alleged and/or held to violate a company's attorney-client privilege and work product protections, or its employees' Fifth or Sixth Amendment rights.[136]

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133. *Id*. at 318–19.

134. *Id*. at 337.

135. *Id*. at 338.

136. United States v. HSBC Bank USA, No. 12-CR-763, 2013 WL 3306161, at *6 (E.D.N.Y. July 1, 2013). Judge John Gleeson added that "for 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 "[t]he 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

This concern over violating employees' Fifth Amendment rights in the context of a criminal investigation within the firm also has attracted the attention of the academy.[137] Legal counsels, too, have voiced serious concerns about the DOJ's "culture of waiver."[138] And as the DOJ itself acknowledged:

> 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 immediately demanded privilege waivers upon initiation of an investigation.[139]

Second, the opening of a criminal investigation casts a heavy shadow on the integrity and reputation of the board and management

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available to the government[;]" and that "[t]he DOJ's corporate charging policies . . . 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 *6 nn.10–12.

137. *See, e.g.*, Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613, 1634–35 (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. LITIG. 603, 605–06 (2006) ("The leverage gained from the corporation's compliance forces the employee to cooperate or risk losing her job.").

138. *The Thompson Memorandum's Effect on the Right to Counsel in Corporate Investigations: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. 68 (2006) (statement of the Coalition To Protect the Attorney-Client Privilege) ("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" where "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.").

139. James McMahon, *Attorney-Client Privilege in the Corporate Setting*, 64 U.S. ATT'YS' BULL. 1, 2 (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 "[t]o be eligible for any cooperation credit." Yates Memo, *supra* note 12, at 2–3; *see also* Gideon Mark, *The Yates Memorandum*, 51 U.C. DAVIS L. REV. 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.").

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.[140] These rumors and suspicions cannot be easily set aside or disproved.[141]

In short, the announcement of an investigation marks the beginning of the via dolorosa for the individuals implicated. Naturally, the investigation may lead to three possible outcomes: a finding of no wrongdoing, a settlement, or an indictment. Obviously, the best possible option from the vantage point of the company and its employees is the first one. Unfortunately, very few investigations have a happy ending;[142] a settlement or an indictment is a much more realistic outcome.

As Part I discussed, 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 later 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

140. Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. 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," and "[t]he 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.").

141. *See* Jonathan M. Karpoff & John R. Lott, Jr., *The Reputational Penalty Firms Bear from Committing Criminal Fraud*, 36 J.L. & ECON. 757, 792, 792 tbl.7 (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 deal with potential reputational loss following the announcement of an investigation. *See, e.g.*, Kevin Bailey & Charlie Potter, *Protecting Corporate Reputation in a Government Investigation*, GLOB. INVESTIGATIONS REV. (Jan. 3, 2020), https://globalinvestigationsreview.com/chapter/1079418/protecting-corporate-reputation-in-a-government-investigation [https://perma.cc/83DC-TY7M] (laying out a comprehensive communications strategy for use throughout an investigation).

142. 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 3,658 criminal investigations conducted on corporations—among which 325 were on public corporations—between 1992–2020, only 209 resulted in acquittal, dismissal, or declination—of which twenty were public corporations. *Data & Documents*, CORP. PROSECUTION REGISTRY, http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/browse/browse.html [https://perma.cc/8C3B-4AAS] (search Disposition Type field for "All," "acquittal," "dismissal," and "declination").

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.

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 statements of facts attribute various illegal actions, omissions, mental states, and intents to various agents of the firm.[143] 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.

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 investigation.[144] Both parties are interested in a quick resolution.[145] 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

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143. *See* GIBSON, DUNN & CRUTCHER, LLP, 2017-YEAR-END UPDATE ON CORPORATE NON-PROSECUTION AGREEMENTS (NPAS) AND DEFERRED PROSECUTION AGREEMENTS (DPAS) 4 (2018), https://www.gibsondunn.com/wp-content/uploads/2018/01/2017-year-end-NPA-DPA-update.pdf [https://perma.cc/B5RW-H5NY] ("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.").

144. As Professor Koehler notes,

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

Koehler, *supra* note 20, at 554 (quoting Matthew E. Fishbein, *Why Individuals Aren't Prosecuted for Conduct Companies Admit*, N.Y. L.J. (Sept. 19, 2014, 12:00 AM), https://www.law.com/newyorklawjournal/almID/1202670499295/Why-Individuals-Arent-Prosecuted-for-Conduct-Companies-Admit [https://perma.cc/JPB9-JUNK]).

145. *See* Reilly, *Sweetheart Deals*, *supra* note 11, at 1120 (explaining how DPAs "can be a means to: speedy and efficient dispute resolution").

difference between its treatments of the two groups. While present employees can have an indirect and limited effect on the negotiations leading to the agreement, former employees are excluded from the process altogether. But a clarification is in order here. As discussed above, the investigation is often conducted by external law firms and consultants that are hired for this purpose. They interview past and present directors, managers, and employees who are relevant to the investigation. Hence, those interviewed receive an opportunity to share their versions of what happened. Thereafter, the attorneys 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. Thus, 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 all the bargaining power lies with the law enforcement authorities.

This is especially true given that 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 presiding directors get a chance to 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 face the risk that the DOJ will reopen its investigation and stiffen its stand.[146]

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.[147]

At this point, one might wonder: Why is all of this problematic? If an employee, current or former, committed a criminal offense, she

146. U.S. Dep't of Just., Principles of Federal Prosecution § 9-27.110 app. F (2018), https://www.justice.gov/jm/jm-9-27000-principles-federal-prosecution#9-27.110 [https://perma.cc/7FV9-HZVW] (emphasizing the broad latitude of prosecutors).

147. *See* 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*." (emphasis added)).

should live with the consequences, whether or not she was given a fair hearing. But therein lies the rub. Many individual directors and officers have not violated the law and cannot be assumed to have done so. 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.[148]

As explained earlier, a corporation may be found guilty of criminal behavior even when no employee has committed a criminal offense on her own. In the case of individual liability, all the elements of a criminal offense must be performed by one person. But in the case of corporate liability, it is possible to collect elements from different employees and attribute them as a whole to the corporation.

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; in many cases, enforcement authorities did not try to prosecute them.[149] Furthermore, it is often not even possible to impose civil liability on directors and officers pursuant to settlements.[150] Thus, there is a gulf between corporate liability and personal 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

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148. *See Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, *supra* note 91, at 1248 (noting that "proving that a corporate defendant committed the illegal act is in practice substantially easier than an individual prosecution," as it is only necessary to prove that "*some* agent of the corporation committed the crime").

149. *See, e.g.*, Mark, *supra* note 139, at 1605–07 (describing "the DOJ's historical failure to prosecute" officers of corporations engaged in PDAs).

150. One famous example is the case of the oil-and-gas services company Tidewater. *See* Tidewater, Inc. *ex rel.* Strong v. Taylor, 877 F. Supp. 2d 433 (E.D. La. 2012). After the company resolved the FCPA investigation by signing a PDA, a derivative suit was filed against Tidewater's directors. *Id.* at 440. The district court in Louisiana dismissed the suit, concluding 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. "[T]he mere fact that the violation occurred does not demonstrate that the board acted in bad faith."

Id. at 451 (quoting Freuler v. Parker, 803 F. Supp. 2d 630, 640 (S.D. Tex. 2011)). As Professor Koehler, a compliance expert, puts 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).

individual employees. Of course, 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 covered by 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 decide to bring derivative actions against them. But even this opportunity is more illusory than real.

The broad and unequivocal admissions found in settlements 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.[151] Plaintiffs in derivative actions base their prima facie case on the admissions made by a company in its settlement with the DOJ or other law enforcement authorities.[152]

Plaintiffs often quote extensively from the admissions and findings in settlement agreements, which do not carefully address the potential personal liability of each individual director and officer. 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. This uniform treatment—what this Article describes as a "pooling effect"—is further discussed in Part II.B.

The point here is that private plaintiffs have neither the capabilities nor the incentives to distinguish between good directors and officers and bad ones. In general, these plaintiffs are individual shareholders who have very limited access to information about the company and its officers and directors.[153] Furthermore, they frequently have only a miniscule stake in the company and therefore "ha[ve] very

151. *See supra* note 119 and accompanying text.

152. *Id.*

153. ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE 86–87 (2007).

little incentive to consider the effect of the action on other shareholders" and the company as a whole.[154]

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."[155]

In sum, innocent directors and officers 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 reputations are irremediably harmed, as are their future employability and earning capacities.[156] 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 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 Professor Edward Rock points 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."[157] And Professor Jayne Barnard further observes 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

154. Fischel & Bradley, *supra* note 129, at 271.

155. Westbrook, *supra* note 31, at 1228; *see also* Kevin M. LaCroix, *FCPA Follow-On Civil Actions: Frequently Filed, Less Frequently Successful*, D&O DIARY (June 18, 2017), https://www.dandodiary.com/2017/06/articles/foreign-corrupt-practices-act/fcpa-follow-civil-actions-frequently-filed-less-frequently-successful [https://perma.cc/8RKJ-S7NX] (explaining the infrequency that such cases find success).

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

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

just a few phone calls. In a rarefied community such as this, the role of reputation is significant."[158]

Finally, the allegations of wrongdoing made against directors and other top officers may cause institutional investors to vote against the directors' reelection[159] or to act in order to fire other senior executives. And large institutional investors have become involved in monitoring the legal and regulatory compliance of public companies in which they invest.

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 attribution of various elements of wrongdoing to them in order to establish the guilt of the corporation in which they serve. A typical agreement begins with a statement that the company admits, accepts, and acknowledges that it is responsible under U.S. 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 omissions of its managers and employees, broke the law during the time period covered by the agreement. The agreement also describes how directors failed to adopt and implement an adequate compliance program and how this failure enabled the wrongdoing.

Agreements do 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 monolithic group. Thus, a pooling equilibrium is created. To illustrate, consider some of the largest agreements signed during the past few years, discussed earlier in Part II.A.

For instance, the plea agreement signed by KBR states that "Kellogg Brown & Root LLC admits, accepts, and acknowledges that it is responsible for the acts of its predecessor companies' officers,

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

159. *See* Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 IOWA L. REV. 507, 551–52 (2020) (detailing Vanguard's vote against reelecting board members of a U.S. financial institution that had committed fraud).

employees, and agents as set forth below."[160] Likewise, the DPA that HSBC entered into following allegations of BSA violations proclaims that "[t]he HSBC Parties admit, accept and acknowledge that they are responsible for the acts of their officers, directors, employees, and agents."[161] Similar statements are in the settlement agreements signed by Telia,[162] Petrobras,[163] and USB.[164] 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.

Notably, 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."[165] Such statements send a strongly negative signal about the parties involved, suggesting 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

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160. Plea Agreement at 33, United States v. Kellogg Brown & Root, No. H-09-071 (S.D. Tex. Feb. 11, 2009) [hereinafter *KBR Plea Agreement*].

161. Deferred Prosecution Agreement at 3, United States v. HSBC, No. 12-CR-763, 2013 WL 3306161 (E.D.N.Y. July 1, 2013).

162. Deferred Prosecution Agreement at 2, United States v. Telia Co. AB, No. 1:17-CR-00581-GBD (S.D.N.Y. 2017). The agreement states:

> The Company admits, accepts, and acknowledges that it is responsible under United 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.

Id.

163. Letter from Sandra Moser, Acting Chief, Fraud Section, Crim. Div., U.S. Dep't of Just., to F. Joseph Warin, Gibson, Dunn & Crutcher LLP (Sept. 26, 2018) (on file with the *Duke Law Journal*) ("The Company admits, accepts, and acknowledges that it is responsible under United 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.").

164. Letter from Geoffrey S. Berman, U.S. Att'y, S. Dist. of N.Y., to Boyd M. Johnson III, Esq., Wilmer Hale LLP, & Samuel W. Seymour, Esq., Sullivan & Cromwell LLP (Feb. 12, 2018), https://www.justice.gov/usao-sdny/press-release/file/1035081/download [https://perma.cc/2KSQ-6EWN] ("USB stipulates that the facts set forth in the Statement of Facts, . . . 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.").

165. *KBR Plea Agreement*, *supra* note 160, at 33.

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.[166] During this time period, a gray cloud hangs over all of the company's directors and officers,[167] and a statute of limitations brings no relief.[168] 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. After an agreement is signed, the enforcement authorities typically issue a press release that describes it in great detail. The content of the release 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 to the rest of the market about the tough consequences of breaking the law.

News about a settlement agreement spreads fast. Publications made by authorities focus on the companies' admissions and the large fines they agreed to pay. The large penalties draw enormous public attention to the publications, and readers are inevitably exposed to the

166. *The Gray Cloud of FCPA Scrutiny Lasted Too Long in 2016*, FCPA PROFESSOR (Jan. 6, 2017) [hereinafter *The Gray Cloud of FCPA Scrutiny*], http://fcpaprofessor.com/gray-cloud-fcpa-scrutiny-lasted-long-2016 [https://perma.cc/T6T6-P3VA].

167. Richard L. Cassin, *The FCPA's Long Shadow*, FCPA BLOG (Aug. 6, 2012, 11:18 AM), http://www.fcpablog.com/blog/2012/8/6/the-fcpas-long-shadow.html [https://perma.cc/2MEA-BRUM] ("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.").

168. As one commentator explains:

> Statute[s] 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 166.

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[169] in order to bolster their statutory enforcement powers.[170] This concern is exacerbated by the lack of procedural safeguards on enforcement agencies' publications.[171] 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.[172] From the beginning of the investigation process until 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, this Part has analyzed in great detail the adverse effect the reverse agency problem has on corporate officers and directors. 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 this Article has emphasized time and again, corporate officers who broke the law should be subjected to the appropriate penalties. The problem is that quite often law enforcement authorities do not go to 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, given that corporations hope to settle the matter as quickly as possible. Currently, there is no way out of this pooling equilibrium.

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169. *See* Nathan Cortez, *Adverse Publicity by Administrative Agencies in the Internet Era*, 2011 BYU L. REV. 1371, 1379.

170. *See* Ernest Gellhorn, *Adverse Publicity by Administrative Agencies*, 86 HARV. L. REV. 1380, 1398–1401 (1973) (describing how the Equal Employment Opportunity Commission and Environmental Protection Agency use publicity to broaden their enforcement powers).

171. Cortez, *supra* note 169, at 1374.

172. *Id.* at 1383; *see also* Gellhorn, *supra* note 170, at 1420 ("[U]sually no protection other than the common sense and good will of the administrator prevents unreasonable use of coercive publicity.").

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 have full control of their own fate. Enforcement actions, and the settlements signed in their wake, create interdependencies among corporate agents. Sometimes, one director or corporate officer who took matters into her 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.[173] The central mechanisms designed to shelter directors and officers from liability are the business judgment rule, exculpation clauses, directors and officers' ("D&O") liability insurance, and indemnification clauses.

The business judgment 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 a conflict of interest.[174] Exculpatory clauses are contractual provisions that relieve high-level employees from liability arising from a breach of a duty of care owed to the corporation.[175] 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

173. *See, e.g.*, Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 865 (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"). Put simply,

> The director will not serve unless the package offered meets his or her reservation utility . . . level of other pay necessary to compensate the director for . . . 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 compensation for the additional risk (the "risk premium").

John E. Core, *On the Corporate Demand for Directors' and Officers' Insurance*, 64 J. RISK & INS. 63, 66–67 (1997).

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

175. DEL. CODE ANN. tit. 8, § 102(b)(7) (2020).

to the firm.[176] And indemnification clauses guarantee directors and officers reimbursement for attorneys' fees, legal expenditures, and even judgments.[177]

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

Critically, though, two of these mechanisms—the business judgement rule and exculpation clauses—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 "boundaries"[178] and depend on the company's willingness to provide them, the documents governing them, and the terms of the insurance policy.[179] At any rate, none of these mechanisms can compensate directors and officers for the reputational and economic harms they suffer as a result of criminal investigations and settlements. These harms lie outside the ken of protection firms can provide.[180]

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

177. DEL. CODE ANN. tit. 8, § 145(a).

178. For example, under Delaware corporation law, directors and officers who are determined to have acted in bad faith or unlawfully cannot be indemnified. *Id*. Also, D&O insurance policies generally exclude coverage for intentionally dishonest and criminal conduct, willful violations of law, and the like. *See, e.g.*, Joseph P. Monteleone & Nicholas J. Conca, *Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues*, 51 BUS. LAW. 573, 598–607 (1996).

179. Monteleone & Conca, *supra* note 178, at 598–607. Furthermore, 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. 755, 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.").

180. David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1833 (2001) (describing how defenses that the company provides 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.").

Since companies cannot offer directors and officers adequate protection against the reverse agency problem, they must inflate directors' and officers' compensation to reflect the increased risk to which they are exposed.[181] 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 will 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 margins, the reverse agency problem may drive capable candidates away from the corporate world.[182] 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.[183]

III. POTENTIAL SOLUTIONS

This Part considers possible mechanisms to address the reverse agency problem. Again, a root cause of the reverse agency problem is the collective treatment of directors and officers in settlements and the insinuation and attribution of various elements of wrongdoing to them in order to establish the guilt of the corporation in 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. Directors and officers involved in criminal investigations need a way to prove that they are neither guilty of a criminal offense nor of a breach of a fiduciary duty to the corporation. To this end, this Part outlines four specific legal mechanisms that can ameliorate the reverse agency problem. These proposals are intended

181. *Supra* note 173.

182. Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1140 (2006) ("A significantly higher level of risk for outside directors could well deter good candidates from serving . . . ."); *see also Risks Facing Directors & Officers*, FINANCIER WORLDWIDE (Aug. 2016), https://www.financierworldwide.com/roundtable-risks-facing-directors-officers-aug16#.X7fcE9NKhTY [https://perma.cc/H9LE-5GQE] ("[T]he 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.").

183. *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.").

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.

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 would enable individual directors and officers to review settlements and offer changes before they are signed. The second mechanism is to give individual directors and officers who were implicated in settlements the right to bring an action for a declaration of innocence that could clear them of liability. This would 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 solution 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. Our fourth, and final, proposal is to let directors and officers bring suits against the corporations for which they worked and seek compensation from them for harm unjustly incurred as a consequence of DPAs and plea agreements.

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 would 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. Even small changes in the language of the settlement agreement may have a significant impact on the future of the directors and officers involved.[184]

The hearing will give those implicated in the settlement agreement an opportunity to set the record straight by correcting potential

184. To illustrate, there is a huge difference between 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 offense and a DPA that lacks such descriptions.

misstatements about them and other factual errors. It appears to be the simplest and most cost-effective solution to the reverse agency problem. True, introducing 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. As long as their additional cost is not unreasonably high, such hearings may be in society's best interest.

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

But it is questionable that law enforcement agents would adopt the requisite mindset to make the hearings work. Such 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 law enforcement agencies will be focused 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,[185] may limit the effectiveness of the proposed hearing.

If law enforcement agencies cannot hold these hearings with an open mind and an open heart, they 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.

One possible solution is to appoint a relatively neutral body to hold the hearing. Put differently, separating the body holding the hearing from the body leading the investigation may lead to a more meaningful opportunity for officers and directors to clear themselves

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185. Justice Stephen Breyer reasons that

> 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 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.

STEPHEN BREYER, REGULATION AND ITS REFORM 365 (2009).

of guilt. Two paths could potentially achieve this purpose: first, the hearing could be managed by the prosecutors' supervisors, namely their U.S. attorney or the deputy attorney general for the criminal division of the DOJ; second, a court could hold the hearing and the judge could exclude any misstatements. Unfortunately, both paths face severe practicality issues in the status quo.

The first path resembles the DOJ's effort in increasing procedural safeguards for corporate defendants in the aspect of attorney–client privilege waivers. Amid widespread criticism for its practice of seeking attorney–client privilege waivers from companies that hope to secure a DPA, the DOJ published the McNulty Memorandum in December 2006.[186] The Memo states that before requesting that a corporation waive its attorney–client privilege, "prosecutors must first obtain written authorization from their United States Attorney who, prior to authorizing the request, must provide a copy of the request to, and consult with, the Assistant Attorney General for the Criminal Division."[187] Despite such efforts, commentators argue that the new procedural framework "is quite unlikely to reverse the tide of eroding rights and privileges"[188] for two principal reasons. First, the McNulty Memo, like any other memo published by the DOJ, only provides nonbinding guidelines. Absent judicial oversight over the PDA-negotiation process, and considering that the practice of asking for privilege waivers is already entrenched in the prosecution process,[189] the DOJ is not likely to strictly follow the new framework. In fact, there is evidence showing that the DOJ has failed to implement the framework at all.[190]

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186. Gideon Mark & Thomas C. Pearson, *Corporate Cooperation During Investigations and Audits*, 13 STAN. J.L. BUS. & FIN. 1, 12–13 (2007).

187. *Id.* at 46; *see also* Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Just., to Heads of Dep't Components U.S. Att'ys, Principles of Federal Prosecution of Business Organizations 9 (Dec. 12, 2006), https://www.justice.gov/sites/default/files/dag/legacy/2007/07/05/mcnulty_memo.pdf [https://perma.cc/58RV-7P99] (describing the process for obtaining an attorney–client privilege waiver for Category I information).

188. Mark & Pearson, *supra* note 186, at 69.

189. Given that no charge is filed in the case of NPAs, courts are not involved and do not have the power to review the agreements. As for DPAs, both the Second Circuit and the D.C. Circuit have held that "absent 'clear evidence' of prosecutorial misconduct, the district court's supervisory power did not authorize substantive review of a DPA's terms." Nick Werle, *Prosecuting Corporate Crime when Firms Are Too Big To Jail: Investigation, Deterrence, and Judicial Review*, 128 YALE L.J. 1366, 1409 (2019).

190. Mark & Pearson, *supra* note 186, at 70.

Second, the new review process itself may be no more than a rubber stamp:

> U.S. attorneys are unlikely to deny such requests—indeed, they are often pressing their assistants aggressively to seek such materials—[and] it is hard to imagine the "review" process at the assistant attorney general level will be anything but perfunctory. I have talked with former high-ranking department officials who share that view. I would expect the review process to be no more rigorous than the review and approval by the assistant attorney general of requests by line prosecutors to provide statutory immunity to witnesses. Such requests are routinely rubber-stamped. Indeed, approval by the assistant attorney general is not even required for Category I requests made by assistant U.S. attorneys—only "consultation" is mandated.[191]

Moreover, the successor to the McNulty Memo, the Filip Memo, took away the procedural requirement.[192] The DOJ may argue that it removed the requirement because the Filip Memo mandates that prosecutors base their charging decisions on "relevant facts" rather than privilege waivers. But commentators argue that this new form of cooperation still needs procedural protections governing privilege waivers because it "may create an underground system of waiver and coercion."[193] The failed attempt to rely on internal procedural reforms to remedy issues in negotiating PDAs caused by wide prosecutorial discretion and unequal bargaining power between prosecutors and corporations is illustrative. The reverse agency problem, as we discussed before, raises similar concerns. Thus, entrusting the DOJ with the responsibility to solve the problem by holding an internal hearing is unrealistic, at least for now, no matter whether the party conducting the hearing is nominally independent of the prosecutors or not.

At the end of the day, 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.

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191. N. Richard Janis, *The McNulty Memorandum: Much Ado About Nothing*, WASH. LAW., Feb. 2007, at 35, 38.

192. Attorneys' Manual, *supra* note 127, § 9-28.720 (describing the cooperation-credit analysis).

193. Peter Reilly, *Negotiating Bribery: Toward Increased Transparency, Consistency, and Fairness in Pretrial Bargaining Under the Foreign Corrupt Practices Act*, 10 HASTINGS BUS. L.J. 347, 374 (2014).

B. Declaration of Innocence

The second solution to the reverse agency problem relies exclusively on the courts. It harnesses the judicial system to help directors and officers. Specifically, directors and officers who were implicated in investigations and settlements should have a cause of action to seek a declaration of innocence against the corporation in court to clear their names of wrongdoing. A declaration of innocence that clears individual agents of wrongdoing would dispel the uncertainty that hovers over them, prevent the automatic filing of derivative actions against them, and allow them to restore their reputation[194] and carry on with their careers.

Moreover, if the action for a declaration of innocence is successful, directors and officers should be able to receive indemnification from their companies for the legal fees and judicial costs they incurred. This, in turn, would incentivize companies not to agree to a broad attribution of culpability given that doing so might attract a significant number of suits for declarations of innocence. Furthermore, successful claims would make it harder for firms to attract future talent; employees may rightfully hesitate to join firms that are willing to extricate themselves from an investigation by sacrificing their employees.

The declaration of innocence should be distinguished from the traditional declaratory judgment. Although securing a declaratory judgment against the company before it settles with the government would protect directors and officers from reputational or emotional harm,[195] it is unlikely that the directors and officers would be able to overcome the procedural obstacles necessary to obtain a declaratory judgment.

To secure a declaratory judgment, corporate agents must satisfy the actual controversy requirement, and the relevant test is "whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a

194. Note in this regard that the Supreme Court has suggested a constitutional right to protect one's reputation. *See* Rosenblatt v. Baer, 383 U.S. 75, 92 (1966) (Stewart, J., concurring) ("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.").

195. A declaratory judgment indicating the innocence of the directors and officers in relation to the corporate crime committed would preempt the companies from using inappropriately broad statements of facts to secure a PDA.

declaratory judgment."[196] A declaratory judgment is a remedy for injury in fact,[197] not "an opinion advising what the law would be upon a hypothetical state of facts."[198] Because former directors and officers of the suspect company are excluded from any settlement negotiations, it would be difficult for them to prove real and imminent threat by showing that their company will exaggerate their role in the crime committed in exchange for a PDA and that the misstatements will create reputational and emotional damages. Asking the court to rule on misstatements that may appear in the future is asking it to issue an opinion based on hypothetical facts.

A solution to this problem is to create a new statutory right and remedy called a declaration of innocence that allows for a judicial determination that the plaintiff did not cause the harm alleged in the settlement agreement, and give corporate agents a cause of action to sue the company for it after the company has settled with the government. Some commentators have proposed a similar solution to address the reputational harm resulting from a wrongful conviction.[199] A plaintiff would not face the same hurdle of satisfying the actual controversy requirement because the controversy has already occurred. Another benefit of establishing a new statutory right is that it could be designed to minimize the plaintiff's procedural burden. For instance, Professor Frederick Lawrence has advocated for a "no-fault, no damages suit" in which "the plaintiff's case is narrowly focused on the falseness of the accusation or conviction" and the plaintiff does not have to prove fault on the part of the defendant.[200]

Giving directors and officers the right to sue for a declaration of innocence 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 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.

196. MedImmune, Inc. v. Genentech, Inc., 549 U.S. 118, 127 (2007).

197. Steel Co. v. Citizens for a Better Env't, 523 U.S. 83, 103 (1998).

198. *MedImmune, Inc.*, 549 U.S. at 127.

199. *See, e.g.*, Frederick Lawrence, *Declaring Innocence: Use of Declaratory Judgements To Vindicate the Wrongly Convicted*, 18 PUB. INT. 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.").

200. *Id.* at 399–400.

In sum, individual employees, directors, and officers cannot challenge the content of the settlements their corporations enter, or correct the statements made about them in those settlements. Leaving them to live with the negative implications of settlements, to which they were not a party and which they could not meaningfully influence, is a highly unjust result. Individual directors and officers should not be barred from suing because of the procedural burden imposed by the traditional declaratory judgment. Under these circumstances, Congress should lend them a helping hand and allow them to initiate legal action to clear themselves. We therefore call on Congress to create a new statutory right and remedy—the declaration of innocence—that allows directors and officers to exonerate themselves from allegations of wrongdoing.

C. An Action Against Other Directors and Officers

A 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, criminal investigations are commenced for a reason, and corporate admissions of guilt are not groundless. In a typical case, the acts or omissions of the guilty employees trigger the criminal investigation that will result in the attribution of illicit behavior to their colleagues, who have done no wrong. Under this proposal, directors and corporate officers who suffered losses as a consequence of the decisions or behaviors of their peers would be allowed to sue their peers to recover compensation for their losses.

Importantly, this proposal would not allow suits against the corporation itself, but only against individual directors and officers who strayed from the path. Neither the corporation nor its shareholders would be affected by such suits. But implementing this 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.[201] At present, therefore, fiduciary duties apply only vertically—that is, in the relationship between corporations and their top agents.

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

Elsewhere, we have argued that the modern business world has become so complex and specialized that directors and corporate officers have become dependent on one another.[202] Each of them brings a unique set of skills and backgrounds to the table. No individual director or officer can be expected to perform on her own all the tasks necessary for the successful functioning of the corporation. 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 example, one director's behavior may have been the main factor that led to a derivative action and a subsequent judgment for breach of fiduciary duty against the board. But in many circumstances, courts will only assign collective liability to the board, instead of individual liability to each board member.[203] Even if the board won the lawsuit, treating it as a whole without recognizing a horizontal fiduciary duty may impose equally serious reputational harms on all the directors.[204] Such a corporate-law regime is unfair and harms corporate governance.[205] For this reason, we have suggested recognizing a new fiduciary duty that would apply horizontally among directors and officers in their working relationships.[206] 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 would provide 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 monetary damages would 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 would allow courts to go beyond all-or-nothing solutions.

202. *Id.* at 852–53 ("The rise of criminal and administrative enforcement campaigns against corporations has increased the level of interdependence among corporate officers and directors.").

203. *Id.* at 816–17.

204. *Id.* at 820–21.

205. *Id.* at 809–11.

206. *Id*.

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 damages for unnecessarily implicating them in wrongdoing.[207] On its face, this solution is similar to giving directors and officers a cause of action to sue for a declaration of innocence. And it appears to be a straightforward response to the reverse agency problem. After all, it is the company that chose to enter into the agreement and chose *not* to go to the trouble of carefully distinguishing between culpable executives and innocent ones. On closer examination, the matter is not nearly as simple as it may appear and may lead to the problem of split loyalties.

As explained throughout this 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 owe any obligation to protect them.[208] To allow executives to sue the firm would require creating a new legal duty, though not necessarily a fiduciary duty, that prohibits the company from negligently or recklessly making false statements that its directors and officers are culpable. It is, of course, possible to recognize such a duty. But unlike recognizing the horizontal fiduciary duty, 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. Imposing additional duties on corporate officers and directors puts 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 much 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 is an extreme measure that this Article does not support, at least in ordinary cases. Law enforcement authorities should be able to do their jobs undeterred. This kind of lawsuit should be allowed, if at all, only

207. We are grateful to Professor Zohar Goshen for pointing out this possibility to us.

208. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

in extreme cases—those in which companies were reckless or grossly negligent.

CONCLUSION

This Article demonstrates that the agency problem in corporate law is not unidirectional, as conventional theory suggests, but rather is bidirectional. For almost a century, a central tenet of corporate-law scholarship and policy has been that corporate officers and directors are predisposed to sacrifice the interests of their companies and shareholders to promote their own narrow self-interest. 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 government authorities and strike a favorable settlement with them. Like its more famous kin, the reverse agency problem arises from a perfectly rational motivation in the compliance age—namely, firms' desire to avoid criminal indictment and bring criminal investigation to a rapid close. That to achieve this goal firms are willing to attribute wrongdoing to large groups of directors and managers, without distinguishing among guilty and innocent individuals, is consistent with the wealth-maximization goal of the firm and its shareholders.

In addition to unveiling the reverse agency problem and analyzing its causes and effects, this Article proposed four possible solutions to it. First, directors and officers should be afforded special hearings that would give them an opportunity to set the record straight prior to the finalization of settlements. Second, directors and officers should have the right to seek a declaration of innocence clearing them of wrongdoing. Third, corporate officers who suffered reputational harms on account of wrongful actions or omissions by their peers should have a cause of action to seek recourse from the latter by bringing civil actions against them. And finally, in extreme cases, it may be appropriate to allow innocent corporate directors and officers to seek monetary compensation from their corporate employers for the harms they suffered as a result of settlement agreements that were entered into with gross negligence or reckless disregard of their rights.

By bringing to light the reverse agency problem, this Article depicts a fuller and more nuanced understanding of the complex interaction between firms and their officers. In the age of compliance, the agent's problem is as central to corporate law as the agency problem.