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DEFERRED PROSECUTIONS AND CORPORATE GOVERNANCE: AN INTEGRATED APPROACH TO INVESTIGATION AND REFORM

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Abstract

When evaluating how to proceed against a corporate investigative target, law enforcement authorities often ignore the target's governance arrangements, while subsequently negotiating or imposing governance requirements, especially in deferred prosecution agreements. Ignoring governance structures and processes amid investigation can be hazardous, and implementing improvised reforms afterwards may have severe unintended consequences—particularly when prescribing standardized governance devices. Drawing, in part, on new lessons from three prominent cases—Arthur Andersen, AIG, and Bristol-Myers Squibb—this Article criticizes prevailing discord and urges prosecutors to contemplate corporate governance at the outset and to articulate rationales for prescribed changes. Integrating the role of corporate governance into prosecutions would promote public confidence in prosecutorial decisions to broker firm-specific governance reforms currently lacking, and would increase their effectiveness. The Article, therefore, contributes a novel perspective on the controversial practice: though substantial commentary urges prosecutors to avoid intruding into corporate governance, this Article explains the importance of prosecutors investing in it.

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INTRODUCTION

"Prosecutors in the boardroom" is a slogan that reflects an unintended early twenty-first century overlap of corporate governance and corporate criminal liability.[1] Although exaggerated, the phrase reflects how prosecutors increasingly demand corporate governance

1. It also inspired a book title. PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT (Anthony S. Barkow & Rachel E. Barkow eds., 2011).

reforms when using deferred prosecution agreements (DPAs) to settle criminal cases.[2] While a growing body of scholarship seeks to put governance beyond the purview of prosecutors—ousting prosecutors from the boardroom[3]—this Article explains why prosecutors should carefully consider governance in determining how to proceed *ex ante* and articulate rationales for governance changes in DPAs *ex post*.

Prosecutorial failure to consider governance *ex ante* can have adverse consequences, including activating governance mechanisms not designed for the purpose and forcing corporate actors to hastily adopt changes that they would ordinarily evaluate and debate dispassionately.[4] Subsequent prosecutorial prescriptions of governance changes are rarely the product of articulated rationales and can seem like ad hoc ransoms or trophies created on the fly by prosecutors seeking to claim victory. Irreconcilable criticisms result, with many observers saying that DPAs are coerced extractions of overzealous prosecutors while others say that DPAs are mere whitewash and let corporate crooks off the hook.[5]

Prosecutors should publicly articulate *ex post* their rationales for proposed governance changes, and that articulation should be based on their assessment *ex ante* of the target's governance profile. Creating such an *ex ante* profile would involve modest incremental costs while improving the quality of prosecutorial decisions on how to proceed with a case. The subsequent articulation of rationales would add substantial systemic benefits by increasing rationality, building credibility, deflecting criticism, and creating a catalogue of knowledge useful in future prosecution, regulation, and governance design. This Article thus parts with critics of prosecutors in the boardroom by explaining the value of prosecutorial investment in corporate governance.

Part I of this Article first defines the concept of corporate governance. It then highlights the most important developments of the corporate governance movement of the past two generations and

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2. *See* Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 887–89 (2007); *see also* Leonard Orland, *The Transformation of Corporate Criminal Law*, 1 BROOK. J. CORP. FIN. & COM. L. 45, 60–61 (2006).

3. *E.g.*, Jennifer Arlen, *Removing Prosecutors from the Boardroom: Limiting Prosecutorial Discretion to Impose Structural Reforms, in* PROSECUTORS IN THE BOARDROOM, *supra* note 1, at 63; *see also* Miriam H. Baer, *Choosing Punishment*, 92 B.U. L. REV. 577, 627–39 (2012) (exploring reasons why *ex post* prosecution rather than *ex ante* regulation may occur and suggesting that the effects may leave society worse off).

4. *See* Harry First, *Branch Office of the Prosecutor: The New Role of the Corporation in Business Crime Prosecutions*, 89 N.C. L. REV. 23, 32–58 (2010); *see also* Samuel W. Buell, *Criminal Procedure Within the Firm*, 59 STAN. L. REV. 1613, 1623–24 (2007).

5. *Compare* Richard A. Epstein, Op-Ed., *The Deferred Prosecution Racket*, WALL ST. J. (Nov. 28, 2006), http://online.wsj.com/article/SB116468395737834160.html, *with* Letter from Ralph Nader & Robert Weissman, to Alberto Gonzales, Att'y Gen. of the U.S. (June 5, 2006), http://www.multinationalmonitor.org/editorsblog/?p=30 (discussing DPA with Boeing). The truth, undoubtedly, is somewhere in between.

distinguishes corporate governance features from compliance. While critics allow room for prosecutors to consider compliance in the exercise of their discretion, this preliminary discussion stresses the importance of addressing governance, not merely compliance. The well-known story of the 2002 prosecution of the venerable accounting firm Arthur Andersen is invoked to illustrate the underappreciated importance of governance. Many take the lesson of Andersen's destruction by indictment to warn against indicting large business organizations. Part I, in contrast, argues that Andersen's seminal lesson is the prudence of prosecutorial consideration of governance when deciding how to proceed against a business.

Part II presents an original account of a more obscure but richer story: the 2005 prosecutorial probe into American International Group (AIG). It explains how prosecutorial failure to evaluate AIG's corporate governance realities in 2005 propelled AIG's culpability at the center of the 2008 financial crisis. Analysis reveals concern that prosecutors fail to appreciate how formal uniformity in corporate governance regulation masks considerable substantive variation and how this failure can be costly.

Part III explores the relationship between prosecutors and corporate governance, particularly the proper scope of DPAs. One approach, implicitly reflected in the status quo, conceives of DPAs as pure contracts whose terms are limited only by standard contract doctrine. Another approach, critical of current practice, conceives of DPAs as pure regulation whose terms are limited to those targeting compliance, and prohibits consideration of broader aspects of corporate governance. A third approach, the most apt, recognizes DPAs as products of prosecutorial discretion that are subject to prosecutorial restraint. In this view, DPAs warrant an integrated approach covering a wide range of terms—including governance terms—that are subject to prudential restrictions. Prosecutors should only proffer such terms when they have assembled a formal governance profile of a corporate target *ex ante* and should publicly explain the rationale for such terms when announcing DPAs *ex post*. Benefits and costs are hypothesized and assessed, lending support to the integrated approach.[6]

Part IV offers examples of governance terms found in DPAs and discusses credible rationales that prosecutors might have articulated for them. Examples include terms from the DPA in the case of Bristol-Myers Squibb, which drew sharp criticism. Prosecutors subsequently published a detailed explanation,[7] illustrating the articulated rationale

6. Costs are discussed *infra* pp. 57–58.

7. *See generally* Christopher J. Christie & Robert M. Hanna, *A Push Down the Road of Good Corporate Citizenship: The Deferred Prosecution Agreement Between the U.S. Attorney for the District of New Jersey and Bristol-Myers Squibb Co.*, 43 AM. CRIM. L. REV. 1043, 1047–

that this Article prescribes. Appendices excerpt governance terms of the Bristol-Myers Squibb DPA and related prosecutorial explanations, not so much to assert their optimality or ideality, but to suggest the feasibility of fulfilling this Article's prescriptions at reasonably low cost with valuable payoffs.

This Article concludes that the Department of Justice (DOJ) should lead by updating its guidelines for federal prosecutions of corporate targets to reflect the integrated approach, and that other prosecutors should follow the DOJ's lead. The DOJ has been reluctant to publish guidance on corporate governance reforms in DPAs.[8] But this Article urges steps that should be acceptable to prosecutors. The first is to add corporate governance as a factor to the existing list of factors prosecutors are told to consider when evaluating how to proceed with a case.[9] The other, only slightly lengthier, would direct prosecutors to publicly articulate their reasoning for proffered governance reforms.

Critics who seek to oust prosecutors from the boardroom see frequent and extensive incursions into corporate governance that must be repelled, while those who perceive excessive leniency are eager for greater prosecutorial inroads into governance. Under the integrated approach, the exact DPA population or density of governance terms becomes less important than whether there is an investigation ahead of time and an articulated rationale afterwards.

I. CORPORATE GOVERNANCE AND ARTHUR ANDERSEN

Prosecutors must appreciate both the variety of corporate governance arrangements and the varying governance regimes across different forms of business organizations when deciding how to proceed in a criminal case against a business.[10] Instead, prosecutors talk in sweeping

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60 (2006) (discussing the 2005 DPA entered into by the United States Attorney's Office for the District of New Jersey and Bristol-Myers Squibb Co.).

8. *Compare Deferred Prosecution: Should Corporate Settlement Agreements Be Without Guidelines?: Hearing Before the Subcomm. on Commercial & Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 151–54 (Mar. 11, 2008) (written testimony of Brandon L. Garrett, Associate Professor of Law, University of Virginia School of Law) (calling for DOJ to adopt clearer rules or guidance on corporate governance aspects of DPAs), *with* Letter from Brian A. Benczkowski, Principal Deputy Assistant Att'y Gen., U.S. Dep't of Justice, to John Conyers, Jr., Chairman, House Comm. on the Judiciary (May 15, 2008) (on file with author).

9. *See infra* notes 79, 378 and accompanying text.

10. The popular press portrayed prosecutors as anemic in failing to charge individuals or firms with crimes arising out of the financial crisis of 2008. *See, e.g.*, Editorial, *No Crime, No Punishment*, N.Y. TIMES (Aug. 25, 2012), http://www.nytimes.com/2012/08/26/opinion/sunday/no-crime-no-punishment.html. Prosecutors explained that abstinence was not for lack of power but for lack of evidence, with both the DOJ and the SEC noting that they had conducted an in-depth, unhindered investigation into numerous firms, including Goldman Sachs. *See, e.g.*, Halah Touryalai, *Goldman Sachs: No Longer Enemy #1*, FORBES (Aug. 10, 2012, 1:39 PM), http://www.forbes.com/sites/halahtouryalai/2012/08/10/goldman-sachs-no-longer-enemy-numb

and vague terms about rehabilitation of corporate cultures—for example, from a "culture of corruption or criminality" to a "culture of compliance."[11] This Part defines corporate governance, highlights the achievements and shortcomings of the corporate governance movement of the past two generations, and distinguishes governance from compliance. It concludes by drawing a new lesson from an old story: the 2002 federal indictment of Arthur Andersen *does not* necessarily teach that prosecutors should refrain from indicting large businesses because doing so presents adverse collateral consequences for innocent parties.[12] Rather, the seminal lesson is the importance of prosecutors weighing the significance of governance when making decisions about whether and how to charge organizations with crimes.

A. *Definition and Variability*

Corporate governance is defined as "[t]he system of rules, practices[,] and processes by which a company is directed and controlled."[13] It is a broad term applicable to any business organization. It encompasses a company's business purpose and the mechanisms used to achieve that business purpose.

Firms have a variety of business purposes, and any given company may have multiple purposes. Common purposes for U.S. companies are to maximize stock price (if publicly traded) and net profits. Some companies, such as Ben & Jerry's, seek to promote social objectives.[14] Others, such as Johnson & Johnson, seek to advance the interests of particular stakeholders in given orders, such as customers, employees, communities, and shareholders.[15] Foreign companies have even more varied business purposes.[16]

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11. *See* BRANDON L. GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS TAKE ON CORPORATIONS ch. 3 (forthcoming 2014) (draft manuscript on file with author and cited with permission); Peter J. Henning, *Corporate Criminal Liability and the Potential for Rehabilitation*, 46 AM. CRIM. L. REV. 1417, 1431 (2009); Press Release, U.S. Att'y's Office Dist. of N.J., Complaint Dismissed Against Wright Medical Technology, Inc. (Oct. 5, 2012), http://www.justice.gov/usao/nj/Press/files/Wright%20Medical%20Technology%20Inc.%20Complaint%20Dismissal.html (boasting of inducing the target company to "implement a compliant corporate culture").

12. *See infra* text accompanying notes 88–107.

13. *Corporate Governance*, INVESTOPEDIA, http://www.investopedia.com/terms/c/corporategovernance.asp (last visited Feb. 26, 2014).

14. *See* Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment*, 50 WASH. & LEE L. REV. 1625, 1637–38, 1642–43 (1993).

15. *Our Credo*, JOHNSON & JOHNSON, http://www.jnj.com/sites/default/files/pdf/jnj_ourcredo_english_us_8.5x11_cmyk.pdf (last visited Nov. 12, 2013).

16. *See* Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1140–42 (1999).

Organizational arrangements bearing on the pursuit of business purposes address the board of directors, officers, employees, and owners.[17] Terms concern board size, board procedures, director selection, director identity, officer functions, reporting protocols, leadership philosophies, employee training, and organizational policies and procedures. Features include shareholder demographics, such as the degree of ownership by institutional and individual investors as well as the firm's directors, officers, and employees. Features also include the characteristics of any controlling shareholder and whether a company is publicly traded.

Further delineation of an overall governance profile reaches matters of employee compensation and morale, as well as internal controls, including compliance with the law. A corporation's regulatory environment can be important too, especially for firms in highly regulated industries where criminal prosecution—or even indictment—can expose firms to debarment from government contracts or licenses. Within this framework, governance may encompass how professional advisors such as auditors and lawyers are recruited, supervised, and paid. Among a potpourri of other attributes of governance are topics such as charitable giving, political speech, and CEO succession. Finally, the subjects of financial reporting and disclosure are also critical aspects of corporate governance for publicly traded companies.

Corporate governance, therefore, includes a wide variety of features that may be a product of norms, practices, history, culture, contract, bylaw, charter, regulation, or statute. Some features are definite, observable, and changeable by law or bargain, such as the type and number of directors and how employees are trained and paid. Others are more fluid, intangible, and persistent, such as the "tone" at the top, employee culture, and shareholder apathy or activism. Given such variety within companies, corporate governance changes have vastly different effects on each company.

Although corporate governance literally denominates governance of the *corporate* form of business organization, the concepts and issues apply to other forms of business organization as well, including partnerships, limited liability companies, and others. Ownership, control, and related governance attributes in those other business forms vary further. For example, partnerships tend to involve a greater degree of participation in management among the partners, and partner capital investments consist of skills and reputation as well as money.

Understanding what makes a given business organization function requires a rudimentary grasp of such governance attributes, including an

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17. *See* 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3.01 (1994).

appreciation that what works for one enterprise may not work for another. As important, developments in the broader field of business law in recent generations have emanated from the corporate form, especially those associated with the corporate governance movement.

B. *Movement and Power Shifts*

During most of the twentieth century in America, boards of directors tended to be collegial bodies operating in an atmosphere of trust and informality.[18] Largely due to historical and political accident, managers were strong, directors supportive, and shareholders, especially in publicly traded firms, weak.[19] This structure was famously described in the 1930s by Adolph A. Berle Jr. and Gardiner C. Means as resulting in the separation of corporate ownership from corporate control.[20]

Beginning in the mid-1970s, there emerged a corporate governance movement that, along with a burgeoning scholarly literature, forged change in the traditional model of corporate governance.[21] The corporate governance movement contended that corporations should maximize shareholder value.[22]

Demand for change arose due to a combination of social, business, and legal factors, including corporate scandals that alienated shareholders, and judicial and regulatory reformers eager for change.[23] For shareholder advocates, the original goal of this movement was to focus corporations on the purpose of maximizing shareholder value. In the legal literature, this objective was expressed in terms of reducing agency costs associated with the separation of ownership from control in publicly traded corporations.[24] Other proponents stressed broader concerns about civic responsibility.[25]

Institutional Investors. The most significant development in the modern history of corporate governance has been the rise in institutional

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18. *See* MYLES MACE, DIRECTORS: MYTH AND REALITY 68–71 (1971).

19. *See* MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 4–6 (1996).

20. ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 69 (1932).

21. *See* Kenneth B. Davis, Jr., *Structural Bias, Special Litigation Committees, and the Vagaries of Director independence*, 90 IOWA L. REV. 1305, 1306 (2005) ("Since the beginning of the corporate governance movement in the mid-1970s, enhancing the independence of corporate directors and their function on the board has been at the center of corporate governance reform.").

22. *See id.*

23. *See* MELVIN EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 34–36 (1976).

24. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 73–74 (1996).

25. *E.g.*, ROBERT A.G. MONKS & NELL MINOW, POWER AND ACCOUNTABILITY 74 (1991).

ownership of corporate stock.[26] Historically, individuals owned a significant percentage of the equity of large U.S. corporations.[27] Since the 1970s, however, institutional investors have come to own a steadily growing percentage of these companies.[28] These institutional investors drove the corporate governance movement.

With vast pools of capital and the associated votes in corporate director elections concentrated in fewer hands, these shareholders gained greater influence in corporate boardrooms. In particular, institutional investors were unaffected by the expense of collective action and the problem of rational apathy that limit the power of individual shareholders.[29]

Active shareholders, such as the California Public Employees Retirement System (CalPERS), transformed many aspects of corporate governance. For example, in 1992 the federal proxy rules were amended to improve the ability of institutional investors to plan coordinated campaigns to advance their corporate governance agendas.[30] Further manifestations include increased frequency and adoption of shareholder proposals addressed to governance rather than social issues and expanded shareholder access to the corporation's own proxy statement for the election of directors (so-called proxy access).[31] Active shareholders also campaigned for specific corporate governance devices, such as imposing age limits for directors holding executive sessions of the board attended solely by outsiders, and prohibiting the same person from serving as both board chairman and CEO.[32]

Outside Directors. But the single greatest consequence of the rise of

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26. *See* Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 995–96 (2010).

27. *Id.*

28. *See* G.J. Previts, A Pie Chart View of U.S. Publicly Traded Corporate Equity Distribution: 1950–2011 (2012) (slide show presentation on file with the author); *see also* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy* 33–34 (Fordham Univ. School of Law Working Paper Series, 2012), *available at* http://www.ssrn.com/abstract=2079607.

29. Directors began to pay more attention to shareholder "voice," offering shareholders an alternative to the only traditional way to object to disappointed expectations, which was to "exit," meaning to sell the stock (once called the Wall Street rule). *Cf.* ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 4 (1970) (noting the "voice" and "exit" options as two methods by which management will discover the corporation's shortcomings).

30. *See* Jill A. Hornstein, Note, *Proxy Solicitation Redefined: The SEC Takes an Incremental Step Toward Effective Corporate Governance*, 71 WASH. U. L.Q. 1129, 1132–34 (1993).

31. *See* Lisa M. Fairfax, *The Future of Shareholder Democracy*, 84 IND. L.J. 1259, 1260–61 (2009); Jill E. Fisch, *The Destructive Ambiguity of Federal Proxy Access*, 61 EMORY L.J. 435, 447 (2012); Kahan & Rock, *supra* note 26, at 1019.

32. *See* Kahan & Rock, *supra* note 26, at 1022–23.

institutional investors, and the other most significant achievement of the corporate governance movement, has been the consequent rise in the number and power of outside directors—those not otherwise employed by or associated with the corporation.[33] Institutional investors saw outside directors as a mechanism for monitoring management and therefore reducing agency costs.[34] Outside directors promised a unique ability to render independent judgments and promote shareholder value.[35]

Reinforcing the institutional investor appetite for outside directors, laws and regulations also increased outsiders' number and power. State corporation law in the 1980s encouraged boards to have outside directors, especially for tasks such as evaluating takeovers and other transactions posing conflicts of interest.[36] In federal securities law, the Sarbanes-Oxley Act of 2002[37] expanded the power of outside directors regarding the auditing function, including giving outside directors complete power over the company's auditor.[38] The Dodd-Frank Act of 2010[39] created similar requirements concerning compensation committees.[40] Due to institutional investor preferences for outside

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33. *See* Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 873 (1991). The concepts of outside and inside directors are vernacular terms whose precise definitions vary with context but the distinction generally is between directors who are employees of a company (inside) and those who are not (outside). More particular distinctions attempt to define a notion of "independent" to denominate directors whose lack of employee or other corporate status enables them to exercise judgments free of conflict of interest. Specific and varying definitions of director independence appear in such authorities as the federal securities laws, state corporation laws, stock exchange rules, corporate and board committee charters, corporate contracts, and various law reform documents. *See* Donald C. Clarke, *Three Concepts of the Independent Director*, 32 DEL. J. CORP. L. 73, 78, 84–90 (2007).

34. *See* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1281–82 (1991).

35. *See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1526 (2007).

36. *E.g.*, DEL. CODE ANN. tit. 8, § 144 (2013); Weinberger v. UOP, Inc., 457 A.2d 701, 709–10 (Del. 1983) (finding that the lack of conflict disclosure by directors and failure to utilize independent directors in negotiating an arm's length transaction was unlawful); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1147, 1154 (Del. 1989) (viewing the use of independent directors favorably in analyzing a management-sponsored alternative to hostile takeover); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 44 (Del. 1993) (highlighting the importance of independent directors in conflict of interest situations); MODEL BUS. CORP. ACT §§ 8.60–8.61 (2013).

37. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

38. 15 U.S.C. § 78j-1(m)(2),(m)(3)(A)–(B) (2012).

39. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of 12 U.S.C.).

40. *Id.* § 952; *see also* Listing Standards for Compensation Committees, 77 Fed. Reg. 38,422 (June 27, 2012) (adopting SEC Rule 10C-1 that implements statutory directives

directors and support from regulators, today's boards of the largest publicly traded corporations often have no more than one or two inside (management) directors.[41]

Gatekeepers. The third most significant development of the corporate governance movement was the increased involvement of professional advisors, called gatekeepers, in corporate process. Gatekeepers—traditionally auditors and lawyers—are participants in corporate process who stake their reputation when vouching for the validity or integrity of corporate decision-making.[42] In financial reporting, for instance, auditors attest to the truth and fairness of accounting results. In raising capital, lawyers conduct due diligence to assure the legality of the offering.[43]

Though gatekeepers had been involved in these transactions throughout the prior century, the corporate governance movement amplified the importance of their role.[44] In a recent trend, outside directors retain their own lawyers to represent them. Historically, outside directors had not hired their own lawyers, but Sarbanes–Oxley authorized audit committee members to do so.[45] A specialty legal practice emerged: representing outside directors, especially advising on disagreements with chief executives.[46]

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requiring independent compensation committee members for issuers).

41. *See* Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 135–36 (2010).

42. Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 61 & n.20 (1986).

43. *See* Lawrence A. Cunningham, *Sharing Accounting's Burden: Business Lawyers in Enron's Dark Shadows*, 57 BUS. LAW. 1421, 1432 (2002).

44. *See* Abraham J. Briloff, *The Corporate Society: We Are* In Pari Delicto, 1 J. CORP. L. 457, 462–64 (1976) (discussing the moral and ethical failures of professionals leading to public fiascos); Lincoln Sav. & Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990). Evidence of the importance attached to the gatekeeping function is clear from the expanding list of professionals who can provide such a service, which today includes rating agencies, research analysts, D&O insurers, and investment banks. *See* CLAIRE A. HILL & BRETT H. MCDONNELL, RESEARCH HANDBOOK ON THE ECONOMICS OF CORPORATE LAW 255–369 (2012) (including pieces about such gatekeepers by Lawrence A. Cunningham, Jill E. Fisch, Tamar Frankel, Sean J. Griffith, Richard W. Painter, Aline Darbellay, and Frank Partnoy).

45. Proposals to equip outside directors with power to retain independent advisors remained rare even after being ordained in 1992 by the American Law Institute. 1 AM. LAW. INST., *supra* note 17, § 3.04; *see also* James D. Cox, *Managing and Monitoring Conflicts of Interest: Empowering the Outside Directors with Independent Counsel*, 48 VILL. L. REV. 1077, 1090 (2003) (making the "modest proposal" that outside directors asked to approve interested transactions of other directors retain their own lawyer).

46. Among the earliest and most prominent examples of outside lawyers exerting power in the boardroom to oust a chief executive occurred when Ira Millstein, of Weil, Gotshal & Manges, played that role in the 1992 dismissal of General Motors CEO Robert Stempel. *See* John A. Byrne, *The Guru of Good Governance*, BUS. WK. (Apr. 27, 1997), http://www.businessweek.com/stories/1997-04-27/the-guru-of-good-governance; Alison Leigh

Shortcomings. These corporate governance developments have several shortcomings. First, the rise of institutional investors and outside directors may not have reduced agency costs as much as promised. Institutional investors, after all, manage money for others, meaning they are agents as well for their investors, and those investors face the costs of having those agents manage their money. The rise in power of institutional investors may have reduced one set of agency costs while creating another set in its place. Debate has centered on contesting the net effects.[47] Further, institutional investors vary in many features, including relative activism and goals. Most institutional investors stress shareholder value, but many engage in "socially responsible investing" that addresses varied objectives such as environmental protection or human rights.[48]

Concerning outside directors, there is not much empirical evidence that their presence improves shareholder value or corporate performance.[49] Some evidence suggests a board's independence is less important than its active engagement.[50] Other evidence suggests that certain kinds of outside directors improve the performance of certain functions, such as adherence to accounting requirements.[51] But, clearly, there is a trade-off between the expertise of inside directors and the independence of outside directors.[52]

Debate continues over the exact value of gatekeepers and ways to improve their effectiveness.[53] An acute case concerns the new practice of outside directors retaining independent counsel to advise them,

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Cowan, *The High-Energy Board Room*, N.Y. TIMES (Oct. 28, 1992), http://www.nytimes.com/1992/10/28/business/the-high-energy-board-room.html (noting GM's hiring of Ira Millstein).

47. *See generally* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992) (listing arguments for both sides of the institutional investor agency cost debate).

48. *See* CAROLYN KAY BRANCATO, INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE: BEST PRACTICES FOR INCREASING CORPORATE VALUE 87 (1997).

49. *E.g.*, Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 922 (1999); Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 248, 262 (2002); Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature*, FED. RES. BANK N.Y. ECON. POL'Y REV. 7, 8 (2003).

50. *See* Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 COLUM. L. REV. 1283, 1283, 1298–99 (1998).

51. *See* Lawrence A. Cunningham, *Rediscovering Board Expertise: Legal Implications of the Empirical Literature*, 77 U. CIN. L. REV. 465, 478 (2008).

52. *Id*. at 467; Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 460 (2008).

53. *See* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 345–63 (2004) (discussing methods of improving the effectiveness of gatekeepers).

especially on disagreements with management. Some experts see this development as perilous, as it cleaves boards into factions, injects lawyers deeply into corporate deliberations, and compromises the independence of outside directors when lawyers advise them of their personal best interest instead of the corporation's best interest.[54] In some cases, however, outside directors have assumed considerable power and authority in corporate boardrooms and have been exposed to personal liability—most notably in the cases of Enron and WorldCom.[55]

Studies and debate concerning corporate governance features correctly suggest that any governance reform, from adding outside directors to having the audit committee supervise outside auditors, could have differing effects from company to company.[56] Such differences expose a final weakness about the corporate governance movement: it often advanced reforms for adoption generally that overlooked variation among companies.[57] That has been especially problematic concerning governance devices adopted in the aftermath of corporate scandal.[58]

Despite broad observable phenomena, such as the rise of institutional investors, outside directors, and gatekeepers, there remains considerable variation in relevant corporate governance attributes at particular companies. Thus, boards may be required by law, stock exchange rule, or shareholder mandate to produce governance guidelines, committee charters, or ethics codes. But the resulting products and effects are unlikely to be identical at different firms. Indeed, some governance

54. *See, e.g.*, E. Norman Veasey, *Separate and Continuing Counsel for Independent Directors: An Idea Whose Time Has Not Come as a General Practice*, 59 BUS. LAW. 1413, 1417–18 (2004) (identifying situations where independent counsel is appropriate and noting the potential downsides of independent counsel); *see also* Geoffrey C. Hazard, Jr. & Edward B. Rock, *A New Player in the Boardroom: The Emergence of the Independent Directors' Counsel*, 59 BUS. LAW. 1389, 1402–03 (2004) (quoting AM. BAR ASS'N, REPORT OF THE AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY 157 n.54 (2003)) (offering tepid acceptance of the concept).

55. *See infra* text accompanying notes 74–80.

56. *See* Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 814 (2001) (noting the "ideal board structure may be firm-specific, or in some cases, industry-specific"); Jill E. Fisch, *Taking Boards Seriously*, 19 CARDOZO L. REV. 265, 284–85 (1997).

57. *See, e.g.*, Larry E. Ribstein, *The Mandatory Nature of the ALI Code*, 61 GEO. WASH. L. REV. 984, 995–96 (1993) (discussing the failure of certain firm theories based on lack of consideration for the adaptive nature of corporate governance).

58. *See* Larry E. Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 89 (2003) (explaining that legislation following a crash can harm executive officers and firms that are risk-seeking rather than risk-averse); Roberta Romano, *The Sarbanes–Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1587–90 (2005) (noting that Sarbanes–Oxley created differing burdens on smaller firms compared with larger firms). This literature addresses generally applicable laws and regulations adopted in response to financial crises, not the individualized setting of DPAs, which differs, as noted *infra* Subsection III.B.2.

regulations explicitly recognize that one size does not fit all, as when certain devices are required only of large companies and waived for smaller ones.[59]

LLCs and LLPs. Finally, it should be noted that alternative forms of business organization have proliferated in the past two generations. The limited liability partnership and the limited liability company are the most prominent examples. They originate from the limited partnership and the corporation, respectively, and are defined by the high degree to which investors in them may enjoy the benefits of limited liability along with other advantages. At one time, entrepreneurs had to accept trade-offs among alternative forms of business organization, such as between the limited shareholder liability of the corporate form that was subject to two levels of taxation or the single taxation of the partnership that exposed partners to unlimited liability. Thanks to statutory and contractual innovations that combine the appealing attributes of historical forms of business organization into modern hybrids, these alternative forms have developed to eliminate such trade-offs.[60] Governance features in these new forms of business organization are extensively tailored by contract and, therefore, are even more variable than the traditional partnership or corporation.

C. *Compliance and the Rise of DPAs*

The subject of compliance is a narrow component of corporate governance. Its roots are anchored not so much in the corporate governance movement but in the concurrent intensification of organizational criminal liability. Although corporate-level criminal liability was recognized in a famous 1909 case,[61] organizational criminal liability remained relatively rare throughout most of the twentieth century. During the 1970s, however, an eruption of corporate scandals inspired law enforcement authorities to strengthen their policing of corporate behavior.[62] The Watergate-induced disclosures of corporate wrongdoing around the world by U.S. companies prompted legislation cracking down on such practices.[63] Congress strengthened

59. *E.g.*, Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 989G, 124 Stat. 1376, 1948 (2010) (to be codified in scattered sections of 12 U.S.C.) (relieving internal control audit obligations for certain smaller public companies); Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, § 501, 126 Stat. 306, 325 (to be codified at 15 U.S.C. § 78l(g)(1)(A)) (creating a securities registration exemption for companies below a certain threshold).

60. *E.g.*, LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 137 (2010).

61. N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 499 (1909).

62. *See* John C. Coffee, Jr., "*No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 386 & n.3 (1981).

63. *See* Walter Perkel, *Foreign Corrupt Practices Act*, 40 AM. CRIM L. REV. 683, 683 (2003).

criminal penalties under federal law across many fields, from antitrust to environmental to securities. Prosecutions ensued against corporations with household names, such as Drexel Burnham Lambert in finance and Exxon for the Exxon Valdez oil spill.[64]

Compliance. The general approach of corporate-level criminal liability held corporations vicariously liable for acts of their agents taken within the scope of employment.[65] Policing corporate wrongdoing through criminal law assumed a more formal dimension with the formation of the U.S. Sentencing Commission in 1987 and the Commission's production of the Federal Organizational Sentencing Guidelines.[66] These guidelines codified an approach to deterring corporate crime through a calibrated sentencing format. It gave corporations credit in sentencing for having effective compliance programs in place and for cooperating with lawmakers during investigations and resulting prosecutions. This amounted to a slight shift from the traditional standard of vicarious liability to a modified duty-based approach to liability.[67] That is, corporate exposure came to hinge on the relative effectiveness of a corporation's compliance program.[68]

The importance of effective compliance programs became more central to corporate life after 1996 when the Delaware Court of Chancery in *Caremark* announced clear compliance duties of corporate directors.[69] Drawing in part on the Federal Organizational Sentencing Guidelines, *Caremark* questioned the continuing soundness of a 1963 Delaware Supreme Court opinion that limited any such duties to cases in which red flags would have stimulated a reasonable director's attention.[70] *Caremark* stated that corporate directors must take reasonable efforts to assure that the company maintains effective compliance programs, a stance later validated by the Delaware Supreme

64. *See* DANIEL FISCHEL, PAYBACK: THE CONSPIRACY TO DESTROY MICHAEL MILKEN AND HIS FINANCIAL REVOLUTION 69 (1995).

65. More sweeping variations were formulated as well. *E.g.*, United States v. Bank of New England, 821 F.2d 844, 855 (1st Cir. 1987) (describing the collective knowledge standard as an attribution of the sum total of employee knowledge across a corporation).

66. *See* Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 WASH. U. L.Q. 205, 207–09 (1993) (discussing the Sentencing Reform Act's creation, underlying principals, and future development).

67. *See generally* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997) (comparing and analyzing vicarious liability and various forms of duty-based liability).

68. *See id.* at 697.

69. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

70. *Id.* at 969 (questioning Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 131 (Del. 1963), which held that, in the absence of a reason to suspect antitrust violations, directors are not liable for failure to prevent antitrust activities by employees).

Court.[71]

Caremark's holding was narrow and arose in the settlement of a derivative suit that required the court to assess only whether a settlement was fair. But it spawned extensive commentary and expanded work for consultants as companies scrutinized internal compliance programs.[72] Scholars, meanwhile, questioned whether the preoccupation with compliance would produce cosmetic exercises in window dressing rather than substantive control over internal corporate agents.[73] After all, compliance systems and governance structures are rarely effective unless both senior management and individuals responsible for maintaining the structures believe in and endorse them. Employees and other constituents pick up on signals about whether management holds such commitments or is merely going through the motions.

Enforcement Intensity and Andersen. The era of Enron and Sarbanes–Oxley brought renewed intensity to corporate criminal law, just as it did to corporate governance.[74] Sarbanes–Oxley, enacted in 2002, defined new crimes for wrongful financial statement certification,[75] enhanced penalties for other business crimes,[76] and directed the Sentencing Commission to design optimal approaches to corporate criminal liability.[77] President George W. Bush formed the President's Corporate Fraud Task Force within the DOJ to fortify this area of law enforcement.[78] The government's rationale was outlined in a series of DOJ memos that focused on "getting tough" on corporate malfeasance, one of which stressed "vigorous enforcement" of law

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71. *Id.* at 967; Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

72. *See generally* H. Lowell Brown, *The Corporate Director's Compliance Oversight Responsibility in the Post* Caremark *Era*, 26 DEL. J. CORP. L. 1 (2001) (discussing the implications of the *Caremark* decision); Charles M. Elson & Christopher J. Gyves, In re Caremark*: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 701–02 (2004).

73. *E.g.*, Lawrence A. Cunningham, *The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills*, 29 J. CORP. L. 267, 314 (2004); Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 513–14 (2003).

74. *See* Lawrence A. Cunningham, *The Sarbanes–Oxley Yawn: Heavy Rhetoric, Light Reform (and It Just Might Work)*, 35 CONN. L. REV. 915, 917 (2003).

75. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, § 302, 116 Stat. 745, 777–78 (codified at 15 U.S.C. § 7241).

76. *Id.* §§ 801–906 (codified in scattered sections of 18 and 28 U.S.C.).

77. *Id.* § 1104 (codified at 28 U.S.C. § 994).

78. *See The President's Corporate Fraud Task Force*, U.S. DEP'T OF JUSTICE ARCHIVES, http://www.justice.gov/archive/dag/cftf/ (last visited Nov. 18, 2013). President Barack Obama expanded the program under a new name, the Interagency Financial Fraud Task Force. *See President Obama Establishes Interagency Financial Fraud Enforcement Task Force*, U.S. SEC. & EXCHANGE COMM'N (Nov. 17, 2009), http://www.sec.gov/news/press/2009/2009-249.htm.

against "corporate wrongdoers."[79] The focus remained on corporate compliance programs as the key to optimal deterrence, with a new emphasis on mandatory cooperation that intensified the internal policing of corporate employees.[80]

In response, prosecutors escalated high-profile suits against esteemed corporate directors and prominent auditing firms. A symbol of the seismic shift in enforcement occurred when twenty-two directors of Enron and WorldCom paid $39.25 million out of their own pockets, unreimbursed by insurance or the corporation, to settle suits against them.[81] Whether desirable or not, directors across corporate America began to fear for their personal liability.

A stunning result of the Enron-era enforcement intensification occurred in 2002 when the DOJ filed criminal charges for obstruction of justice against the venerable independent accounting firm Arthur Andersen, whose Houston office had signed off on Enron's books.[82] During the government's investigation of Enron, two senior Andersen employees destroyed drafts of documents related to the work.[83] For that, the government indicted the entire firm, which at that time employed 85,000 people[84] and earned billions annually.[85] The government won a fine of only $500,000.[86] Settlement negotiations between prosecutors

79. Successive Deputy Attorneys General of the United States signed the memos, the first of which was issued in 1999. *See* Memorandum from Eric Holder, Deputy Att'y Gen., U.S. Dep't of Justice, to All Component Heads and U.S. Att'ys, Bringing Criminal Charges Against Corporations (June 16, 1999), *available at* http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.PDF; Memorandum from Larry D. Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), *available at* http://web.archive.org/web/20060201083908/http://www.justice.gov/dag/cftf/business_organizations.pdf (archived at the Internet Archive); Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006), *available at* http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf; Memorandum from Mark Filip, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys, Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008), *available at* http://www.justice.gov/dag/readingroom/dag-memo-08282008.pdf.

80. *See* Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 953–54, 1007–08 (2009).

81. *See* Bernard Black, Brian Chefffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055, 1057 (2006).

82. Indictment at 7, United States v. Arthur Andersen LLP, CRH-02-121 (S.D. Tex. Mar. 7, 2002).

83. *Id.* at 7–8.

84. *See* Kathleen F. Brickey, *Andersen's Fall from Grace*, 81 WASH. U. L. Q. 917, 935 (2003).

85. Jonathan D. Glater, *Audit Firms Await Fallout and Windfall*, N.Y. TIMES (Mar. 14, 2002), http://www.nytimes.com/2002/03/14/business/audit-firms-await-fallout-and-windfall.html.

86. *Arthur Andersen Is Fined $500,000*, N.Y. TIMES (Oct. 17, 2002),

and the firm to avoid that result failed when the two could not agree on the firm's admission of wrongdoing.[87] Though a unanimous U.S. Supreme Court eventually overturned the firm's later conviction,[88] by then the prosecutorial enthusiasm had destroyed the firm.

Proliferation of DPAs and Controversy. After Andersen, prosecutors became reluctant to indict entire companies that employed large numbers of innocent people, though they continued to hold that threat over the heads of top corporate officials.[89] Such reluctance led to the proliferation of deferred prosecution agreements (DPAs), in which companies opt for cooperative settlement to avoid the fate that befell firms like Andersen. In DPAs, prosecutors agree with target corporations to defer or refrain from prosecution in exchange for the target admitting allegations, paying fines, and committing to various undertakings.[90] Corporate undertakings include reforms such as detailed public disclosure of the matter, enhanced internal compliance programs, and top-level governance changes. If the government determines that the target breached, however, it can prosecute. At such a time, given the admissions, conviction is nearly certain.[91]

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http://www.nytimes.com/2002/10/17/business/arthur-andersen-is-fined-500000.html.

87. The sticking point was important because the exact admission would influence the SEC's decision about debarring the firm from auditing public companies—its bread and butter—a concern over civil consequences of the criminal procedure. *See* Brickey, *supra* note 84, at 921.

88. Arthur Andersen LLP v. United States, 544 U.S. 696, 708 (2005).

89. *See* Elizabeth K. Ainslie, *Indicting Corporations Revisited: Lessons of the Arthur Andersen Prosecution*, 43 AM. CRIM. L. REV. 107, 109–10 (2006); Andrew Weissman & David Newman, *Rethinking Corporate Criminal Liability*, 82 IND. L.J. 411, 442 & n.107 (2007). *See generally* James Kelly, *The Power of an Indictment and the Demise of Arthur Andersen*, 48 S. TEX. L. REV. 509 (2006) (discussing the negative consequences of indicting entire corporations at the expense of thousands of innocent employees).

90. Technically, prosecutors distinguish between deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs), but the distinction is immaterial to the questions addressed here concerning the legitimacy of including corporate governance terms in any such agreements. *See* First, *supra* note 4, at 45–46. NPAs are typically used in cases where no criminal charges are filed, while DPAs are reached to settle filed charges. Court approval is involved in the latter but not the former case, though little or no judicial second-guessing occurs. *See infra* text accompanying notes 266–276.

91. DPAs can resemble structural reform litigation developed through consent decrees in the civil rights area and resemble contemporary regulatory agency settlements. *See* Garrett, *supra* note 2, at 869–74 (noting parallels to and differences from structural reform litigation evaluated in the landmark work, Abram Chayes, *The Role of the Judge in Public Law Litigation*, 89 HARV. L. REV. 1281 (1976)). DPAs invert the consent decree model, however, as they target private rather than public actors and enforce criminal law not civil rights. Administrative settlements, apart from the civil/criminal distinction (and related risks of collateral consequences), more often than DPAs do not require admissions of facts or guilt and do not routinely entail commitments to reform compliance and governance. Agencies also bring the expertise of specialists in the substantive field to their task—such as environmental or health care—while prosecutors tend to be generalists. On the other hand, federal prosecutors, at least,

DPAs are age-old devices, but have become popular in the U.S. only in the past decade. Less than two dozen DPAs were ever used before 2003, but nearly 300 have been signed since.[92] During the summer of 2012 alone, federal prosecutors entered into over a dozen DPAs with various corporate targets.[93] In late 2012, the United Kingdom opted to follow this American development.[94] Other countries are doing so as well.[95] Nevertheless, while DPAs may be popular among prosecutors and some corporations, they are controversial among scholars and policymakers.[96]

Critics detect prosecutorial overreaching in certain cases.[97] They say prosecutors impose terms on corporations rather than enter into good

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increasingly coordinate cases with expert administrative colleagues. Coordination sometimes results in compliance and governance reforms appearing in the civil settlement rather than the DPA. Such reforms draw on agency guidelines in the relevant regulatory field—yet another difference with the more ad hoc quality that seems to characterize the DPA population. Even so, the analysis in this Article is intended to provide a useful general framework for DPAs pursued by all prosecutors, especially criminal (federal, state, and local) but civil as well—possibly because of the emphasis on context throughout. *See infra* note 300 and accompanying text.

92. A database of federal corporate DPAs is maintained at the University of Virginia, organized by Professor Brandon Garrett and Jon Ashley. *See* Brandon L. Garrett & Jon Ashley, *Federal Organizational Prosecution Agreements*, U. VA. SCH. L. http://lib.law.virginia.edu/Garrett/prosecution_agreements/home.suphp (last visited Nov. 18, 2013).

93. *Id.* DPAs are also increasingly used to settle cases against individuals. One example includes the CEO of Monster Worldwide, who resolved a case against him using a DPA primarily because of unusual medical conditions he faced. Deferred Prosecution Agreement, United States v. McKelvey, No. 08 Mag 0137 (S.D.N.Y. Jan. 23, 2008), *available at* http://lawprofessors.typepad.com/whitecollarcrime_blog/files/mckelvey_deferred_prosecution_agreement.pdf. Another example is Floyd Landis, an Olympic cycling star accused of doping, who created a legal defense fund that turned out to be based on misleading statements. *Former Pro Cyclist Floyd Landis Admits Defrauding Donors and Agrees to Pay Hundreds of Thousands of Dollars in Restitution*, FBI (Aug. 24, 2012), http://www.fbi.gov/sandiego/press-releases/2012/former-pro-cyclist-floyd-landis-admits-defrauding-donors-and-agrees-to-pay-hundreds-of-thousands-of-dollars-in-restitution.

94. *See* Samuel Rubenfeld, *U.K. to Move Forward with Deferred-Prosecution Agreements*, WALL ST. J. (Oct. 23, 2012, 3:14 PM), http://blogs.wsj.com/corruption-currents/2012/10/23/uk-to-move-forward-with-deferred-prosecution-agreements/.

95. *See Global Compliance Panel: Insights of Four Former Prosecutors*, METRO. CORP. COUNS. (Sept. 2012), http://www.metrocorpcounsel.com/pdf/2012/September/29.pdf.

96. *See* Joseph Warin, *Update on Corporate Deferred Prosecution and Non-Prosecution Agreements*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (July 26, 2012, 9:10 AM), https://blogs.law.harvard.edu/corpgov/2012/07/26/update-on-corporate-deferred-prosecution-and-non-prosecution-agreements/ ("More often than not, the narrative surrounding DPAs . . . is negative . . . .").

97. Peter Spivack & Sujit Raman, *Regulating the "New Regulators": Current Trends in Deferred Prosecution Agreements*, 45 AM. CRIM. L. REV. 159, 161–62 (2008); Miriam Hechler Baer, *Insuring Corporate Crime*, 83 IND. L.J. 1035, 1044–72 (2008) (discussing how "[b]usinesses [o]verpay for [c]orporate [c]rime"); Arlen, *supra* note 3, at 62–86; PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 177, 177–85 (Anthony S. Barkow & Rachel E. Barkow eds., 2011).

faith negotiations that result in a voluntary or more tailored agreement.[98] Critics infer this from the inclusion of peculiar terms, such as requiring donations to be made to causes with which a prosecutor may have a connection.[99] Other critics stress that there is simply no objective basis for determining the net cost and benefit of DPAs or whether they are effective.[100] A broader critique questions the competence of prosecutors to propose or negotiate certain terms commonly used in DPAs, which extend from enhanced internal corporate procedures concerning compliance to personnel changes and other top-level governance mandates.[101]

Several rationales, however, support DPAs. Rationales include avoiding the risk of adverse collateral consequences of corporate convictions—the so-called Andersen effect. From the perspective of economic theory, the adverse collateral consequences are essentially negative externalities, and DPAs are designed to avoid those. On the upside, DPAs are designed to achieve positive externalities, which arise from their production of general deterrence. DPAs may be valuable alternatives to criminal convictions or civil regulation when investigations generate firm-specific information about corporate defects that the agreements can cure. Finally, both sides may find a DPA appealing simply to avoid the cost and uncertainty of a trial.[102]

D. *Andersen's Seminal Lesson*

A new line of criticism is emerging to challenge the lessons that have been taken from the Andersen case. The extensive literature routinely repeats that the lesson of Andersen is that prosecutors should try earnestly to avoid indicting large business organizations because of the risk of the collateral consequences for innocent people.[103] Prosecutors embraced the point, as the frequency of prosecution, especially of large business organizations, declined.[104] This Andersen

98. Spivack & Raman, *supra* note 97, at 173.

99. Such criticisms can seem overstated. *See* discussion *infra* Section IV.B.

100. Kathleen M. Boozang & Simone Handler-Hutchinson, *"Monitoring" Corporate Corruption: DOJ's Use of Deferred Prosecution Agreements in Health Care*, 35 AM. J.L. & MED. 89, 119 (2009); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-110, CORPORATE CRIME: DOJ HAS TAKEN STEPS TO BETTER TRACK ITS USE OF DEFERRED AND NON-PROSECUTION AGREEMENTS, BUT SHOULD EVALUATE EFFECTIVENESS 25–28 (2009). Legislators have taken heed, with bills in Congress proposing standards to govern DPAs and promote prosecutorial accountability. *E.g.*, H.R. 1947, 111th Cong. (2009) ("To regulate certain deferred prosecution agreements and nonprosecution agreements in Federal criminal cases.").

101. *See* Arlen, *supra* note 3, at 64–68. See *infra* Section III.C for an evaluation of such objections and others.

102. See *infra* Subsection III.B.3 for additional references to possible rationales for DPAs.

103. *See* sources cited *supra* note 89.

104. *See* Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775,

effect, however, is not necessarily a valid lesson of Andersen, nor is it the most important lesson.

On the contrary, empirical evidence accumulated since Andersen demonstrates that corporations and other businesses rarely collapse from indictments or face other serious collateral consequences. For example, recent research identified several dozen indictments of large public corporations in the past decade; only a handful of the firms failed and the indictment was not necessarily the cause.[105] Even iconic firms such as Steve Madden's shoe company and Martha Stewart's lifestyles business survived criminal convictions of those people.[106] As a matter of theory, moreover, there is reason to doubt whether such collateral risks are a sufficient justification for DPAs as opposed to indictment and prosecution.[107]

Underappreciated Governance. A more important lesson of Andersen is how prosecutors may have given inadequate attention to the firm's governance. Andersen's salient governance features were those associated with its form, ownership, and management. Andersen was a partnership. Its members owned the firm and managed it. Many members had considerable human and financial capital tied to the firm.[108] Threats to the firm's survival from an indictment could be expected to induce partner withdrawals, including flights to peer firms,

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1794 (2011).

105. *See* Gabriel Markoff, *Arthur Andersen and the Myth of the Corporate Death Penalty: Corporate Criminal Convictions in the Twenty-First Century*, 15 U. PA. J. BUS. L. 797, 837–39 (identifying fifty-one companies, though a review of the list suggests the need to add and subtract a few, in part to verify which were public at the time of prosecution and conviction and in part to address the exact posture of the case in terms of criminal procedure). The companies that reportedly failed were Utilicorp United, Winn Dixie Stores, Energy Partners, Ltd., Elpida Memory, and Japan Airlines International—and two of those failed businesses were nevertheless later taken over and rehabilitated to some extent by other companies. *Id.* at 823, 840–42. Among companies indicted without subsequent failure were several global airlines (for antitrust violations); Chiquita Brands (for terrorist financing violations); and Eli Lilly (for selling misbranded drugs). *Id.* at 826, 833, 837–42.

106. *See* Laura M. Holson, *Steve Madden Is Back*, N.Y. TIMES (Feb. 13, 2013), http://www.nytimes.com/2013/02/14/fashion/steve-madden-is-back.html (noting the company's success); *Martha Stewart Profit Helped by TV Show, Ads*, L.A. TIMES (Feb. 23, 2006), http://articles.latimes.com/2006/feb/23/business/fi-earns23.3 (reporting the company's rising profits).

107. *See* Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Non-Prosecution* 22–25 (2012) (unpublished manuscript) (on file with the author and cited with permission), *available at* http://web.law.columbia.edu/sites/default/files/microsites/law-economics-studies/Arlen,%20J%20-%202012%20Fall%20WS.pdf (explaining how the concept of asset insufficiency in the economic theory of regulation cannot justify DPAs containing *ex post* regulatory terms).

108. *See* Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence, and Governance in the Accounting Industry*, 48 VILL. L. REV. 1167, 1170–72 (2003).

and fuel a self-fulfilling spiral.[109]

In contrast, had Andersen been a corporation, owned by diversified outside shareholders and managed by professional directors and officers, a different prediction would have been warranted. Such groups would have been less dependent on the firm than the partners were and thus better able and willing to bear the risk of staying the course. Despite the salient features of Andersen's governance—a partnership owned and managed by its members—the warnings of an Andersen effect that stoked prosecutorial allergies to organizational indictments spoke of the danger indictments pose for large *corporations*.[110]

As for clients, other aspects of Andersen's governance, broadly defined, come into play. They might reasonably believe that an indictment could prompt federal regulators at the SEC to threaten to debar the firm's authority to audit SEC registrants. Even private clients, not needing such SEC approval, valued Andersen as a partnership of professional accountants and its related reputation that the indictment threatened. An indictment of such a firm thus seems relatively likely to precipitate or accelerate defection by clients and partners alike. Collateral consequences, which ultimately destroyed the firm, were grave for the firm's vast employee base that was largely innocent of wrongdoing. Also, clients were negatively impacted as they had to scramble to retain other auditors.[111]

Governance Matters. The exact risks of indictment and probabilities of adverse collateral consequences cannot be gauged definitively. Yet the question of adverse collateral consequences—which DOJ guidelines since Andersen direct prosecutors to study[112]—requires an examination of governance features. That is the only way to determine whether the fallout from indictment will hurt innocent parties who warrant protection—and not every employee or shareholder group can claim such innocence. The DOJ's solicitude for such groups is unusual within criminal law,[113] which ordinarily offers little sympathy to the family and

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109. *See* Macey & Sale, *supra* note 108, at 1167–68.

110. *See* sources cited *supra* note 89.

111. To be sure, factors other than Andersen's legal status as a partnership—and what prosecutors thought about that structure—played a role in the saga. Indeed, the firm's disintegration began before prosecutors arrived on the scene. Moreover, a major problem was the lack of compromise between prosecutors and the firm. Prosecutors alleged that they had uncovered criminal obstruction: the firm refused to acknowledge any such thing. There was no middle ground. For an account of the case from the perspective of one of the prosecutors, see Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 479–88 (2006).

112. *See* sources cited *supra* note 79.

113. *See* Darryl K. Brown, *Third-Party Interests in Criminal Law*, 80 TEX. L. REV. 1383, 1387–88 (2002).

associates of defendants.[114] The DOJ cannot intend its collateral consequences principle to protect such groups unless they are deemed innocent, and assessing such a question *ex ante* requires considering the target's governance.

Among corporations, distinctions must be drawn between publicly held and closely held firms. These may imply different owner attitudes toward and managerial capacity for firm wrongdoing, probative of the degree to which collateral consequences of indictment or prosecution should be seen as adverse. The separation of ownership from control is starker in the case of a large public corporation, such as Archer Daniels Midland, where shareholders should be seen as relatively more worthy of protection than shareholders of an equally large nonpublic corporation, such as Cargill, where ownership is concentrated in the hands of a single family.[115] Such differences warrant predicting different reactions to different forms of prosecutorial pressure and different perceptions of what constitutes adverse collateral consequences.

Among publicly held corporations, distinctions and related predictions can be drawn on the basis of such potentially relevant factors such as the level and type of shareholder ownership and its bearing on questions of collective action and rational apathy. Collective action becomes easier as ownership is more concentrated in fewer hands and institutional ownership increases. Institutional investors should not always be seen as innocent victims but, given activism and power, they should be held accountable too.[116]

Again, the type of institutional owner matters along with the size of holdings. Wal-Mart, for instance, is owned 48% by family-controlled Walton Enterprises,[117] an ownership position that may entail responsibility for criminal conduct at the firm. A shareholder's investment purpose may provide clear clues about relative culpability or innocence, with long-term investment outlooks potentially warranting greater respect than short-term arbitrage positions.[118] Similarly, some

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114. *See* Susan Hoffman Fishman, *The Impact of Incarceration on Children of Offenders*, 15 J. CHILD. CONTEMP. SOC'Y 89 (1982).

115. *See* Brian Solomon, *The Secret Cargill Billionaires and Their Family Tree*, FORBES (Sept. 22, 2011, 12:22 PM), http://www.forbes.com/sites/briansolomon/2011/09/22/the-secretive-cargill-billionaires-and-their-family-tree.

116. *See* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1295–96 (2008); Amy J. Sepinwall, *Guilty by Proxy: Expanding the Boundaries of Responsibility in the Face of Corporate Crime*, 63 HASTINGS L.J. 411, 438 & n.127 (2012); *see also* Lisa M. Fairfax, *On the Sufficiency of Corporate Regulation as an Alternative to Corporate Criminal Liability*, 41 STETSON L. REV. 117, 124 (2011).

117. Andy Serwer, *Are Wal-Mart Shares on Sale?*, CNN MONEY (June 3, 2011, 5:00 AM), http://features.blogs.fortune.cnn.com/tag/walton-enterprises/.

118. *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate*

investors concentrate investment in a relatively smaller number of firms that enable close watch and disproportionate gains.[119] Other investors, such as index funds, diversify greatly and should not be expected to provide similar monitoring, especially considering that they do not benefit as extensively from wrongdoing.[120]

Among all corporations, those with higher degrees of insider ownership may respond differently and require different treatment than those with little or no such ownership. In corporations that have substantial employee ownership, as through employee stock ownership plans, the roles of employee and shareholder combine, so that any gains from criminal conduct that might accrue to shareholders are enjoyed by those participating employees.[121] Shareholders who own substantial percentages of a corporation's stock may indeed be victims when senior management commits crimes, but their ability to elect the board who appoints such officers negates the claim to innocent victimhood.[122]

Besides such factors as type of business organization and shareholder demographics, prosecutors should consider additional governance details about targets. The most obvious details concern the special treatment required for businesses owned by other organizations, such as subsidiaries of corporate parents. Evaluating probable culpability and likely collateral consequences requires gauging the norms of governance in such settings and evaluating the degree to which they are followed.[123]

Every governance situation differs somewhat. Prosecutors must therefore follow through with kindred profiles at target companies by specifically researching directors, officers, gatekeepers, employees, and controls. As a further illustration, Part II's case study of AIG begins

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Governance, 37 J. CORP. L. 265, 363 (2012).

119. Examples: State Street Corp., which owns 12% of United Technologies; Berkshire Hathaway, which owns 8% of Wells Fargo; and Davis Selected Advisors, which owns 5% of CVS Caremark. (This and examples in the next few footnotes and accompanying text are drawn from a data set the author is compiling with assistance from Nicholas Stark, Reference Librarian, George Washington University Law School.)

120. The best example is Vanguard, an index investor barely audible among the activist investor crowd and owner of just under 5% of many of the largest American companies. Among the Fortune 50, Vanguard owns just under 5% of the voting stock of Exxon Mobil, Conoco Phillips, General Electric, AT&T, Bank of America, Verizon, J.P. Morgan, Citigroup, Procter & Gamble, Archer Daniels Midland, Boeing, and Pfizer.

121. Employee ownership levels vary among the largest U.S. corporations. Among the greatest percentage levels are Met Life (8%) and Ford Motor (7%).

122. To take some examples from among the Fortune 500 in the United States: Warren Buffett of Berkshire Hathaway (38%); Michael Dell of Dell (16%); Charles Schwab of Schwab (14%); Stephen Wynn of Wynn Resorts (10%); and Bill Gates of Microsoft (5.5%).

123. For a good discussion of the kinds of factors relevant in such a setting by non-experts demonstrating the possibility of mastering such terrain, see United States v. Bestfoods, 524 U.S. 51, 71–72 (1998).

with a thumbnail sketch of its governance. Prosecutors would have done well to consider it when targeting AIG and settling using a DPA. Their failure to consider AIG's governance proved disastrous.

II. AIG, OVERSIGHT, AND INATTENTION

This Part, an original case study of AIG,[124] first canvasses some of AIG's distinctive governance features to illustrate the kind of profile useful for prosecutors to understand at the outset of investigation.[125] It then explains how prosecutors' ignorance or disrespect of those governance realities resulted in a hasty and costly upheaval that included ousting the company's iconic CEO, Maurice R. "Hank" Greenberg. It shows how prosecutorial failure to investigate before intervening came at a high price as the subsequent discovery of only limited transgressions did not warrant the ouster decision, let alone an indictment. Finally, it shows the perils of conceiving of corporate governance as a uniform set of off-the-rack devices with no articulated rationale, as new governance at AIG led the company to the center of the 2008 financial crisis. The basis for two prescriptions emerges: prosecutors should strive to understand corporate governance when exercising discretion concerning prosecutions of business targets, and

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124. Much has been written about AIG's role in the financial crisis of 2008, though much of that concentrates on the terms of related financial transactions rather than the governance history leading up to their creation. *See, e.g.*, Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151, 1151 (2010). *See generally* William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009) (explaining the collapse of AIG, conditions accompanying the government bailout and why it was undertaken, and discussing whether it was necessary).

125. The AIG case study can seem aberrational, given the characters involved, peculiar features of New York law and politics, and the timing of events. But, in addition to remaining a bracing cautionary tale worth telling and mining for lessons, the potential for a replay should not be discounted. Similar controversy recurs about the exercise of prosecutorial authority and the independent streak of New York law enforcement authorities. One instance arose when New York's Department of Financial Services, headed by Benjamin Lawsky, settled charges of terrorism-finance law violations against Standard Chartered, the British bank, while federal authorities pursued a parallel investigation. *See* Jessica Silver-Greenberg, *British Bank in $340 Million Settlement for Laundering*, N.Y. TIMES (Aug. 14, 2012), http://www.nytimes.com/2012/08/15/business/standard-chartered-settles-with-new-york-for-340-million.html. Some stories drew explicit analogies between the two chief prosecutors involved (Eliot Spitzer in AIG and Benjamin Lawsky in Standard Chartered). *See* Jessica Silver-Greenberg, *Regulator Shines a Spotlight on a Bank, and on Himself*, N.Y. TIMES (Aug. 9, 2012), http://www.nytimes.com/2012/08/10/business/regulator-shines-spotlight-on-a-bank-and-on-himself.html. More generally, federal prosecutors' offices vary from many state counterparts, such as those in New York, where the attorney general's office holds both prosecutorial and regulatory responsibilities and pursues both civil and criminal cases arising from the same circumstances. Federal prosecutors invariably cooperate and coordinate with regulatory counterparts, *supra* note 91, while Spitzer, at least, often disrespected federal agencies. *See* Jonathan R. Macey, *Wall Street in Turmoil: State-Federal Relations Post-Eliot Spitzer*, 70 BROOK. L. REV. 117, 117 (2004).

should articulate the rationales of governance reforms they proffer when settling cases using DPAs.[126]

A. *AIG's Governance Profile*

A profile of AIG's corporate governance highlights factors that prosecutors need to understand when targeting a business organization. Such attributes are important to grasp as they reflect the inner workings and mechanisms of a company. Along with the personnel involved, a company's governance attributes are what makes the company succeed. In this case, readily discernible matters included a nimble, innovative, employee-driven culture with global reach; a diverse shareholder mix that included heavy insider ownership, considerable retail ownership, and a mix of passive and activist institutional shareholders; deep and longstanding internal control systems; and a fractious board with members debating executive succession planning. A rudimentary grasp of such examples of a corporate governance structure would greatly assist a prosecutor looking to formulate a profile to help make decisions about whether to charge a company or individuals and whether to proceed with an indictment and prosecution or settle.

Scale. AIG's foundations were domestic insurance operations assembled in the 1960s by Greenberg, along with a collection of international insurance businesses created during the previous five decades by the American international business pioneer, Cornelius Vander Starr.[127] From 1969, when AIG went public, to 2004, the total market value of AIG's stock rose from $300 million to $150 billion—an increase of approximately 19,000% compared to the 700% increase in the S&P 500.[128] By 2004, AIG employed 80,000 people, earned more than $11 billion annually, and commanded total assets exceeding $500

126. The case study arose out of my collaboration on a book with Greenberg. *See generally* MAURICE R. GREENBERG & LAWRENCE A. CUNNINGHAM, THE AIG STORY (2013). It is based on my original research into extant public materials, as well as considerable non-public materials, including documents obtained under New York State's Freedom of Information Law, and interviews with many participants. Some of those interviewed requested anonymity; some requests for interviews were declined. The result is an imperfect record of events, offering the benefits, along with the limits, of case studies as a research method. *See generally* ROBERT K. YIN, CASE STUDY RESEARCH: DESIGN AND METHODS (4th ed. 2009) (describing the use of case studies as a research method and how they are applied in practice). Single-event case studies must be interpreted cautiously and lessons drawn narrowly to avoid incorrect causal explanations. *See* Gregory Mitchell, *Case Studies, Counterfactuals, and Causal Explanations*, 152 U. PA. L. REV. 1517, 1522–24 (2004); *see also supra* note 125 (acknowledging that the AIG case may appear sui generis, but also noting how its high stakes and possible repetition warrant studying it). In this instance, the case study is supplemented by analysis and examples elsewhere in this Article and is sufficiently reliable to support the two prescriptions noted.

127. GREENBERG & CUNNINGHAM, *supra* note 126, at 5–6.

128. *See* C.J. Prince, *CEO of the Year 2003*, CHIEF EXEC. MAG. (July 1, 2003), http://chiefexecutive.net/ceo-of-the-year-2003.

billion.[129] It was the largest insurance company in history.

Innovative Internationalists. AIG's culture valued product innovation. The company pioneered insurance covering a variety of unusual risks, such as armies, kidnapping, oil pipelines and rigs, satellites, and shipping, which helped American companies expand internationally in the process that evolved into globalization.[130] In addition, despite its size, AIG fostered this innovation by creating mechanisms within the company that could quickly respond to a need for new products,[131] even if the need was on the other side of the world.[132] Decades before globalization, AIG opened markets not only in Mao's China[133] but also behind the Iron Curtain in the Soviet Union and its Eastern European satellites.[134] AIG also opened markets in Japan, Malaysia, the Philippines, Latin America, the Middle East, and Africa.[135]

Employees. AIG's management cultivated an employee-centric

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129. GREENBERG & CUNNINGHAM, *supra* note 126, at 172.

130. *Id.* at 46–47.

131. AIG led the charge to change the world's view of service industries. International trade conventions had long covered trade in goods, but countries discriminated against service providers, such as AIG. Beginning in the late 1970s and early 1980s, the company led efforts by scores of other companies and successive U.S. Trade Representatives, from the Carter to the Clinton administrations, finally winning in 1997's World Trade Organization financial services agreement. Many scholars and policy analysts contributed independent research that reached the same conclusions about the value of trade in services globally. *E.g.*, GEZA FEKETEKUTY, INTERNATIONAL TRADE IN SERVICES: AN OVERVIEW AND BLUEPRINT FOR NEGOTIATIONS 238–39 (1988); Jagdish N. Bhagwari, *Trade in Services and the Multilateral Trade Negotiations*, 1 THE WORLD BANK ECON. REV. 551 (1987) (arguing that developing countries perceive developed countries as seeking removal of barriers on trade in goods instead of establishing quid pro quo relationships); *accord* RONALD KENT SHELP, BEYOND INDUSTRIALIZATION: ASCENDANCY OF THE GLOBAL SERVICE ECONOMY 208–12 (1981) (Shelp was an AIG government relations employee).

132. GREENBERG & CUNNINGHAM, *supra* note 126, at 62, 66, 80, 84–85, 89–90, 98, 111–12, 121. For example, AIG was among the first substantial American companies to do business in China in the twentieth century. Starr's businesses, founded in China in 1919, were ousted along with all other foreign companies in 1949 amid its civil war, which was followed by the nation's isolation for several decades. After the thawing of China–U.S. relations in 1972, Greenberg undertook an arduous process that spanned through 1992. The result: AIG was the first foreign insurance company licensed by China in the modern period and among the first large foreign companies to resume business there. *See* DAVID M. LAMPTON, SAME BED, DIFFERENT DREAMS: MANAGING U.S.-CHINA RELATIONS 1989–2000, at 348–52 (2001).

133. GREENBERG & CUNNINGHAM, *supra* note 126, at 97–98.

134. *Id.* at 64–68.

135. As AIG grew into a leading American international insurance company, its interests and activities became increasingly intertwined with those of the United States. For example, it insured equipment used in national intelligence gathering exercises and military commitments. More broadly, AIG fought for open trade in dozens of countries and in several important global trade negotiations alongside U.S. trade negotiators. It joined forces with the United States government in numerous episodes promoting democracy and capitalism in the Soviet Union, Iran, Korea, Nigeria, Peru, and Vietnam—to name a few.

atmosphere by stressing mutual loyalty and never leaving any employee behind, whether navigating treachery abroad or facing personal crises at home.[136] A distinguished cohort among AIG employees were the "mobile overseas persons" or M.O.P.s. This group did service stints in numerous countries during their career, as many as ten to fifteen, taking two-to-three year terms in each place. Akin to the U.S. Foreign Service, they were corporate ambassadors who could troubleshoot the thorniest problem anywhere in the world.[137]

Employee compensation was long-term, with most payoffs deferred until age sixty-five.[138] In the corporate restructurings that occurred to take AIG public, one company that contributed assets to AIG, Starr International Co. (SICO), also received shares of AIG's stock.[139] A small group of SICO's closest business associates, including Greenberg, owned all the SICO stock, which entitled them to all the AIG shares received in exchange.[140] They decided instead to preserve a portion of the AIG shares for SICO's future corporate use. An important use, made over the next three decades, was providing incentive compensation to AIG managers paid in AIG shares.[141] The incentives were long-term: awards were made annually based on the previous two years' performance, but shares did not vest until age sixty-five.[142]

AIG did not enter into employment contracts with any employee, from the CEO to underwriter trainees, as these were not considered necessary for employee security or desirable from an incentives perspective.[143] Valuing experience highly, AIG eschewed mandatory retirement for employees, and many employees, including senior management, worked into their seventies and eighties.[144]

Shareholders. Many AIG employees were also shareholders with large portions of their net worth in AIG stock.[145] SICO continued to

136. GREENBERG & CUNNINGHAM, *supra* note 126, at 40, 45.

137. *Id.* at 50.

138. *Id.* at 39.

139. *See* Starr Int'l Co. v. AIG, 648 F. Supp. 2d 546, 549 (S.D.N.Y. 2009).

140. GREENBERG & CUNNINGHAM, *supra* note 126, at 39.

141. *Id.*

142. The SICO-funded AIG compensation plan had some kinship to Employee Stock Ownership Plans that Louis Kelso developed in the same time period. *See* LOUIS O. KELSO & MORTIMER J. ADLER, THE CAPITALIST MANIFESTO 210–13 (1958); LOUIS O. KELSO & PATRICIA HETTER KELSO, DEMOCRACY AND ECONOMIC POWER: EXTENDING THE ESOP REVOLUTION 59–66 (1986) (describing Employee Stock Ownership Plans); Andrew W. Stumpff, *Fifty Years of Utopia: A Half-Century After Louis Kelso's* The Capitalist Manifesto*, A Look Back at the Weird History of the ESOP*, 62 TAX LAW. 419, 425–26 (2009) (noting how ESOPs gained momentum after passage of 1974's Employee Retirement Income Security Act, ERISA, which provided favorable tax treatment).

143. GREENBERG & CUNNINGHAM, *supra* note 126, at 45.

144. *Id.*

145. *Id.* at 40.

own a large percentage of AIG's stock, which portion eventually declined to 12% in 2005 due to AIG's growth.[146] AIG's other management–directors owned or controlled substantial shares, and the company earned a reputation as a "core holding" for many portfolios, including state pension funds.[147] AIG's large size, with a market capitalization reaching $180 billion, made it a choice target of institutional investors during the corporate governance movement, particularly during the push to enable shareholders to nominate directors (the proxy access movement).[148]

Controls. AIG developed sophisticated systems of internal control. These dated to the 1970s when global operations demanded aggregating financial and insurance information arising from millions of transactions annually in more than 100 countries.[149] AIG established an audit committee that was led by board members and staffed by senior accounting officials. They divided AIG's operational world into thirty reporting regions, appointed controllers for each, and established foreign and domestic internal auditors to oversee the entire operation.[150]

By 1984, AIG won a AAA credit rating, which enabled it to diversify earnings by expanding into a few other fields besides insurance.[151] AIG moved into private equity, aircraft leasing, global infrastructure funds, and financial products.[152] The latter, called the FP division, required adding even more elaborate internal controls because it managed an investment portfolio not subject to the liability reserve requirements of insurance companies.[153] Several distinct internal groups, as well as the outside auditor, consistently monitored the FP division's risk portfolio. Risk management was part of AIG's corporate DNA.[154]

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146. *Id.* at 203–04.

147. *See* RODDY BOYD, FATAL RISK: A CAUTIONARY TALE OF AIG'S CORPORATE SUICIDE 45 (2011).

148. *See* Am. Fed'n of State, Cnty. & Mun. Emps. v. AIG, 462 F.3d 121, 123–24 (2d Cir. 2006).

149. GREENBERG & CUNNINGHAM, *supra* note 126, at 50–51.

150. *Id.* at 50–51.

151. *Id.* at 140.

152. *Id.*

153. *Id.* at 146–47.

154. Nevertheless, even the most rigorous internal controls can be porous as AIG discovered in two instances during the period following Enron and Sarbanes–Oxley. In one, a junior manager at a small AIG subsidiary wrote a policy that apparently enabled another party, a small telecom supplier called Brightpoint, to manipulate its financial results. The SEC threatened suit, but AIG settled the case for $10 million and allowed an SEC-designated monitor to roam around AIG's other subsidiaries in search of any similar problems, which did not appear to exist. *See* SEC v. Brightpoint, Inc., Litigation Release No. 18340, 2003 WL 22110371 (Sept. 11, 2003). In the second case, the SEC and the DOJ asserted that the company's Financial Products (FP) division aided violation of accounting rules by PNC Bank when providing asset

Directors. AIG's founding corporate board in 1967 included the luminaries who would spend their careers making AIG the world's largest insurance company. As traditional inside directors, they knew the company and the insurance business well, and were world travelers who understood the demands of building a global financial services company.[155] From 1984, when AIG listed on the NYSE, stock exchange rules, federal securities law, state court rulings, and institutional investor advocacy all gradually required or induced AIG to add increasing numbers of outside directors.[156] By the early 2000s, outside directors comprised a majority of AIG's board, which created a culture in which outside directors were newly inspired to challenge inside directors.[157] The traditional mutually supportive and respectful relationship among board members frayed.

Succession. During the early 2000s, part of AIG's corporate objectives included planning for CEO succession.[158] Succession is a challenging process, especially when the company's leader has invested his career and identity in the company, as Greenberg had with AIG.[159] Nevertheless, AIG's board and Greenberg began working on succession in 2000, when Greenberg was seventy-five.[160] They narrowed the potential successors down to two senior managers—both of whom were in their early fifties.[161] By late 2004, Greenberg and the board reached an understanding that one of those two would become CEO for a trial period starting on the company's annual meeting in June 2005, while Greenberg remained chairman.[162] Despite the arrangement, some directors worried that such a transition would result in Greenberg, a

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management services. This was settled using a deferred prosecution agreement that called for a monitor to assure that the FP division did not offer products that other parties could use to manipulate accounting records, along with payment of $126 million. *See* SEC v. AIG, Litigation Release No. 18985, 2004 WL 2721457 (Nov. 30, 2004); *American International Group, Inc. Enters into Agreements with the United States*, DEP'T JUSTICE (Nov. 30, 2004), http://www.justice.gov/opa/pr/2004/November/04_crm_764.htm. This monitor's performance would prove dismal during these years leading to the financial crisis of 2008 in which AIG played a central role. *See infra* text accompanying notes 379–82.

155. GREENBERG & CUNNINGHAM, *supra* note 126, at 149.

156. *Id.* at 150; *see also* Joseph B. Treaster, *Some A.I.G. Shareholders to Press for More Independent Board*, N.Y. TIMES (May 15, 2000), http://www.nytimes.com/2000/05/15/business/some-aig-shareholders-to-press-for-more-independent-board.html; Joseph B. Treaster, *A.I.G. Head Will Consider Altering Board*, N.Y. TIMES (May 18, 2000), http://www.nytimes.com/2000/05/18/business/aig-head-will-consider-altering-board.html.

157. GREENBERG & CUNNINGHAM, *supra* note 126, at 155.

158. *Id.* at 163.

159. *See* Tom C.W. Lin, *The Corporate Governance of Iconic Executives*, 87 NOTRE DAME L. REV. 351, 380 (2011).

160. GREENBERG & CUNNINGHAM, *supra* note 126, at 163.

161. *Id.* at 155, 163.

162. *Id.* at 163.

formidable figure, overshadowing the CEO-elect.[163] A faction of outside directors even retained special counsel to advise them on succession.[164] Conversations were continuing in early 2005 when prosecutors began a probe into AIG.[165]

B. Ex Ante *Miscalculation*

Eliot L. Spitzer, attorney general of New York, started the 2005 probe into AIG.[166] Spitzer made a name for himself investigating prominent companies and people. He became famous for controversial tactics and disrespecting corporate governance realities.[167] For instance, in 2004, Spitzer aimed at insurance brokers for bid rigging by filing a civil case against Marsh & McLennan Companies.[168] He threatened criminal charges against the firm as a bludgeon to induce the board's cooperation in seeking the resignation of its CEO.[169] Spitzer forced the resignation by declaring that he would not negotiate with Marsh's board while the incumbent remained chief executive.[170] Spitzer's ultimatum overstepped prosecutorial bounds into the realm of corporate governance.

Intervention. In February 2005, Spitzer targeted AIG and Greenberg.[171] Some of AIG's outside directors were concerned about corporate liability or personal liability, while one faction was focused on succession. This latter faction relied heavily on the lawyer they had retained four months earlier.[172] These directors and their lawyer became not merely cooperative, but aligned with Spitzer.[173] It is not clear why they did so, but their alignment shifted the governance machinery in favor of a more rapid and complete succession than was originally agreed upon.[174]

Through early March, AIG's auditor was prepared to sign off on the company's 2004 financial statements.[175] But the auditor soon made a

163. *Id.* at 186.

164. *Id.* at 162.

165. *Id.* at 181–87.

166. *Id.* at 172–79.

167. *See, e.g.*, Kulbir Walha & Edward E. Filusch, Note, *Eliot Spitzer: A Crusader Against Corporate Malfeasance or a Politically Ambitious Spotlight Hound? A Case Study of Eliot Spitzer and Marsh & McLennan*, 18 GEO. J. LEGAL ETHICS 1111, 1111 (2005).

168. GREENBERG & CUNNINGHAM, *supra* note 126, at 175.

169. *Id.*

170. *Id.*; *see also* Joseph B. Treaster, *Broker Accused of Rigging Bids for Insurance*, N.Y. TIMES (Oct. 15, 2004), http://www.nytimes.com/2004/10/15/business/15insure.html.

171. *See* BROOKE A. MASTERS, SPOILING FOR A FIGHT: THE RISE OF ELIOT SPITZER 229–30 (2006); PETER ELKIND, ROUGH JUSTICE: THE RISE AND FALL OF ELIOT SPITZER 84 (2010).

172. GREENBERG & CUNNINGHAM, *supra* note 126, at 180–82.

173. *Id.* at 180–82.

174. *Id.* at 185–86.

175. *Id.* at 182.

turnabout, again for reasons that are not clear except that the auditor faced extraordinary pressure—either from the outside director faction, lawyers, or prosecutors—amid great sensitivity given Andersen's recent collapse.[176] Spitzer questioned AIG's accounting for a transaction it had made in 2000 with a large reinsurance company called Gen Re, which was notorious for engaging in aggressive reinsurance deals with many other insurance companies.[177] Though the Gen Re deal proved trivial as the saga played out over the next seven years, Spitzer's questions became ominous threats that drove AIG's corporate governance.[178]

On Sunday, March 13, before an investigation had been conducted, AIG's outside directors held a special meeting.[179] They debated the risks to AIG of a corporate indictment, shared concerns about personal liability, and addressed the pending succession issue.[180] At that meeting, the auditors dropped a bombshell, saying they would not certify the 2004 financials unless the board got Greenberg to resign.[181] Aside from not having conducted any investigation, the auditors clearly crossed a line with such a threat.

Spitzer had previously issued a subpoena requesting that Greenberg testify about Gen Re and other unspecified matters.[182] AIG's employment manuals instructed employees to cooperate in any investigation.[183] Such cooperation commitments are now common in corporate employment manuals, prompted by the Organizational Sentencing Guidelines and DOJ practice of giving corporations credit for cooperation.[184] One director asked whether Greenberg would answer all of Spitzer's questions or take the Fifth.[185] Greenberg explained that, although he had nothing to hide, his lawyers adamantly advised taking the Fifth because Spitzer refused to show him documents or limit the scope of questioning.[186] Some directors seemed to believe that taking the Fifth would violate AIG's employment manuals, although it is unclear as a legal and prudential matter that such a conclusion is

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176. *Id.* at 183–84.
177. *Id.* at 177–78.
178. *Id.* at 177–80.
179. *Id.* at 179–80.
180. *Id.* at 181–87.
181. *Id.* at 182–84.
182. *Id.* at 184.
183. *Id.*
184. U.S. SENTENCING GUIDELINES MANUAL § 8C2.5(g) (2010).
185. GREENBERG & CUNNINGHAM, *supra* note 126, at 184.
186. A witness recounting the same events more than once rarely does so exactly the same way. When two witnesses recount events to a prosecutor, they often contradict each other. Either common pitfall exposes a witness under oath to charges of perjury or obstruction of justice. *See* Andrew Countryman, *AIG Chief to Take 5th in Spitzer Interview: A Wise Decision, Say Several Legal Experts*, CHI. TRIB. (Apr. 12, 2005), http://articles.chicagotribune.com/2005-04-12/business/0504120130_1_aig-and-greenberg-mr-greenberg-mr-spitzer.

valid.[187]

At the end of the lengthy meeting, the directors asked Greenberg to resign.[188] Motives were mixed, however, since no investigation had been conducted; the decision was made in the context of ongoing negotiations over succession; the auditors exerted unorthodox pressure; and no one knew whether taking the Fifth violated company policy in these circumstances.[189] This was a manifestation of prosecutorial prerogative conjoined to a new model of corporate governance in which power had been reposed in outside directors advised by outside counsel and supported by outside auditors. It showed how the prosecutorial power met a corporate governance struggle that the prosecutor did not seem to understand.

*Investigation***.** After the prosecutorial intervention in March, AIG's auditors and outside counsel conducted an investigation during April, May, and June. They restated AIG's accounting statements for the previous five years, though the auditor had certified them during that time.[190] The firm cooperated with Spitzer, going beyond ordinary cooperation to the point of aligning their interests with those of Spitzer.[191] The changes cut shareholders' equity, cumulatively across five years, by 2.7% in total and net income by 2.1% per year.[192] A longstanding rule of thumb in corporate accounting treated variations of

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187. *Cf.* United States v. Stein, 541 F.3d 130 (2d Cir. 2008) (endorsing employee objection on constitutional grounds concerning right to counsel and due process, to prosecutorial insistence that corporation refuse to cover legal defense expenses for any employee pleading the Fifth).

188. MASTERS, *supra* note 171, at 236–38.

189. GREENBERG & CUNNINGHAM, *supra* note 126, at 184–85, 187.

190. Accounting restatements became so common during the mid-2000s, that officials cautioned about restatements that were themselves suspect. *E.g.*, John White, Dir. of the Div. of Corp. Fin., SEC, Corporation Finance in 2008—A Focus on Financial Reporting at the 35th Annual Securities Regulation Institute (Jan. 23, 2008) (transcript available at http://www.sec.gov/news/speech/2008/spch012308jww.htm) (commenting on concerns expressed and proposals made by an SEC Advisory Committee); *see also* Marlene Plumlee & Teri Lombardi Yohn, *An Analysis of the Underlying Causes Attributed to Restatements*, 24 ACCT. HORIZONS 41 (2010) (noting the mushrooming in the number of restatements during this period, up from 475 in 2003 to 1,538 in 2006).

191. *See* Ian McDonald & Theo Francis, *Spitzer Expects a Civil Settlement with AIG*, WALL ST. J. (Apr. 5, 2005), http://online.wsj.com/news/articles/SB111263623864097279.

192. The raw dollar amounts were large but AIG was a massive company: equity changed $2.26 billion and income $4 billion (for the whole period), but AIG owned $800 billion in assets and earned nearly $10 billion annually. Eileen Alt Powell, *AIG Files Report, Admits to Some Improprieties*, SALT LAKE TRIB. (June 1, 2005, 12:01 AM), http://archive.sltrib.com/article.php?id=2772694&itype=NGPSID; Joann Weiner, *AIG's Former Chief Greenberg Suing Feds for Bailing Out His Company,* WASH. POST (Feb. 23, 2013, 9:48 AM), http://www.washingtonpost.com/blogs/she-the-people/wp/2013/02/23/aigs-ex-chief-greenberg-says-fed-bailout-was-wrong/.

less than 5% as immaterial.[193] Although the SEC abrogated that custom in 1999, auditors signed off on reports so long as they were within 5% of their calculations of a fair financial picture, as AIG's were.[194] The changes, moreover, congregated in areas where there had been controversy about the proper accounting for certain types of transactions and which auditors had debated for years.[195]

The restatement did not provide probable cause for a criminal case, and one was never filed against Greenberg or AIG.[196] Spitzer filed a civil case against Greenberg, under New York's Martin Act, initially based on seven changes reflected in the restatement.[197] He eventually dropped all claims except for the Gen Re matter and one other issue in a case that continues unresolved today, more than seven years later.[198] Nor did the restatement vindicate the decision to seek Greenberg's resignation; if it defined the threshold for determining to oust a CEO, few CEOs of large public corporations would remain in office for long.[199]

Nevertheless, the restatement, along with Greenberg's resignation, caused AIG's stock price to drop dramatically and rating agencies to slash its AAA rating.[200] Immediate direct costs to shareholders

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193. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 19, 1999) (to be codified at 17 C.F.R. pt. 211).

194. *See id.*

195. Examples applicable to the insurance industry included accounting for finite insurance transactions and for liability reserves. Examples applicable to all companies concerned topics such as accounting for equity-based compensation and for special purpose entities. After the restatement was released in May 2005, Greenberg's lawyers and accountants spent the next two months examining every change made in it. GREENBERG & CUNNINGHAM, *supra* note 126, at 196. Completed on July 26, 2005, their detailed memorandum challenged every change point-by-point. *Id.*

196. The only criminal charges arising out of the entire affair targeted one AIG employee and six Gen Re employees over the AIG–Gen Re transaction. The case resulted in early plea agreements by two Gen Re employees who became the government's star witnesses against the others. After seven years of litigation, which included a trial, appeal, and order for a new trial, United States v. Ferguson, 653 F.3d 61, 68–69, 95 (2d Cir. 2011), the case resulted in individual deferred prosecution agreements in which the defendants did not admit guilt. The appellate court characterized the testimony of one of the government's star witnesses as "suspicious." *Id.* at 71.

197. GREENBERG & CUNNINGHAM, *supra* note 126, at 191, 196.

198. *See* People v. Greenberg, No. 401720/2005 (N.Y. Sup. Ct. filed May 26, 2005). The New York Court of Appeals accepted the case to adjudicate the validity of the Martin Act, which Greenberg argued was preempted by federal securities laws. Under federal law and most state laws, proving business fraud requires "scienter," referring to a mental state evincing a deliberate intention to deceive, which does not purport to be a requirement under the Martin Act. *See* Steve A. Radom, *Balkanization of Securities Regulation: The Case for Federal Preemption*, 39 TEX. J. BUS. L. 295, 302 (2003); *see also* People v. Greenberg, 994 N.E.2d 838 (N.Y. 2013) (holding that it would not pass on the issue of federal preemption).

199. GREENBERG & CUNNINGHAM, *supra* note 126, at 201.

200. *Id.* at 230.

exceeded several billion dollars—an amount greater than the restatement and punishment to shareholders that suggested prosecutorial confusion about corporate governance.[201] Worse, AIG settled with Spitzer and other government authorities under a DPA that would prove even more costly because of the failure to relate its governance terms to AIG's governance realities.

C. Ex Post *Standardization*

After Greenberg's early resignation, while prosecutors continued to hold the threat of prosecution over AIG, outside counsel negotiated governance reforms with Spitzer.[202] Drafts of the agreement recited actions already taken, including Greenberg's resignation, and prescribed further changes.[203] As part of these governance reforms, the board opted to separate the roles of the board chairman and CEO.[204] Splitting the functions of CEO from board chairman had become fashionable, seen by many as a best practice.[205] It manifested the same rationale of prescriptions for adding outside directors, a desire to reduce the boardroom power of the CEO. At AIG, this separation had little to do with its prevailing governance realities and contrasted sharply with the previous succession plan, which, while entailing a separation of those functions, was tailored to the needs of the transition. As will be elaborated below, three years later, amid the financial crisis of 2008, it became clear that the separation of functions had failed and the board repealed it.

Off-the-Rack Governance. A pivotal clause in the Spitzer–AIG agreement required the board to hire a special advisor to identify additional outside director nominees and to prescribe best practices on governance issues.[206] That advisor, Arthur Levitt, a former SEC

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201. *Id.* at 201.

202. *See id.* at 22 & n.6 (citing e-mail from Martin Flumenbaum, Paul, Weiss, Rifkind, Wharton & Garrison, LLP, to Eliot Spitzer et al. (July 19, 2005), FOIL 09777 011247–09777 011262).

203. AIG entered into separate settlement agreements with the DOJ, the SEC, and New York authorities. The DOJ DPA did not address governance reforms. Deferred Prosecution Agreement, United States v. AIG (Feb. 7, 2006), *available at* Garrett & Ashley, *supra* note 92, http://lib.law.virginia.edu/Garrett/prosecution_agreements/sites/default/files/pdf/aig.pdf. But both the SEC and New York agreements contained numerous compliance and governance provisions and negotiated drafts of the New York agreement recited more extensive governance provisions, most of which AIG enacted. Proposed Deferred Prosecution Agreement, para. 6–20, New York v. AIG (July 19, 2005) [hereinafter New York DPA] (on file with author).

204. GREENBERG & CUNNINGHAM, *supra* note 126, at 224.

205. *Id.* at 228; *see* Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 866 (1993) (stating that "for [a] board to be effective, it is important to separate the CEO and chairman positions").

206. New York DPA, *supra* note 203, at para 7. DPAs often require a company to hire a consultant to obtain input and agree to accept the directives or else file a request to reject the

chairman, directed a list of reforms, all of which were standard terms he said were best practices and all of which AIG was required to adopt.[207] Along with the ill-fated endorsement of splitting the identities of the chairman and CEO, reforms called for adding even more outside directors,[208] holding executive sessions of the board that excluded any management directors, eliminating the executive committee, imposing mandatory director retirement at age seventy-three, and barring any former chief executive from serving on AIG's board.[209] None of these changes had anything particularly to do with AIG or its needs. In fact, Levitt chose his recommended reforms after consulting shareholder advocates, corporate governance experts, and selected directors[210]—but none of AIG's management, employees, or largest shareholders.

A telling mismatch between AIG's realities and Levitt's changes concerned abolishing the executive committee. Levitt supported that recommendation by saying that executive committees are "often a symbol of board cronyism."[211] This general impression said nothing about the committee's quality or value at AIG. It had consisted of Greenberg and four outside directors, avoiding cronyism, and had a clear business rationale: to enable nimble operations in a dynamic global environment, reflected in AIG's entrepreneurial and internationalist culture.

Another ill-suited reform concerned age limits for directors. AIG's traditional employee-centric philosophy and its reliance on experienced mobile overseas personnel led it to embrace employees wishing to work beyond traditional retirement ages at other companies. People could retire at age sixty-five, and many did. But a large number of AIG employees, including many in senior management and on the board, continued working well into their seventies or eighties.[212] Greenberg was seventy-nine at the time of his forced resignation.[213] While age

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directives with the governmental authority. *See infra* text accompanying note 386. The AIG DPA took such an approach.

207. Letter from Arthur Levitt to AIG Board of Directors (Mar. 21, 2006), *reprinted in* AIG 2006 Proxy Statement, *available at* http://www.sec.gov/Archives/edgar/data/5272/000095011706001641/a41737.htm [hereinafter Levitt Governance Letter].

208. The addition of so many outside directors at AIG ultimately yielded a board with only two manager–directors out of a total of fifteen or sixteen, depriving AIG's board of the expertise and company inside knowledge that had long been its hallmark. For criticism of this result, with reference to the ensuing financial crisis, see P.M. Vasudev, *Default Swaps and Director Oversight: Lessons from AIG*, 35 J. CORP. L. 757, 793 (2010).

209. *See* Levitt Governance Letter, *supra* note 207.

210. *See id.* ("[W]e have canvassed the views of directors, shareholders, governance experts, and shareholder activists for recommendations.").

211. *Id.*

212. GREENBERG & CUNNINGHAM, *supra* note 126, at 45.

213. *AIG's Chief Executive Greenberg Resigns*, USA TODAY (Mar. 14, 2005, 8:03 AM), http://usatoday30.usatoday.com/money/industries/insurance/2005-03-14-greenberg_x.htm.

limits for directors were trendy during this period—with some 40% of Fortune 1000 companies adopting them in response to urgings from governance gurus such as CalPERS—they were an anomaly at AIG.[214]

Controls. The Spitzer–AIG DPA prescribed and the board adopted a different set of committees, officers, and reporting lines to handle matters of control and compliance.[215] This approach put the form of internal controls above the substance, thereby threatening AIG's rigorous risk management. For example, controls at the FP division had been designed to assure that no transaction would jeopardize AIG's AAA credit rating.[216] All transactions were negotiated on the strength of that rating, which enabled AIG to assure counterparties of its ability to make good on its obligations at low cost, without posting collateral or pledging assets.[217] Such controls kept the FP division from taking on too much risk and saddling the company with debts that would threaten AIG's insurance businesses.[218]

Employees. The board's new practice of giving employment contracts to executives is a more tangible example of AIG's transformation.[219] No AIG employee, from the CEO to underwriter trainees, had ever had an employment contract.[220] Further, AIG adopted new bonus policies that moved from the long-term orientation of the employee compensation program run for three decades under Greenberg's stewardship toward short-term incentives, including at the FP division.[221] All these corporate governance changes would change AIG, though not in the ways that prosecutors or executives would have hoped. Short-term incentives, combined with slackened controls, would prove perilous.

Chaos. In April 2005, the FP division began writing credit default swaps on increasingly risky pools of mortgage-related debt, called "subprime."[222] During 2005, the FP division's portfolio steadily declined

214. GREENBERG & CUNNINGHAM, *supra* note 126, at 228.

215. *Id.* at 229–31.

216. *Id.* at 229.

217. *Id.* at 229–30.

218. *Id.* at 230.

219. *Id.* at 231.

220. *Id.*

221. *Id.* Today's intense debates over executive compensation stress the value of incentives driven by long-term compared to short-term compensation, which AIG understood for decades before such debates. *See* Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Focusing and Committing to the Long-term*, 26 YALE J. ON REG. 359, 365 n.23 (2009).

222. GREENBERG & CUNNINGHAM, *supra* note 126, at 231. Credit default swaps are contracts in which a lender reduces its risk of exposure to loss due to borrower default by swapping that risk to another party, essentially an insurer, who bears that risk in exchange for a fee. Subprime pools of mortgage related debt gathered loans taken by homebuyers with relatively poor credit histories. That increased the risk of default on any given loan; but those

in quality; it started with a small fraction of subprime mortgage pools and became almost entirely subprime.[223] By June 2007, AIG had written $80 billion of swaps on the riskiest mortgage pools, quintupling its 2005 position, all unhedged.[224] Many of the swaps required AIG to post cash collateral if AIG's credit rating fell or the value of covered contracts declined.[225] Following industry practice, AIG subsidiaries historically lent securities to borrowers in exchange for cash collateral that would be invested in short-term, low-risk investments to gain modest interest.[226] From 2006 through 2008, AIG greatly increased these stakes, taking longer-term, riskier assets, including mortgage backed securities.[227]

At the same time, a global financial crisis had been brewing due to a combination of forces that overheated real estate markets worldwide.[228] During 2007, the U.S. housing market weakened, contributing to an intertwined series of economic problems that spread globally into a financial crisis. Mortgage-related assets began to decline in value. From mid-2007 to late 2008, these problems gathered momentum and amplified worldwide. AIG's liquidity problems began to emerge in July 2007 when customers requested that AIG post cash collateral amid the weakening market.[229]

AIG faced a growing gap between its duty to return that cash collateral to counterparties and the fair value of the mortgage securities its insurance subsidiaries bought with it.[230] The combination of this gap

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who sold pools of such loans sliced them into tranches with varying degrees of risk. The FP division backstopped the tranches that deal designers called "super senior," denoting that the risk of default was remote. In many cases, it appears that these firms misrepresented the quality of the pools—what AIG was told were "super senior" were the bottom of the barrel. *Id.*

223. *Id.*

224. *Id.* at 231.

225. *Id.* at 232.

226. *Id.*

227. BETHANY MCLEAN & JOE NOCERA, ALL THE DEVILS ARE HERE: THE HIDDEN STORY OF THE FINANCIAL CRISIS 328 (2010).

228. GREENBERG & CUNNINGHAM, *supra* note 126, at 232; *see* Lawrence A. Cunningham & David Zaring, *The Three or Four Approaches to Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response*, 78 GEO. WASH. L. REV. 39, 49 n.24 (2009). Factors included: (1) U.S. policy overstimulated appetites for home ownership and kept interest rates low for too long; (2) regulation of financial institutions was poor, as commercial banks fed the appetite for home ownership with generous mortgages while investment banks churned demand with complex financial products and increased leverage; (3) rating agencies failed to analyze many financial products adequately and the lack of trading in such products on organized markets made them difficult to value; and (4) regulators at the SEC failed to monitor the leverage of many financial institutions, whose debt levels rose to as much as 30–40 times capital and, in AIG's case, regulators at the Office of Thrift Supervision, which had authority because AIG owned a savings and loan association, simply ignored any signs of trouble. GREENBERG & CUNNINGHAM, *supra* note 126, at 232.

229. GREENBERG & CUNNINGHAM, *supra* note 126, at 232.

230. *Id.* at 233; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-751, REVIEW OF FEDERAL

and the escalating collateral calls facing the FP division squeezed AIG's liquidity.[231] But the mounting turmoil escaped the attention of AIG's senior management and board, as the company's internal controls failed.[232] It was not until June 2008 that AIG's board responded by asking the CEO to resign and the board chairman to assume the role of CEO as well, repudiating an important part of the governance reforms begun three years earlier.[233] The repair efforts came too late, however, as the company sailed into the financial crisis to be taken over by the U.S. government in September 2008.

Causation, Correlation, and Best Practices. One must ask whether the governance changes caused AIG's role in the crisis or were merely correlated with it.[234] Investigation and testimony point to the changes playing a causal role. Forensic reports on the crisis blamed AIG's role in the crisis on governance, risk management, and internal control problems during 2007 and 2008.[235] Testimonial evidence from AIG's general counsel, not a Greenberg ally, said that after Greenberg left "there was no one in charge."[236] The type and scale of practices at the FP division and at the insurance subsidiaries were novel adventures for AIG inconsistent with its cautious risk management. AIG's outside auditors discovered the gathering crisis in February 2008 and wrote to its chairman a scathing critique of top management and the governance and control environment they had created.[237] The governance prescriptions clearly had a causal role in AIG's near destruction.[238]

RESERVE SYSTEM FINANCIAL ASSISTANCE TO AMERICAN INTERNATIONAL GROUP, INC. 5, 17 (2011).

231. GREENBERG & CUNNINGHAM, *supra* note 126, at 233.

232. By February 2008, it had become clear to AIG's outside auditors that disaster was coming. It reported a chilling and pervasive problem at the new AIG: an appreciation of risk and risk management, once a defining trait of AIG, had been pushed out of its corporate culture. The auditor provided detailed and scathing criticism of AIG's top three executives. *See id.* at 235 (reprinting the auditor's notes).

233. Press Release, AIG, AIG Names Robert B. Willumstad Chief Executive Officer (June 15, 2008), *available at* http://www.reuters.com/article/2008/06/15/idUS65315+15-Jun-2008+BW20080615.

234. A stronger version of this inquiry asks whether, had Greenberg not been replaced, AIG's role in the crisis would have been diminished. Many believe that the answer is yes, including leading insurance industry executives who knew AIG and Greenberg well enough to be in good positions to make a judgment. *See* Michael Loney, *30 Years in Insurance: Learning the Hard Way*, REACTIONS, Apr. 1, 2011 (quoting Jack Byrne, former chairman of the insurance companies GEICO and Fireman's Fund).

235. *E.g.*, CONG. OVERSIGHT PANEL, JUNE OVERSIGHT REPORT: THE AIG RESCUE, ITS IMPACT ON MARKETS, AND THE GOVERNMENT'S EXIT STRATEGY 55 (2010).

236. *Id.* at 52 n.144 (quoting AIG General Counsel Anastasia Kelly).

237. *See supra* note 232. Additional evidence, and another culprit, appears in the failure to detect any problems by an outside monitor installed at the company in another DPA on an earlier matter. *See infra* text accompanying notes 375–82.

238. Another hypothesis attributes the problems at AIG in 2008 not to anything that

The case for a causal connection is also supported by the evidence that the reforms implemented at AIG reflected an unfortunate tendency among corporate governance experts to celebrate best practices. That can readily lead to believing that certain devices are so appealing that they are suitable for every company without regard to particular governance realities. Many of those devices—such as making outside directors dominant on the board, separating the chairman and CEO roles, abolishing the executive committee, and redesigning control oversight by creating new offices and committees—were put into place at AIG after the Spitzer-led prosecution and were ordained by Arthur Levitt, who is considered a leading expert on the subject.[239]

But these and other changes—including offering employment contracts with short-term bonuses and imposing age limits for directors—were implemented at AIG without considering its existing corporate governance attributes, including its entrepreneurial culture, employee-centric philosophy, employee ownership, long-term incentive program, absence of employment contracts, strict internal control regimens, and reliance on experienced and engaged directors.[240]

When evaluating how to proceed against corporate targets, prosecutors, in both formal guidelines and practice, tend to emphasize compliance programs and cooperation.[241] The AIG case study indicates that such an isolated focus can be perilous. Prosecutors must understand and work within a corporation's overall corporate governance profile rather than ignore it (or try to revolutionize it). The AIG case study suggests the value of prosecutors taking an integrated approach to corporate governance by considering it from the outset to the end of a case, including in settlement under a DPA. The next Part pursues this suggestion more comprehensively.

III. AN INTEGRATED APPROACH

Given the degree of controversy surrounding DPAs, it is tempting to delineate a precise conceptual model of their legitimacy and to prescribe exactly which terms are valid and which should be seen as off-limits. This Part considers alternatives and, rather than offering a precise formula, calls for particular explanations of chosen terms based on an initial investigation. The articulations would then form a body of knowledge providing considerable systemic advantages for the public and prosecutors alike. Section A explores DPAs in conceptual and

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occurred after Greenberg left in early 2005 but to the complexity of the company's structure or practices (often described as "byzantine") that existed in 2005 and before. Research conducted for this Article did not find evidence to support that conjecture.

239. GREENBERG & CUNNINGHAM, *supra* note 126, at 224.

240. *See supra* notes 206–214 and accompanying text.

241. *See supra* notes 65–73 and accompanying text.

analytical terms to define their proper scope, best seen as neither contract nor regulation, but as exercises of prosecutorial discretion. It concludes that such discretion warrants asking prosecutors to articulate the rationales of governance terms they proffer based on *ex ante* investigation. Section B explains the benefits of this approach compared to alternatives. Section C considers costs and various objections.

A. *Conceptualization: Contract, Regulation, Discretion*

The following discussion first probes the defining attributes of DPAs and then draws implications about their proper scope. Alternative conceptions view DPAs as pure contract (implicitly the status quo view), pure regulation (a stance directly at odds with the status quo), or as a device derived from prosecutorial discretion (the conception that emerges from the following analysis as most faithful to reality). To summarize: (1) under the contractual conception, no terms are off limits and bargains are policed solely by contract doctrines; (2) under the regulatory conception, the proper terms of DPAs would be exceedingly narrow, given the superiority of *ex ante* legislation or administrative rulemaking, putting governance terms off-limits; and (3) under the discretionary conception, the most apt, the range of proper terms is open-ended, and certainly includes governance terms, but warrants prudential limitation given broad prosecutorial power and limited judicial review.

1. Pure Contract? The Implicit Status Quo Conception

Practice. The current practice concerning DPAs implicitly assumes that they are pure contracts to be governed primarily by contract law. No business organization is obliged to enter into one. Companies differ in their response to prosecutorial overtures due to variation among governance participants such as directors, chief executives, general counsel, and outside counsel. Every case differs due to variables such as the scope of alleged wrongdoing, the relative difficulty of proof, the costs of defending a case, and the risk of losing customers or facing other constituent defections. Terms are negotiated and defense counsels, as well as the organized defense bar, push back on given terms in particular cases. As a result, not all DPAs or all terms in them should be seen as impositions akin to regulation.

Indeed, it seems that details venturing beyond fines and compliance into the deeper realms of corporate governance are more likely subject to greater negotiation. In any event, both sides to DPAs find the deals advantageous, each getting and giving something. At minimum, both sides avoid the costs and risks of a trial. In some cases, companies may find some governance changes appealing independent of the prosecutor's presence. Or prosecutors might propose simply adhering to requirements to which a company is committed, such as to maintain as many outside directors as applicable stock exchange rules require.[242] Prosecutors may value the bragging rights more highly as a way to boost a DPA's deterrence power.[243] In such cases, including governance terms in a DPA is an inexpensive way to achieve closure.

Theory and Doctrine. Were DPAs purely contractual, contract theory would be relevant to the framework for assessing DPAs, and they would presumably pass muster given the foregoing observations about their features. They would be governed by the general law of contracts, with policing according to such doctrines as duress, illegal bargain, and unconscionability.[244] That is generally how plea agreements are handled. Courts declare that plea agreements are simply another form of contract,[245] while appreciating special features emanating from constitutional protections,[246] and recognizing that plea agreements are formed only upon judicial approval in the settlement of a pending criminal action.[247]

In DPAs, the validity of certain terms, such as waivers of attorney–client privilege and restrictions on reimbursing legal fees, is suspect. In fact, since a federal court ruled that such terms are out of bounds in a DPA, the DOJ has eschewed them.[248] This sequence of events is evidence that the contractual conception—and the status quo based on it—has some purchase. Private parties can obtain judicial review and declarations of unenforceability on the grounds that some terms constitute illegal bargains. Certainly, it indicates the prospect and pressure of judicial review and a constraint on the exertion of excessive prosecutorial bargaining power.

Limits. Yet there are aspects of the DPA process that call the contractual conception into question. The balance of power in DPA negotiations may heavily favor prosecutors. First, companies know that an indictment could mean destruction, as in the case of Arthur

242. Agreement Between Friedman's Inc. and the United States Attorney's Office for the Eastern District of New York at 10 (Nov. 21, 2005) [hereinafter Friedman's, Inc. NPA], *available at* Garrett & Ashley, *supra* note 92, http://lib.law.virginia.edu/Garrett/prosecution_agreements/sites/default/files/pdf/friedmans.pdf.

243. Government's proper interests exclude any conclusions of lack of guilt, which would require dropping the case, but include factors such as sufficiency of the evidence and likelihood of success at trial. *See* authorities cited *supra* note 79 (series of DOJ memos concerning charges against corporations and other business organizations).

244. *See* Candace Zierdt & Ellen S. Podgor, *Corporate Deferred Prosecutions Through the Looking Glass of Contract Policing*, 96 KY. L.J. 1, 2–3 (2007).

245. *E.g.*, Brooks v. United States, 708 F.2d 1280, 1281 (7th Cir. 1983); *see also* Frank H. Easterbrook, *Plea Bargaining as Compromise*, 101 YALE L.J. 1969, 1974 (1992).

246. *See* Mabry v. Johnson, 467 U.S. 504, 507–09 (1984).

247. *See, e.g.*, FED. R. CRIM. P. 11(c)(3)–(4).

248. United States v. Stein, 541 F.3d 130, 146 (2d Cir. 2008).

Andersen. Second, in many cases, such as with AIG, DPAs are finalized after a firm's prior leadership has been removed and the deal is signed by successors happy to cast blame on predecessors.

Furthermore, were contract law to govern DPAs, some unusual provisions would likely produce results that would surprise participants. For example, absent express language disclaiming the creation of third party rights, it is possible that shareholders, competitors, customers, and other members of the public may have enforcement rights on corporate breach. That would be so if a court concluded that the government intended to give such persons the benefit of the corporation's promises,[249] which is plausible considering that prosecutors are charged with representing the interests of the public at large.[250] If this were the case, it would represent an extraordinary alteration of corporate governance powers.[251]

As another example, it is often up to the government's discretion to declare corporate breach of a DPA, and the government's remedy on breach is penal—an immediate suspension of the deferral and proceeding with a case, likely yielding indictment and conviction.[252] Such a deliberately and inherently penal remedy may pose tensions with the compensation principle of contract remedies, casting doubt on the validity of such a DPA under traditional contract law principles.[253] Accordingly, it may be difficult to both insist that DPAs are purely contractual and assume that they are enforceable as written.

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249. *See* RESTATEMENT (SECOND) OF CONTRACTS: INTENDED AND INCIDENTAL BENEFICIARIES § 302(1)(b).

250. *Cf.* Charles A. Sullivan, *Enforcement of Government Antitrust Decrees by Private Parties: Third Party Beneficiary Rights and Intervenor Status*, 123 U. PA. L. REV. 822, 868 (1975); Larry Kramer, *Consent Decrees and the Rights of Third Parties*, 87 MICH. L. REV. 321, 352–54 (1988). Third parties have participation rights in plea agreements under restitution and victims' rights statutes, such as the Crime Victims' Rights Act of 2004, 18 U.S.C. § 3771 (2012). *See* Stephanos Bibas, *Transparency and Participation in Criminal Procedure*, 81 N.Y.U. L. REV. 911, 917 n.12 (2006).

251. *Cf.* Miriam H. Baer, *Organizational Liability and the Tension Between Corporate and Criminal Law*, 19 J.L. & POL'Y 1, 11–14 (2011).

252. *See* Joe Warin, Brian Baldrate & Joe Spinelli, Resolving Corporate Investigations with Deferred Prosecution Agreements and Non-Prosecution Agreements 26 (Sept. 16, 2011) (slide show presentation accompanying webcast).

253. Probation differs. Probation contracts, formed between a convicted offender and a judge, are made after a defendant is sentenced and consist of the suspension of that sentence so long as stated objective conditions are met. Failure to meet those conditions lifts the suspension and results in incarceration. *See* Joan Petersilia, *Probation in the United States*, 22 CRIME & JUST. 149, 164–65 (1997). In DPAs, there has been no sentence (or conviction) that is merely being conditionally suspended. What's being conditionally deferred is the indictment or prosecution and the combination of features that give rise to breach—often by unilateral government declaration—and remedy—a stipulation to given facts almost guaranteeing conviction—makes the result more consciously penal, even draconian, compared to probation contracts.

Yet, as a further mark of the limits of the pure contractual conception, when corporations allege breach of DPAs by prosecutors, courts do not automatically invoke contract principles to evaluate either the claim of breach or remedy. Rather, they defer to prosecutorial discretion over such basic matters as whether the government has surrendered contractual rights to pursue an indictment.[254] But the status quo is most objectionable if DPAs are conceived to be pure regulation, rather than pure contract.

2. Pure Regulation? The Mirror-Image Critique

DPAs are more akin to regulation than contract when one appreciates the massive imbalance of bargaining power that prosecutors wield over targets.[255] Prosecutors have extraordinary state powers in the DPA setting, far different in magnitude and type from the concept of relative bargaining power contemplated in the realm of contract practice.[256] It is not as if the corporation is negotiating a loan agreement or long-term lease with one of many lenders or landlords in the market. The corporation faces a government agent wielding monopoly power.[257] The DPA is a sword over the corporation's head.[258] DPAs have other regulatory qualities as well, including that violations expose the private party to public criminal law enforcement sanctions.[259]

Ad Hoc Inferiority. Conceived as pure regulation, prosecutorial interventions are ad hoc solutions to systemic problems better addressed by legislation or administrative rulemaking *ex ante* rather than prosecutors *ex post*.[260] Optimal deterrence is best achieved by inducing corporations to maintain effective internal policing by adopting *ex ante* duties that are generally applicable to companies rather than targeted to a particular one. Hence, general federal laws, such as the Organizational

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254. Stolt-Nielsen, S.A. v. United States, 442 F.3d 177, 183 (3d Cir. 2006), *cert. denied* 549 U.S. 1015 (2006); *see infra* text accompanying notes 266–271.

255. Expressed in terms of economic theory, contracts usually manifest an efficient bargain. Bargains between prosecutors and corporations memorialized in DPAs might be efficient also, to the extent that they reflect the features referenced in the preceding discussion of DPAs as pure contracts. Yet there may be circumstances in which contracts, including DPAs, are inefficient due to some form of "market failure." Examples are massive imbalances in bargaining power or DPAs concluded by successor corporate officials eager to blame their predecessors.

256. Petersilia, *supra* note 253, at 164.

257. This is monopsony power if the government is seen as a buyer of admissions rather than the seller of deferral. *See* Jeffrey Standen, *Plea Bargaining in the Shadow of the Guidelines*, 81 CALIF. L. REV. 1471, 1472 n.1, 1473 n.2 (1993).

258. *See* BRENT FISSE & JOHN BRAITHWAITE, CORPORATIONS, CRIME AND ACCOUNTABILITY 15 (Robert E. Goodin ed., 1993).

259. Garrett, *supra* note 2, at 875; Rachel Barkow, *Organizational Guidelines for the Prosecutor's Office*, 31 CARDOZO L. REV. 2089, 2101 (2010).

260. *See* Arlen & Kahan, *supra* note 107, at 16–18, 21–22 (developing this approach).

Sentencing Guidelines, encourage all companies to maintain effective compliance programs, and specific substantive regulations, such as addressing drug labeling or money laundering, establish industry-wide or generally applicable duties addressed to all companies.[261] This value is particularly high when accompanied by an articulation of rationales, whether through legislative history, such as committee reports, or administrative agency statements, such as those publicized during the course of seeking notice and comment on proposed regulations.[262]

Within such a regime, as a theoretical matter, there is little left for DPAs to do. At best, DPAs could contain terms tailored to matters over which such duty-based criminal liability and general regulation are somehow ineffective. This universe of problems is probably limited to terms that are designed to reduce the costs of managerial deviation from optimal policing. That is, the terms address problems particular firms have, such as when managers face private incentives to commit crimes. In the vocabulary of corporate law scholarship, these are collectively known as the agency costs of policing. As a procedural matter, laws and regulations made *ex ante* command legitimacy by concordance with norms of publication, open government, and access to law.[263]

Narrow Scope. Under the conception of DPAs as pure regulation, it may be defensible for a prosecutor, on an *ex post* and firm-specific basis, to call for a particular company not only to maintain an effective compliance program against, for example, money laundering, but also to engage a special officer whose job is to assure that effectiveness.[264] A DPA could likewise properly call for an independent monitor to oversee that person or anti-money-laundering process. An additional rule could require that such personnel be authorized to report directly to the corporation's board chairman or to outside directors.[265]

Such arrangements would be defensible attempts to reduce agency costs associated with internal policing—i.e., managerial incentives to avoid optimal compliance for personal gain. But, under the regulatory conception, prosecutors should be discouraged from proffering corporate governance terms that go beyond compliance. Delimiting DPA terms to those addressing agency costs of policing has some theoretical appeal and offers a way to curtail prosecutorial excesses. Yet

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261. *See id.* at 4–5.

262. *See* RICHARD J. PIERCE, JR. ET AL., ADMINISTRATIVE LAW AND PROCESS 420, 476, 480 (3d ed. 1999).

263. *See* Lawrence A. Cunningham, *Private Standards in Public Law: Copyright, Lawmaking and the Case of Accounting*, 104 MICH. L. REV. 291, 331 (2005) ("[A] powerful norm pulsing through the administrative lawmaking function requires publication of regulatory promulgations in the spirit of open government and public access to law.").

264. Arlen & Kahan, *supra* note 107, at 13–14.

265. The 2010 amendments to the Organizational Sentencing Guidelines give targets credit for such a provision. U.S. SENTENCING GUIDELINES MANUAL § 8C2.5(f)(3)(C) (2010).

given the contractual features of DPAs, this conception of DPAs as pure regulation is not entirely faithful to reality.

3. Prosecutorial Discretion: Most Faithful to Reality

There is a fundamental problem with conceiving of DPAs as pure contracts, pure regulation, or even a hybrid. True, such conceptions may help evaluate the appeal of DPAs or assess their proper scope, but a more immediate question appears: the legality of a DPA, which is to say its enforceability in court. From the judicial perspective, conceptualizing DPAs as contracts or regulation may be trivial compared to conceptualizing them as products of prosecutorial discretion.

Limited Judicial Review. Prosecutorial practice and venerated traditions of prosecutorial discretion put DPAs substantially beyond the scope of meaningful judicial review. An original rationale for DPAs is to enable handling probable criminal wrongdoing with limited formal public procedures, such as an indictment. True, upon declaration of breach by the government, the corporation may be able to obtain judicial review. But given the typical terms—government having power to declare breach and the remedy of proceeding immediately to prosecution on admitted facts—the corporation will face pressure unique to DPAs.

Consider also the opposite case of a corporation's declaration of prosecutorial breach.[266] A corporation may declare breach and seek to enjoin the indictment on the basis that the prosecution sought to indict it despite a DPA and the corporation's cooperation and compliance.[267] But federal courts do not necessarily classify such cases as involving contracts or regulation, citing prosecutorial discretion.[268]

As the Supreme Court has explained, prosecutorial discretion is entailed by constitutional separation of powers in which the "Executive Branch has exclusive authority and absolute discretion to decide whether to prosecute a case."[269] A longstanding feature of the separation-of-powers-based conception of prosecutorial discretion is that the judicial branch generally lacks jurisdiction to enjoin a criminal prosecution.[270] Narrow exceptions to this jurisdictional limit concern enforcing government–defendant agreements, but even such agreements

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266. Stolt-Nielsen, S.A. v. United States, 442 F.3d 177, 181–82 (3d Cir. 2006), *cert. denied* 549 U.S. 1015 (2006).

267. *Id.* at 181.

268. Technically, the agreement, with the Antitrust Division of the DOJ, was a leniency agreement, but the differences between such traditional tools of that Division and the more general class of DPAs is immaterial in this context. *Id.* at 179–80.

269. United States v. Nixon, 418 U.S. 683, 693 (1974).

270. *See* United States v. Cox, 342 F.2d 167, 171 (5th Cir. 1965) (en banc).

are construed strictly in light of the constitutional separation of powers.[271]

Many object to prosecutorial discretion, of course. Critics claim overreaching due to biased discrimination, political aspirations, excessive zeal, and, for DPAs, intrusion into the domain of corporate governance.[272] Solutions include constraining prosecutorial discretion by greater delineation of substantive criminal law, legislative or judicial review of prosecutorial judgments, or, for DPAs, ruling governance off-limits by statute or perhaps strengthening the role of grand juries in the process.[273] For technical reasons, judicial review may nominally be required of DPAs upon execution,[274] but no judge has ever rejected a DPA.[275] Many do not even hold a hearing when asked to review them.[276] A jurisdiction may require prosecutors who ultimately decide to drop a criminal case to file a written statement of reasons with a court for its approval.[277]

Prosecutorial discretion has staunch defenders as well, and even its toughest critics acknowledge the necessity of some discretion.[278] Legislators and judges also seem to appreciate the necessity, as they have not interfered significantly with prosecutorial discretion. For DPAs, such interference would be of uncertain value. It would put judges, individuals with limited investigative resources and institutional competence, in the difficult position of second-guessing prosecutors who have conducted an investigation and engaged in negotiations with targets. Drawbacks also include adding a layer of costs. Another important indirect cost: sharing responsibility with the judicial branch

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271. For criticism of this stance, see Sarah Baumgartel, *Nonprosecution Agreements as Contracts:* Stolt-Nielsen *and the Question of Remedy for a Prosecutor's Breach*, 2008 WIS. L REV. 25, 60–63.

272. *See, e.g.*, Jennifer Arlen, *Removing Prosecutors from the Boardroom*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 62 (Anthony S. Barkow & Rachel E. Barkow eds., 2011); Wilson Meeks, *Corporate and White-Collar Crime Enforcement: Should Regulation and Rehabilitation Spell an End to Corporate Criminal Liability*, 40 COLUM. J.L. & SOC. PROBLEMS 77, 106–07 (2006).

273. *See* Roger A. Fairfax, Jr., *Grand Jury Innovation: Toward a Functional Makeover of the Ancient Bulwark of Liberty*, 19 WM. & MARY BILL RTS. J. 339, 359–60 (2010) (discussing the oversight role played by grand juries).

274. *E.g.*, 18 U.S.C. § 3161(h)(2) (2012) (allowing for deferral period to be excluded from counting time elapsed before trial if deferral agreement is judicially approved).

275. GARRETT, *supra* note 11, ch. 3 at 18, 37.

276. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 100, at 25 (finding that nine out of twelve judges interviewed did not conduct a hearing before approving DPAs).

277. *E.g.*, NEB. REV. STAT. § 29-1606 (2012); *cf.* SEC v. Citigroup Global Mkts., Inc., 673 F.3d 158, 162 (2nd Cir. 2012) (criticizing district court judge Jed Rakoff's assertion of power to upset settlement between regulatory agency and corporation).

278. *See* Stephanos Bibas, *The Need for Prosecutorial Discretion*, 19 TEMP. POL. & CIV. RTS. L. REV. 369, 369 (2010).

does not stimulate prosecutors to prepare governance profiles *ex post*, an important objective of the integrated approach, the seminal lesson of Andersen, and a vital lesson of AIG.

Prosecutorial discretion is a bulwark against excessive disclosure of matters better kept confidential. Obvious examples concern protecting victims or witnesses and maintaining the confidentiality of internal investigation and deliberation. Less obvious is how opacity can usefully obscure law enforcement resource constraints that can undermine deterrence. An excessively transparent process would reveal resource constraints that may have adverse effects on the public's confidence in law enforcement or in its deterrent value. Relative opacity may offer other benefits, such as promoting public confidence in the fairness and efficiency of criminal law enforcement.[279] When such concerns are not at stake or are outweighed by other factors, prosecutors make exceptions, such as declining to prosecute or giving reasons in individual cases.[280]

Restraint. The solution is prosecutorial restraint, which evidence demonstrates can be highly effective.[281] For example, evidence drawn from recently publicized records in several big-city prosecutors' offices, such as New Orleans and Milwaukee, includes written statements of the reasons for their decisions, including decisions not to prosecute.[282] The reasons given showed prosecutors making reliable judgments in accordance with the law. The brief statements of rationales lacked the completeness of judicial opinions but demonstrated a pattern of valid reasons at work, not abuses of discretion warranting judicial review or legislative constraint.[283]

In the case of DPAs, a similar exercise, with public statements of the rationales, would be useful. After all, prosecutors occupy a special position as ambassadors for justice—quasi-judicial officers—and thus have some duty to look out for the interests of the target corporation and

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279. *See* Tom Baker et al., *The Virtues of Uncertainty in Law: An Experimental Approach*, 89 IOWA L. REV. 443, 480 (2004).

280. *See* Richard S. Frase, *The Decision to File Federal Criminal Charges: A Quantitative Study of Prosecutorial Discretion*, 47 U. CHI. L. REV. 246, 292–94 (1980); John Eligon, *Strauss-Kahn Drama Ends with Short Final Scene*, N.Y. TIMES (Aug. 24, 2011), http://www.nytimes.com/2011/08/24/nyregion/charges-against-strauss-kahn-dismissed.html (referencing the twenty-five-page memo prosecutor Cyrus Vance released articulating reasons for declining to proceed with the prosecution of the French dignitary Strauss Kahn alleged to have committed sexual assault in the United States). The narrow exception for DPAs is warranted because this setting does not ordinarily implicate such broad-gauged problems and, when they might, confidential treatment can be provided accordingly.

281. *See* Marc L. Miller & Ronald F. Wright, *The Black Box*, 94 IOWA L. REV. 125, 149 (2008) (explaining that prosecutors may focus efforts on certain crimes or offenses over others).

282. *Id*. at 130, 134, 163–66.

283. *See id.* at 134–35, 183.

its constituencies.[284] Important strands of the principle of prosecutorial neutrality direct prosecutors to act as objective public servants and to not represent partisan interests.[285] Just as judicial supervision of unconscionable bargains invokes paternalistic impulses, prosecutors negotiating DPAs must protect the interests of their counterparties and must not act arbitrarily.[286]

The integrated approach to DPAs is drawn narrowly to minimize infringement on prosecutorial discretion. The articulation practice addresses only governance terms in DPAs, not reasons for deferral, fines imposed, or admissions obtained. DPAs may be novel and controversial, but those should not necessarily be the tests warranting a call for public articulation. It is the uncharted territory and it is the damage that can be done to large organizations and related innocents that prompts this call.[287]

No broader call for articulation is warranted. There are many contexts in which scholars have considered asking for public statements of prosecutorial decision-making.[288] One example concerns prosecutorial decisions not to file charges—declinations akin to DPAs that some believe can amount to prosecutorial nullification.[289] A public statement of reasons would address that concern but also prove burdensome, costly, and ultimately unwieldy.

In short, the best way to conceptualize the DPA is not so much as a species of contract or regulation but as a product of prosecutorial discretion and to think about its proper scope and limits as such. So conceived, prudential prosecutorial restraint warrants the integrated approach of asking prosecutors to prepare a corporate governance profile *ex ante* as part of their investigation of corporate targets and then to publicly articulate the rationale for corporate governance terms in DPAs when they settle a case. Assuming such steps, prosecutors should feel free to proffer such terms, which would produce considerable net benefits, both systemic and parochial.

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284. *See* Stanley Z. Fisher, *In Search of the Virtuous Prosecutor: A Conceptual Framework*, 15 AM. J. CRIM. L. 197, 216 (1988).

285. *See* Bruce A. Green & Fred C. Zacharias, *Prosecutorial Neutrality*, 2004 WIS. L. REV. 837, 866.

286. *Id*. at 870–71. Far from returning the analysis to contract law, these observations underscore why conceiving of DPAs as products of prosecutorial discretion is more faithful to reality.

287. Another reason for this narrow focus is that these are the terms most likely to be improved by an articulation practice, as discussed *infra* text accompanying notes 290–297.

288. *See* Roger A. Fairfax, Jr., *Prosecutorial Nullification*, 52 B.C. L. REV. 1243, 1277 (2011).

289. *Id.* at 1244.

B. *Comparative Benefits of the Integrated Approach*

This section probes the comparative benefits of the three conceptions analyzed in the previous section and shows the net superiority of the integrated approach. The integrated approach conceptualizes DPAs as products of prosecutorial discretion and calls for prosecutors to prepare a governance profile *ex ante* and to articulate rationales for governance terms *ex post*. The section first identifies advantages of the integrated approach over both the pure contract and the pure regulation conception. It also discusses the advantages that the integrated approach offers over the pure regulation conception alone and then the advantages it offers over the pure contract conception alone. (The ensuing section considers costs and other potential objections.)

1. Integrated Approach v. Pure Contract and Pure Regulation Conception

Improved Decision-making. A practical problem with the pure regulation conception's barring prosecutors from proffering governance reforms *ex post* is that it discourages prosecutors from considering governance *ex ante*. The pure contract conception creates the same disincentive for a different reason, signaling to prosecutors that there is no need to give governance terms any more thought than is given to any term in any ordinary contract. A primary advantage of the integrated approach is that it would lead prosecutors to invest in understanding a target's governance profile, which would improve the quality of prosecutors' analysis *ex ante* and *ex post*.

In the integrated approach, all the varied aspects of corporate governance, referenced above in Part I, would be potentially probative. Prosecutors would include the creation of a basic profile as part of the initial investigative phase of a case. The profile would provide a basis on which to negotiate DPAs and would be updated throughout the investigation. Such knowledge likely would imply different signals to prosecutors about how to proceed, i.e., whether to indict or settle. In some cases, that would lead to eschewing the DPA in favor of proceeding with an indictment and perhaps trial and conviction. In cases where settlement is indicated, the *ex ante* profile would inform prosecutorial judgment about appropriate changes.

Tailoring. A related advantage of the integrated approach is the opportunity to fix specific problems within a company. After all, governance terms operate differently at different companies, and the formal uniformity of typical regulatory conceptions obscures those different operations.[290] DPAs can supply custom-tailored terms that *ex ante* legislation and administrative rulemaking cannot.

290. *See supra* text accompanying notes 56–59.

The practice of articulation, moreover, would improve the fit of tailored terms to given firms. Providing written reasons for decisions tends to improve the quality of decision-making, in most settings.[291] This is one of several values underlying the widespread practice in the United States of judicial opinion writing and regulatory statements accompanying proposed rulemaking by administrative agencies.[292] The legal community agrees that such writing improves reasoning, especially concerning legal decision-making.[293] Prosecutors do not routinely give reasons for their decisions, but current research indicates that prosecutors believe that articulation of reasons benefits their decision-making too.[294]

Evidence from psychological research largely affirms such beliefs.[295] A written rationale sharpens the reasoning, which improves decision-making. It appears to be most effective for decisions that involve factors that are relatively finite, causal, logical, precise, and technical[296]—the characteristics of corporate governance terms. Not all decisions require a written rationale, of course, and there is no imperative to explain the obvious or to reach for reasons when a decision is reasonably made on the basis of hunch or intuition. In such situations, research suggests writing exercises can actually be counterproductive.[297] For DPAs, the decision to defer and the fines set may be respected as products of hunch and intuition, whereas the choice of particular substantive governance terms calls for reason. The articulation practice should thus improve the tailoring of fit between terms and targets.

Generality. A third factor affecting the relative appeal of conceiving of DPAs as contractual, regulatory, or discretionary concerns how each conception deals with prosecutors' offices, which vary greatly across the United States.[298] For instance, institutional differences distinguish federal district offices from state and local offices: many state attorneys

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291. *See* Chad M. Oldfather, *Writing, Cognition, and the Nature of the Judicial Function*, 96 GEO. L.J. 1283, 1286 (2008).

292. *See id.*; Jodi L. Short, *The Political Turn in American Administrative Law: Power, Rationality, and Reasons*, 61 DUKE L.J. 1811, 1845 (2012).

293. *See* Frederick Schauer, *Giving Reasons*, 47 STAN. L. REV. 633, 654 (1995).

294. E-mail from Ronald Wright, Needham Yancy Gulley Professor of Criminal Law, Wake Forest Univ. Sch. of Law, to Lawrence A. Cunningham (Oct. 12, 2012) (on file with author) (referencing interviews with some 200 prosecutors conducted over a recent two-year period as part of a qualitative project that reflects such beliefs).

295. Oldfather, *supra* note 291, at 1322.

296. *Id*. at 1286–87, 1321–22.

297. *See* Chris Guthrie et al., *Blinking on the Bench: How Judges Decide Cases*, 93 CORNELL L. REV. 1, 37 (2007); Charles M. Yablon, *Justifying the Judge's Hunch: An Essay on Discretion*, 41 HASTINGS L.J. 231, 234 (1990).

298. *E.g.*, MICHAEL L. BENSON & FRANCIS T. CULLEN, COMBATING CORPORATE CRIME: LOCAL PROSECUTORS AT WORK 46–48 (1998); Stephanos Bibas, *Regulating Local Variations in Federal Sentencing*, 58 STAN. L. REV. 137, 149–50 (2006).

general have more autonomy than their federal counterparts and many local prosecutors are elected rather than appointed.[299] Caseloads differ, with the Southern District of New York handling more corporate matters than the Southern District of Texas, for example. The relative efficacy of *ex ante* regulation or *ex post* judicial or legislative review may diverge across settings.

All such factors are potentially relevant to defending a conception of DPAs as either contracts or regulation but, more importantly, would be relevant to assessing the validity of given DPA terms as a matter of contract or of regulation. Relative bargaining power would influence whether a DPA is best conceived as contract but also whether it is the reasonable product of volition rather than an unconscionable result of duress. The efficacy of *ex ante* regulation—say for local law regulating taxi fleets or liquor sales—would be relevant to evaluating the validity of a DPA term requiring a corporation to create a chief public safety officer. The relevance of such factors dissolves when DPAs are appreciated as species of prosecutorial discretion as each prosecutors' office exercises discretion in accordance with its unique features and completes the requested investigation and explanation accordingly.[300]

2. Integrated Approach v. Pure Regulation Conception

Line Drawing. Compared to the pure regulation conception, an advantage of the integrated approach is that it overcomes line drawing problems. Under the conception of DPAs as pure regulation, legislators or prosecutors would have to distinguish between compliance terms deemed proper, and governance terms ruled out-of-bounds. Compliance is a subset of corporate governance, but particular devices may evade ready classification. Consider a provision appointing a chief compliance officer who reports directly to the board, a term composed of both compliance and governance attributes. More broadly, consider the example of disclosure, which DPAs invariably require corporations to make. Disclosure is an important topic of corporate governance but may be an equally important topic of corporate compliance. Under the integrated approach, no line drawing is required.[301]

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299. Bibas, *supra* note 298, at 143.

300. Other differences that dissolve include the extent to which prosecutors coordinate with regulatory authorities on any given case. While relevant to evaluations of DPAs as contracts or regulation, this simply becomes an element of the exercise of prosecutorial discretion when DPAs are conceived as such. *Cf.* Garrett, *supra* note 2, at 936–37.

301. One approach to such line-drawing challenges would classify all hybrid devices as compliance and condone their inclusion in DPAs. Indeed, the class of compliance devices could simply be enlarged to admit any device that has more than a remote potential contribution to compliance. Defined thus broadly, many terms that might routinely be thought of as governance devices would be ruled in. Examples of terms that could be fairly deemed compliance rather than governance include the removal and replacement of officers, the expansion of a corporate

Scope of Purposes. Another advantage of the integrated approach compared to the pure regulation conception concerns the purposes of DPAs. The conception of DPAs as pure regulation not only puts governance terms off-limits, but also tests the validity of compliance terms based on their deterrence value by hypothesizing employee calculations concerning whether to comply with the law.[302] But this approach ignores the recognized school of thought that people comply with the law due to norms of obedience that arise from features of a system that give it legitimacy.[303] Many governance mechanisms fit the bill, not merely technical compliance devices.[304] Prosecutors speak of achieving rehabilitation aims, such as changing corporate culture from one of corruption to one that embraces compliance. Governance devices may serve such goals.[305]

Better Regulation. Under the pure regulation conception, *ex ante* legislation and administrative rulemaking are preferred to *ex post* tailoring. Yet one widely recognized problem with general regulation that occurs following financial crises is the risk of overreaction amid widespread psychological and political pressure.[306] True, after scandal, populist backlash against those perceived to have caused problems can increase the risk of exuberant prosecutorial enforcement.[307] But such pressures appear less problematic in given DPAs with a particular company. One reason may be the direct bargaining that occurs between prosecutors and corporations in the DPA setting compared to the bustle of national politics, in which lobbyists battle each other. In any event, the prescribed articulation practice would curb excesses.

Innovative, tailored terms that are explained when adopted could also prove to have value that could be fruitfully adapted to other companies or even provide the basis for broadly applicable law or rule. Experimentation accompanied by explanation would likely improve the development of tools that promote deterrence and compliance.

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board and populating it with new outside directors, designation of new committees addressing compliance as well as risk, legal affairs, or even auditing, environmental matters and so on. There is nothing inherent about many terms that warrant objecting to their inclusion per se. Each term should be taken on its own and evaluated for its role in the given corporation. Judgments made contextually are likely superior to rules stated abstractly.

302. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 200 (1968).

303. *See* TOM R. TYLER, WHY PEOPLE OBEY THE LAW 3–4 (2006).

304. *See* Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. REV. 1265, 1284–85 (1998); Miriam Hechler Baer, *Corporate Policing and Corporate Governance: What Can We Learn from Hewlett-Packard's Pretexting Scandal*, 77 U. CIN. L. REV. 523, 546 (2008).

305. *See* Henning, *supra* note 11, at 1420.

306. *See* Romano, *supra* note 58, at 1563.

307. *See* Baer, *supra* note 3, at 625–26.

3. Integrated Approach v. Status Quo

The chief advantages of the integrated approach compared to the status quo concern the prospect of formalizing, systematizing, and cataloguing what has emerged as a spontaneous and opaque set of practices. DPA practice also appears to be haphazard, although there is evidence that senior lawyers at the DOJ are attempting to systematize it.[308] Their effort supports the view that the status quo could use improvement. Advantages arise from the proposed practice of public articulation of the rationales for governance terms included in DPAs. Aside from how they may improve the quality of decision-making as noted earlier, such written rationales are valuable as precedent and as a source of legitimacy.

Precedent. Precedent is valuable as a resource to guide resolution of future cases in accordance with similar previous cases.[309] The articulation practice would provide a record of the thought process prosecutors and counterparties followed when agreeing on governance terms. Such a system would contribute a base of knowledge on which prosecutors and corporations could draw in future cases, generating fairness gains akin to those of stare decisis, and efficiency gains by reducing the costs of negotiation and settlement and increasing the quality of tailoring terms to particular settings.

Legitimacy. Legitimacy, a complex multifaceted concept, encompasses the notion of justifications for legal decisions.[310] Publicizing such justifications increases the value of legal justification.[311] Otherwise, participants and the public may be mystified, confused, and unable to evaluate the decision fairly. One rationale for published articulation as a source of legitimacy is the reasoned elaboration provided, which demonstrates that a decision is based upon more than fiat, office, or position, but upon principle with a claim to independent respect.[312]

Derivative values include creating the capacity for outsiders to assess the reasoning and its fidelity to prevailing standards and related values such as stare decisis. True, few writings can provide a comprehensive and faithful account of all reasons, as few judicial opinions do, yet the exercise constrains discretion to concord with the

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308. *See* GARRETT, *supra* note 11.

309. *See* KARL N. LLEWELLYN, THE BRAMBLE BUSH 70–72 (1981); Frederick Schauer, *Precedent*, 39 STAN. L. REV. 571, 571 (1987).

310. *See* Micah Schwartzman, *Judicial Sincerity*, 94 VA. L. REV. 987, 1004 (2008).

311. *Id.* at 1005.

312. *See* Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 378 (1978); G. Edward White, *The Evolution of Reasoned Elaboration: Jurisprudential Criticism and Social Change*, 59 VA. L. REV. 279, 285–86 (1973).

criterion of legitimacy.[313] Such ability adds the value of perceived legitimacy, as the public can more confidently accept the judgments of those who explain themselves under the valence of neutrality than those who act by fiat or demand to be trusted with power.

The value in the context of DPAs with business organizations seems even more likely to be pronounced. An authoritative statement of why governance changes are being made would benefit all corporate constituents, including directors, officers, employees, gatekeepers, and shareholders. In corporate settings where internal communications are part of the governance apparatus, it may seem odd to employees that such results are not explained by authorities. The authoritative statement of rationales would communicate institutional resolve, often necessary to induce employees company-wide to take governance and compliance measures seriously.

Critique. DPAs produced without explanation expose participants to criticism when the rationale for particular terms is unclear and open to competing interpretations. Many governance terms often seem jarring to corporate lawyers and other observers. If explained in context, however, the terms might be better understood.[314] No doubt, they may seem jarring to employees and others within the organization with whom they directly deal. With articulations, critics would challenge the stated rationale of a term rather than the unadorned term as it appears on the face of a contract. Whatever the reaction, observers would have a firmer foundation to provide criticism or praise when reviewing DPAs.

Prosecutorial Error and Overreach. Current practice leaves no reliable record of reasoning, one of the important functions of offering public justifications.[315] The AIG case study is a good example, where despite investigation through interviews and primary sources, it is difficult to be certain exactly why certain steps were taken or even when or by whom.[316] A record from participants would have been intrinsically valuable and checked the risk of prosecutorial error—a product of the improved decision-making that articulations offer—and overreach—a product of their legitimation function. Had Spitzer been compelled to understand AIG's governance at the outset and explain why the proffered terms made sense for AIG, the risk of oversight and inattention would have been diminished.

Such an effect would likewise check the risk of prosecutorial

313. *See* Lawrence A. Cunningham, *The Common Law as an Iterative Process: A Preliminary Inquiry*, 81 NOTRE DAME L. REV. 747, 781 (2006).

314. *Cf.* Melvin A. Eisenberg, *Participation, Responsiveness, and the Consultative Process: An Essay for Lon Fuller*, 92 HARV. L. REV. 410, 412 (1978).

315. *See* James Boyd White, *What's An Opinion For?*, 62 U. CHI. L. REV. 1363, 1368–69 (1995).

316. *See supra* note 126.

overreach. Prosecutors may be motivated to settle a case using a DPA for a variety of reasons.[317] These can be arrayed along a continuum relating motive to the merits or relative legitimacy. At one end would be the clearly legitimate avoidance of risks of adverse collateral consequences or organizational indictment, mitigating concerns over the uncertainty of trial, and achieving efficient case closure. Toward the other end are objectives such as bragging rights, which may or may not promote such valid goals as deterrence and, perhaps at the very end, advancing political objectives such as running for higher office. Whatever the motivations, however, the integrated approach (investigation and articulation) should channel them toward the "legitimate" end of the continuum.

Prosecutorial Gains. A special appeal to the interests of prosecutors should not be ignored. Gains to prosecutors from the articulation practice arise from the overall program of building a body of valuable knowledge. These benefits are akin to those judges derive from the practice of opinion writing and regulators derive from drafting releases for public comment, which share many of the same objectives—precedent, stare decisis, efficiency, legitimacy, neutrality, and transparency. Such exercises help to expand their authors' power, especially among branches of government.[318] Likewise, leadership positions and reputations can be made by publishing outstanding accounts of decisions.[319]

Transparency. Many of the foregoing advantages are particular examples of the broader feature of transparency that articulation practice would provide. Transparency is valuable for public acceptability. The public is more likely to accept the practice of legal settlements between government and corporate defendants when the related terms, including underlying reasons, are explained. Transparency carries downsides—a cost to those who would prefer to operate behind closed doors. Some prosecutors, and perhaps many defense lawyers, may prefer a more opaque process. There can be valid reasons for such a preference, such as protecting proprietary business matters or witnesses' identities.[320] Prosecutorial discretion should be maintained for these purposes, while preserving the other benefits of transparency.

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317. *See supra* text accompanying note 102.

318. *See* Thomas W. Merrill, *Judicial Opinions as Binding Law and as Explanations for Judgments*, 15 CARDOZO L. REV. 43, 44–45 (1993).

319. *See* David Klein & Darby Morrisroe, *The Prestige and Influence of Individual Judges on the U.S. Courts of Appeals*, 28 J. LEGAL STUD. 371, 373–74 (1999).

320. *See supra* notes 279–280 and accompanying text.

C. *Costs and Other Potential Objections*

Direct Costs. Few proposals for change are without costs, and there are certainly costs associated with the integrated approach. The costs, however, should be reasonably low and are offset by the substantial gains from error reduction *ex ante* and improved effectiveness *ex post*. As a frame of reference, federal regulations call for the DOJ to conduct a cost–benefit analysis of any proposal that would likely have an annual impact on the economy of $100 million or more.[321] It does not seem likely that this proposal would entail such high incremental costs.[322] Nevertheless, a rough cost summary is worth sketching and should then be compared to the benefits hypothesized in the previous section.

The prescribed corporate investigation would require dispatching an additional team of prosecutors or investigators to conduct a governance profile *ex ante*, and this may require engaging the assistance of outside experts at some cost.[323] Some of the associated fixed costs, however, are already incurred in current practice. The investigation involves reviewing documents and interviewing executives, employees, and sometimes third parties. The specific search for and extraction of information on corporate practices and structures, as well as related analysis, would add incremental costs. But preparing a useful profile of even a relatively large company should be possible with 100 to 300 hours of effort—the AIG profile summarized in Part II took far less time. Charged at a rate of up to $500 per hour, that yields approximate costs of no more than $150,000.

During the settlement process, the incremental costs of articulation are more modest. Under current practice, prosecutors do much of the required work concerning articulation. At the DPA drafting stage,

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321. *See* Exec. Order No. 12866 § 3(f)(1), 3 C.F.R. 638 (1993); OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, CIRCULAR A-4, REGULATORY ANALYSIS at 32 (2003).

322. As an imperfect proxy, the average annual number of DOJ DPAs in the past decade is less than forty. To have an impact of at least $100 million would mean that incremental costs per case equal or exceed $2.5 million. Chief incremental costs per investigation and DPA are up-front investigation efforts and *ex post* articulation practices. As explained below, the additional costs of investigation are unlikely to exceed $150,000 and the additional costs of settlement unlikely to exceed $50,000. True, the total costs would be greater by virtue of *ex ante* investigations that may not lead to DPAs but even that added cost is unlikely to result in costs exceeding $100 million annually.

323. This exercise would be part of the preliminary investigation and consist of assembling a corporate governance profile, akin to that business lawyers might provide ahead of a corporate acquisition, *see* JAMES C. FREUND, ANATOMY OF A MERGER 420 (1975), or underwriters might use to quote premiums for directors' and officers' insurance, *see* Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1813 (2007). Much of the content for public companies would be publicly available; non-public details could be readily obtained by prosecutors exercising standard investigative powers, including the subpoena power.

prosecutors submit work for higher level approval that would include memoranda explaining the basis for the agreement and recommendation. Such a practice assures that prosecutors operate within the agenda of their offices. It does entail additional work but, as the examples in the next Part will show, the envisioned articulation exercise is not overwhelming.[324] In an analogous context, private plaintiffs' lawyers settling derivative shareholder lawsuits based on governance reforms rather than money damages obtain independent legal opinions that the reforms confer substantial benefits—an exercise in which law professors are often engaged at a total cost rarely exceeding $50,000.[325]

When weighing costs and benefits, one objection may be that the frequency of governance terms proffered for DPAs is low compared to the number of investigations opened, as many investigations close, proceed through prosecution, or are resolved using DPAs that do not include governance terms. If so, it might follow that costs of *ex ante* investigation would arguably be wasted, warranting prosecutors to defer developing requisite rationales until the DPA stage when it is known that governance terms are to be negotiated. The proposed integrated approach to investigation and reform, however, includes a prominent role for the investigation stage, independent of the governance terms in DPAs. The Andersen case makes clear the importance of considering governance features at the outset, without regard to whether the topic ever arises in a DPA. The AIG case reinforces that lesson, as prosecutors should have proceeded with greater caution amid the company's ongoing governance debate over executive succession.

A final point about the proposed integrated approach is that incremental costs should not be so great as to dissuade prosecutors from pursuing DPAs in cases where that is judged to be the best outcome. After all, DPAs are currently cheap for prosecutors, and the proposed integrated approach would increase their cost. Costs must not be increased so much that DPAs are abandoned in favor of inferior choices, such as the blunt and risky course of indictment. The concern should be modest, however, as the increased incremental costs, even if high at the outset, should decline over time as knowledge is developed, precedents built, and procedures standardized. In any event, the effects of the switch might marginally reduce the number of DPAs over the short term, but their quality would increase with time as well.

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324. One sample is the law review article that prosecutors published after executing a DPA with Bristol-Myers Squibb, in which they explained their rationale for many of the governance provisions and other terms. *See generally* Christie & Hanna, *supra* note 7; *infra* apps. A and B.

325. Such opinions, which are publicly available, have been provided by such corporate law professors as Jesse Fried (Harvard), Jeffrey Gordon (Columbia), Sean Griffith (Fordham) and Donald Langevoort (Georgetown).

Expertise or Competence. A second objection to the integrated approach concerns prosecutorial expertise or competence. Many prosecutors lack training in corporate governance, and some lack interest. Skeptics might thus wonder about the feasibility of calling for prosecutors to learn corporate governance, particularly of a large organization. This is a good objection to the status quo (featuring governance reforms without evident governance knowledge) but a weak point against the integrated approach. Again, walling off prosecutors from governance would discourage them from considering important facts *ex ante*. Further, while such a learning curve may be steep, it is climbable. The call, after all, is not so much about broad vague intangible notions of corporate culture but about particular governance attributes that contribute to defining it and then (a) what their presence says about the probable and desirable results of steps a prosecutor may consider and (b) what should be changed about them as a condition of settling a case.[326]

Even so, at the DPA negotiation stage, a target board and management likely have greater expertise and knowledge than prosecutors concerning governance terms generally and how they might work at their company.[327] Prosecutors should recognize that and proceed with a degree of deference, though they do not always appear to do so. The articulation practice would improve the dialogue and the sense of shared good faith each side brings to the goal of improving governance. Care is particularly important when settlements are negotiated with corporate officials after predecessors have been removed and replaced, as in the case of AIG. Perverse incentives may lead the succeeding personnel to amplify concerns in a bid to cast all blame on outgoing executives.[328]

In the end, corporate governance is not more sophisticated or inaccessible than any other peculiar subject with which prosecutors must familiarize themselves. It is broader than compliance, but even compliance requires expertise that many prosecutors will not automatically have before a case in which it becomes necessary. Prosecutorial resources will increase in time, moreover, as prosecutors develop accessible precedents as reservoirs of knowledge. For those prosecutors unwilling or unable to learn what is required, they can enlist the aid of experts from among current or former securities regulators, corporate law or business professors, and the like. Experts must still exercise caution, of course, as they are not immune from mistakes. The

326. Further, the DOJ is seeking to systematize and coordinate internal knowledge and expertise concerning governance in DPAs. *See supra* text accompanying note 308. The DOJ also increasingly seeks to coordinate with relevant agencies. *See supra* note 91.

327. *See* Christie & Hanna, *supra* note 7, at 1051.

328. *See supra* note 255.

AIG case attests to this: a former chairman of the SEC prescribed off-the-rack reforms that backfired due to improper evaluation of the company's corporate governance profile.[329]

Temperament. A variation on the objection about competence or expertise concerns institutional and personal disposition. Prosecutors may tend to adopt an adversarial outlook due to their interest in—and institutional direction toward—punishment, usually via convictions and fines. The integrated approach differs, as it embraces a more cooperative transactional-bargaining and creative problem-solving approach. Even were chief prosecutors to require such exercises, some prosecutors may not be particularly good at them. On the other hand, the DPA setting marks at least an incremental retreat from the courtroom to the boardroom and thus a shift in outlook from hostility to settlement. Prosecutors inclined to carry such adversarial traits into the bargaining process are better advised to enlist the leadership of prosecutorial colleagues more disposed to the transactional approach to settlement.[330] It is akin to the shift other disputatious types must undergo when opting for other forms of alternative dispute resolution.[331]

Potency. Even assuming prosecutors embraced the profile exercise and produced the articulations, there is no way to know how useful the articulations would be. The product relies upon highly intangible incentives and there is no formal scrutiny. Formal scrutiny could be supplied by judges, but that solution, while potentially adding discipline, would also inflate costs and increase risks of error due to oversight by an individual who may lack expertise and institutional resources.

Furthermore, though intangible, prosecutors have their reputations at stake in the articulation exercise.[332] That may provide a more serious constraint than judicial review, as it exposes prosecutors to the judgment of their peers and other professional and public audiences.[333] In addition, these documents would likely be drafted not solely by prosecutors, but with considerable input from defense counsel, resulting in a more meaningful and comprehensive product.[334]

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329. *See supra* Section II.C.

330. *See* William F. Coyne, Jr., *The Case for Settlement Counsel*, 14 OHIO ST. J. ON DISP. RESOL. 367, 369 (1999).

331. *See* Gary Mendelsohn, Note, *Lawyers as Negotiators*, 1 HARV. NEGOT. L. REV. 139, 145 (1996).

332. *See* Fred C. Zacharias, *Effects of Reputation on the Legal Profession*, 65 WASH. & LEE L. REV. 173, 176 (2008).

333. *See id.* at 208.

334. The practice of articulating rationales would have effects on the bargaining process as well. *See* Russell Korobkin & Chris Guthrie, *Heuristics and Biases at the Bargaining Table*, 87 MARQ. L. REV. 795, 800 (2004). Exploration of such phenomena and their implications are beyond the scope of this Article.

There is some risk that such follow-the-leader practices could simply produce a boilerplate product, but boilerplate is often a sign of optimal contracting.[335] Degenerative repetition would produce thoughtless boilerplate with prosecutors simply going through the motions, copying the last DPA memo released. If that were to occur, there would be little lost costs along the way. It is a typical risk of failure, not an objection that should prevent embracing the proposal.

Window Dressing. A final potential objection is that prosecutorial focus on governance will simply lead corporations to adopt best practices in name only, akin to how companies go through the motions of compliance without promoting legal obedience in fact.[336] When corporations know that prosecutors focus on compliance when evaluating how to proceed with a case and settle it, a propensity toward compliance window dressing arises.[337] The same concern is less likely valid concerning governance reforms.

Ex ante prosecutorial examination of governance features encompasses such intangibles as the tone at the top and power allocations among officers, directors, employees, and shareholders. Such features, unlike many compliance programs, are difficult to fake. The creation and maintenance of an employee stock ownership plan, for example, directly affects an important aspect of governance, yet managers are unlikely to be able to manipulate it solely for cosmetic purposes. Nor can managers as readily manipulate such factors as the concentration of institutional shareholder ownership, ownership by insiders, or employee culture.

On the other hand, prosecutors must avoid the best practices trap that wreaked havoc in the AIG case. Another example of the problem, which befell the most devoted governance watchers, is how Enron's board was named among the best in America[338] just months before Enron was exposed to be a cipher.

IV. SPECIFIC TERMS AND BRISTOL-MYERS SQUIBB

This Part considers examples of specific governance terms that have appeared or may appear in DPAs. It draws examples from numerous DPAs, including several from the controversial Bristol-Myers Squibb DPA.[339] The Appendices contain excerpts of selected governance terms

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335. *See* Omri Ben-Shahar, *Foreword*, 104 MICH. L. REV. 821, 825 (2006) ("Boilerplate": Foundations of Market Contracts Symposium).

336. *See supra* text accompanying note 73.

337. *See id.*

338. Robert W. Lear, *Boards on Trial*, CHIEF EXECUTIVE, Oct. 31, 2000, *available at* 2000 WLNR 4391614.

339. *See generally* Christie & Hanna, *supra* note 7 (exploring prosecutorial discretion in the context of the Bristol-Myers Squibb DPA).

from the Bristol-Myers Squibb DPA followed by prosecutorial explanations of those terms. The point is to illustrate the feasibility of this Article's prescription and some of the immediate benefits apparent from the exercise. It also suggests the value that might arise from the production of libraries or catalogues of similar articulations. This Part also considers objections to specific terms' inclusion in DPAs as well as reasoning to justify such inclusion.[340] These justifications illustrate the rationales that prosecutors should publicly provide when including these terms in DPAs.

A. *Officers and Directors*

DPAs commonly call for the termination of employment of particular individuals, often officers alleged to have been involved in wrongdoing. The AIG case study provided the ultimate example of such an effort, targeting a CEO. Though common, the DPAs and accompanying press releases usually reveal little about the rationale of these changes. Critics oppose allowing DPAs to require such terminations.[341] After all, officers are appointed by directors, and that appointment is among the most important jobs a board performs. It is considered an inviolate mandate as seen in criticism of Spitzer for overtly engineering the ouster of the CEO at Marsh & McLennan[342] and for the more covert effort at AIG.

As a legal matter, such ouster would be objectionable when a prosecutor has not made a good faith study of the claims being lodged. To justify an ouster, prosecutors also should be willing to explain their actions from a corporate governance perspective. Prosecutors must base such judgments on an investigation. Probable cause is a concept of criminal procedure relevant to an *ex ante* determination about whether to proceed. It is not the standard for corporate governance ouster, which is a business judgment that must be based on reliable information, not *ex ante* probabilities.[343]

Many DPAs also prescribe specific structural or organizational attributes for certain officer positions, a topic of corporate governance

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340. Discussion speaks in terms of the corporate form but should be applicable generally to other forms of business organization. It is an illustrative survey rather than an exhaustive inventory, as the subject of corporate governance is vast. It also addresses only cognizable terms, omitting those that cannot be altered by an agreement as a practical matter, such as concerning shareholder demographics, as well as those that are restricted for other legal reasons, such as upsetting settled and reasonable employee expectations concerning indemnification or advancement of expenses to those facing legal claims. *Cf.* United States v. Stein, 541 F.3d 130, 146 (2d Cir. 2008) (endorsing employee objection, on constitutional grounds, to prosecutorial insistence that the corporation refuse to cover employees' legal defense expenses).

341. *E.g.*, Arlen & Kahan, *supra* note 107, at 25.

342. *See supra* text accompanying notes 168–170.

343. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985).

usually left up to boards. Most commonly, DPAs require the appointment of particular officers, such as chief compliance officers or chief risk officers. Some DPAs direct particular reporting protocols, such as that the officer must report directly to the board and not the CEO or other management. Prosecutors may seek to separate the identity of the CEO and chairman. (All these were included in the AIG prosecution.)[344]

Any of these terms may have a defensible logic in the context of a given company's overall corporate governance attributes. It ought to be permissible for prosecutors to negotiate for them or even impose them, so long as they have demonstrated an understanding of those attributes and articulated a rationale for the terms. For example, at Bristol-Myers Squibb, prosecutors requested that the chairman and CEO positions be split.[345] Although the rationale was not articulated as part of the agreement when executed, the prosecutors subsequently published a law review article in which they offered an explanation.[346] It may not be as detailed as one would hope, but it reassuringly demonstrates awareness of important issues and a struggle with balancing trade-offs within the company:

> [The traditional structure of having the top leader hold both positions] has its own benefits and risks: a strong chair/CEO is quite likely a more efficient structure than splitting those jobs, yet it provides fewer checks and balances. . . . [It can be valuable to] have an active, experienced non-executive chairman act as an effective check on the CEO; and to insure that the CEO's office would not act as a bottleneck for information between the corporate officers and the board of directors. We believed this change would enhance the openness and effectiveness of the governance of Bristol-Myers [Squibb]. Eventually, management agreed with our assessment.[347]

This discussion might have offered additional specific reasons to believe why splitting the roles would be effective at Bristol-Myers Squibb, both in terms of compliance and performance. Such explanations should accompany the DPA, not be published afterwards. Despite such shortcomings, articulating rationales is unusual, attractive, and worthy of emulation.

The board of directors is at the core of corporate governance, entailing many attributes such as size, qualification, term of office, use

344. *See infra* app. A.
345. Christie & Hanna, *supra* note 7, at 1052.
346. *Id.* at 1052–53.
347. *Id*. at 1051–52.

of committees, and executive sessions. Skeptics would oppose terms in any of these quintessential topics of corporate governance, though many DPAs contain such intrusions. For example, several have required the board to add one or more outside directors.[348] In at least one case, the agreement provided for the reinstatement of a particular individual.[349] At AIG, numerous outside directors were also added, in part by prosecutorial instigation.

Some might object that it is unlikely that adding any given number of directors or filling the slots with one or more additional outside directors would add deterrence or have any bearing on a corporation's propensity toward compliance with the law.[350] But such sweeping generalities are hard to defend. It is possible that the manager–directors on a given board have outsized influence to emphasize risk-taking and err too often on the side of legal violations and that, had there been just one more outside voice objecting to such a view, a different atmosphere or culture could develop.

In principle, it is even possible that an agreement between a prosecutor and corporation on the designation of a particular person is defensible.[351] That is especially logical in the case of a term calling for the reinstatement of a particular individual, as experience provides observable evidence of probable effectiveness. Of course, one should not have to take it on faith that such terms are ipso facto legitimate. But prosecutors should be entitled to agree to such terms, provided they have considered governance realities and explained in written rationales accompanying the DPAs the basis for including them.

DPAs may call for the creation of particular committees and their various attributes. Notably, neither federal nor state law requires any corporate board to have committees.[352] The closest to a mandatory

348. Order for Continuance, Deferred Prosecution Agreement at 3, United States v. Bristol-Myers Squibb, No. 2:05-mj-06076 (D.N.J. June 15, 2005), ECF No. 2 [hereinafter Bristol-Myers Squibb DPA], *available at* http://lib.law.virginia.edu/Garrett/prosecution_agreements/sites/default/files/pdf/bristol-meyers.pdf (requiring the addition of one outside director); Friedman's, Inc. NPA, *supra* note 242, at 10 (mandating the firm maintain the number of independent directors required by NYSE).

349. ABB Vetco Gray (Feb. 2007) (reappointment of a new executive chair to the board).

350. Arlen & Kahan, *supra* note 107, at 27.

351. Critics fairly object to the naming of particular people or organizations in DPAs on the grounds that doing so may create the appearance of cronyism. At minimum, it seems desirable for prosecutors to refrain from dictating any particular donation or naming any given person to assume any role. If such terms are deemed desirable in good faith based on an assessment of corporate governance realities, then prosecutors should repose discretion over the particulars to the company rather than specify a particular person or organization. To reduce doubt, prosecutors might forbid naming any persons or institutions with which anyone in the prosecutor's office is associated. A credible middle ground might allow for the corporation to choose from a list that the prosecutor pre-approves.

352. State statutes invariably permit but do not require board committees. *E.g.*, DEL. CODE

committee arises from Sarbanes-Oxley which sets stringent requirements for any audit committee that exists and then provides that the stringent requirements apply to the whole board if there is no separate audit committee.[353] A similar effect arises from the Dodd-Frank Act to produce compensation committees.[354] Governance devotees and institutional shareholders also often seek or endorse the creation of other committees at particular companies, including governance and nomination committees.

Some DPAs have followed suit.[355] A good example is the NPA with Gen Re, the Berkshire Hathaway subsidiary at the origin of the AIG case, which required an officer of Berkshire Hathaway to attend Gen Re's audit committee meetings.[356] There may be a credible rationale for this: thanks largely to Warren Buffett, Berkshire exudes corporate integrity.[357] It had recently acquired Gen Re and found that there was a gap between Berkshire's traditionally tight internal control environment and looser practices at Gen Re.[358] This is a quintessential governance issue—in terms of the implicit knowledge of both the need and the remedy—but with a coherent rationale. The principal defect is that the prosecutor failed to publicly articulate that rationale.

B. *Charitable Giving*

Corporate charitable giving is a feature of corporate governance that prosecutors sometimes use when forming DPAs.[359] Terms usually

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ANN. tit. 8, § 141(c)(2) (2010).

353. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, § 301(2), 116 Stat. 745, 776.

354. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 952(a), § 10C, 124 Stat. 1376, 1900–03 (2010).

355. *E.g.*, Friedman's, Inc. NPA, *supra* note 242, at 11–12 (requiring firm to create audit, nomination and compensation committees); Deferred Prosecution Agreement, para. 12(b)–(c), United States v. Computer Assocs. Int'l, Inc. (Sept. 22, 2004) (on file with author) (requiring committees and an extensive array of other governance changes).

356. Letter from Paul E. Pelletier, Acting Chief, & Adam G. Safwat, Assistant Chief, Fraud Section, U.S. Dep't of Justice, to Ronald L. Olson, Outside Counsel, General Re Corp. 5 (Jan. 14, 2010), *available at* http://lib.law.virginia.edu/Garrett/prosecution_agreements/sites/default/files/pdf/genre.pdf (Gen Re NPA).

357. *See generally* ANDREW KILPATRICK, WARREN BUFFETT: THE GOOD GUY OF WALL STREET (1995).

358. This is evident from reading selections from Buffett's annual letters to Berkshire Hathaway shareholders during the period from 2000–2006. *See* WARREN E. BUFFETT & LAWRENCE A. CUNNINGHAM, THE ESSAYS OF WARREN BUFFETT: LESSONS FOR CORPORATE AMERICA 141, 145–47 (2d ed. 2008).

359. The issue of charitable contributions has receded, as the DOJ and Organizational Sentencing Guidelines discourage the practice. But it is worth questioning why. Under the analysis in this Article, there is nothing that warrants excluding the topic from consideration in a DPA. The DOJ and Organizational Sentencing Guidelines discouragement may be unwarranted reaction to critical objections that miss the mark.

involve a corporate commitment to contribute funds to designated organizations. Some critics object to such commitments because, on their face, they are remote from any agency costs of internal corporate policing. Other critics see prosecutorial overreaching when the prosecutor personally favors the charity receiving the required donation. It is obviously indefensible for a prosecutor to propose terms designed to advance personal interests.[360] Such donations may be consistent with the existing corporate governance or have another defensible purpose, but it is up to the prosecutor to provide reasoning and quiet the critics.

Critics often cite the Bristol-Myers Squibb deal as an example of a required donation amounting to an abuse of prosecutorial discretion. They single out the requirement that the company endow a chair in legal ethics at Seton Hall University Law School, from which the prosecuting attorney graduated.[361] But the prosecutors report that the requirement was made in general terms to promote ethical training of company executives and the only restriction was geographic—that it be done in New Jersey, the location of Bristol-Myers Squibb's headquarters.[362] The other law schools in New Jersey already had a program. Management chose Seton Hall after the DPA was finished.[363] This explanation negates the charge of parochialism and adds a compliance-oriented rationale of providing related training to company personnel.[364]

An important factor to consider about charitable donations is the relationship between a company's existing governance philosophy concerning charitable giving and the donation. Some companies have a tradition of corporate charitable giving, while others do not. Those traditions should inform judgments about such terms in DPAs. For example, AIG and Berkshire Hathaway historically foreswore using corporate resources for charitable purposes, both stressing the boards' belief that such allocations were the prerogative of shareholders.[365] But

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360. *See* Green & Zacharias, *supra* note 285, at 856–58.

361. *E.g.*, Albert W. Alschuler, *Two Ways to Think About the Punishment of Corporations*, 46 AM. CRIM. L. REV. 1359, 1384–85 (2009); Arlen & Kahan, *supra* note 107, at 15 n.56; Spivack & Raman, *supra* note 97, at 174 & n.83 (characterizing the textual presentation of the term as objectionable along with a footnote citing other sources explaining its possible legitimacy).

362. *See* Christie & Hanna, *supra* note 7, at 1058 n.29.

363. *Id*.

364. A more prudent approach would be for the prosecutor to forbid targets from naming given institutions with which the prosecutor's office is associated. *See supra* note 351.

365. *See* GREENBERG & CUNNINGHAM, *supra* note 126, at 157–58 (AIG); BUFFETT & CUNNINGHAM, *supra* note 358, at 62 (Berkshire Hathaway). Many AIG directors made charitable giving by endowing private foundations dedicated to their preferred causes. Neil Starr had begun that practice, endowing a foundation of modest size that, concentrated in AIG stock, would grow over three decades after his death to several billion dollars. Other directors, including Buck Freeman, Hank Greenberg, Jimmy Manton, and Ernie Stempel, followed suit by establishing private foundations to make charitable gifts, which aggregated to billions of dollars.

other corporations, including Bristol-Myers Squibb, follow a different philosophy and routinely make such contributions. Corporate charitable giving at Bristol-Myers Squibb included an entire category devoted to professorships and related academic positions.[366] While the DPA was consistent with past practice and thus appropriate as a matter of corporate governance at Bristol-Myers Squibb,[367] at AIG or Berkshire Hathaway such a term would have been inconsistent with their particular practices and therefore inappropriate.

Prosecutors should be able to demonstrate at least some logical link between the company, its alleged wrongdoing, and the related charitable cause. A doubtful example appeared in the DPA with Operations Management International.[368] Prosecutors alleged that it violated environmental laws.[369] The DPA called for Operations Management to donate to the U.S. Coast Guard Academy Alumni Association to endow a chair in environmental studies.[370] Without an explanation, there is no obvious logical connection between the alleged violations and the particular company or between the alleged violations and the prospective improvement.

A similar opacity problem afflicted the DPA with Gibson Guitar Corp. It allegedly violated the Lacey Act and foreign laws restricting the use of certain wood.[371] Gibson allegedly acquired certain protected wood unlawfully for manufacturing the fingerboards of its guitars.[372] In addition to a fine and compliance commitments, the DPA required Gibson to donate $50,000 to the National Fish and Wildlife Federation.[373] Neither the DPA nor accompanying materials explain the rationale for that donation. There may be a defensible logic to this, but without an explanation critics can easily object to this term.[374]

GREENBERG & CUNNINGHAM, *supra* note 126, at 158. At Berkshire, Warren Buffett famously contributed virtually his entire net worth to charitable causes. BUFFETT & CUNNINGHAM, *supra* note 358.

366. *See Grants and Giving*, BRISTOL-MYERS SQUIBB, http://www.bms.com/responsibility/grantsandgiving/Pages/default.aspx (last visited Dec. 20, 2013) (highlighting Bristol-Myers Squibb charitable giving, including "Independent Medical Education" and "Corporate Giving").

367. Bristol-Myers Squibb DPA, *supra* note 348, at 6.

368. Deferred Prosecution Agreement app. A, United States v. Operations Mgmt. Int'l, Inc., No. 3:06-cr-00017-EBB (D. Conn. Feb. 8, 2006).

369. *Id.* at 1351.

370. *Id*. at app. A.

371. Letter from John K. Webb, Deputy Chief, Criminal Div., & Lana N. Pettus, Trial Att'y, Environmental Crimes Section, U.S. Dep't of Justice, to Donald A. Carr & William M. Sullivan, Jr., Att'ys, Gibson Guitar Corp. 1 (July 27, 2012), *available at* http://lib.law.virginia.edu/Garrett/prosecution_agreements/pdf/Gibson_Guitar.pdf (setting forth the terms of the DPA).

372. *Id.* at 3.

373. *Id.*

374. For example, it is possible to classify the Gibson Guitar donation as akin to

C. *Monitors and Consultants*

Monitors have theoretical appeal as an oversight mechanism to assure compliance with the agreed terms of DPAs.[375] Absent some such mechanism, violations could go undetected. Yet, there is also room for abuse, as when cronyism dominates the selection process and additional agency costs plague the monitors.[376] Critics cite a series of monitor appointments made without any bidding process by the then-U.S. Attorney in New Jersey, Christopher Christie, including in the case of Bristol-Myers Squibb.[377] The DOJ has addressed some of these concerns through express guidance on the subject, but the value of using monitors remains uncertain.[378]

In AIG's case, a monitor was installed at its FP division in late 2004, a few months before Greenberg resigned.[379] Initially charged with assuring that customers would not use FP products primarily to massage their books, the assignment gradually expanded over ensuing years after Greenberg left AIG to encompass broader aspects of the FP division's transactions and internal controls.[380] The monitor spent 2005, 2006, and 2007 submitting to the SEC and to management periodic confidential reports on a wide range of topics in accounting, compliance, and disclosure. AIG paid $20 million for these services.[381] The monitor apparently did not discover or report to AIG's board or senior

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community service that judges sometimes impose when sentencing defendants after conviction. A prosecutor's explanation would be better than a professor's speculation, however.

375. *See* Cristie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?*, 34 J. CORP. L. 679, 695 (2009) (arguing that monitors in practice do not "keep[] up with the evolution of the compliance profession"); Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713, 1737 (2007) (urging "greater specificity in the DPA about the tasks and powers of monitors").

376. Khanna and Dickinson, *supra* note 375, at 1736 n.90.

377. *See, e.g.*, Carol Morello & Carol D. Leonnig, *Chris Christie's Long Record of Pushing Boundaries, Sparking Controversy*, WASH. POST (Feb. 10, 2014), http://www.washingtonpost.com/local/chris-christies-long-record-of-pushing-boundaries-sparking-controversy/2014/02/10/50111ed4-8db1-11e3-98ab-fe5228217bd1_story.html.

378. Memorandum from Craig S. Morford, Acting Deputy Att'y Gen., to Heads of Dep't Components & U.S. Att'ys, Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations 2 (Mar. 7, 2008), *available at* http://www.justice.gov/dag/morford-useofmonitorsmemo-03072008.pdf; Memorandum from Gary G. Grindler, Acting Deputy Att'y Gen., to Heads of Dep't Components & U.S. Att'ys, Additional Guidance on the Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations (May 25, 2010), *available at* http://www.justice.gov/dag/dag-memo-guidance-monitors.html.

379. *See supra* note 154.

380. *See* GREENBERG & CUNNINGHAM, *supra* note 126, at 230–31 (recounting the change in the FP division after Greenberg's departure).

381. *See* Peter Lattman, *The U.S.'s Fly on the Wall at AIG*, WALL ST. J. (Mar. 27, 2009, 12:01 AM), http://online.wsj.com/news/articles/SB123812186477454361.

management the brewing problems at the FP division that contributed to the financial crisis of 2008.[382] Monitors can be ineffective, despite being costly.[383]

Such failures, along with aversion to accusations of cronyism, may explain why the use of monitors in DPAs has declined lately. For instance, in the mid-2000s, almost all DPAs required a monitor whereas in recent years only about one-third did.[384] Other alternatives may avoid such pitfalls and be more effective for given companies. An exquisite example appears in the DPA with Gen Re. The requirement[385] that a Berkshire official attend all Gen Re audit committee meetings installed a functional monitor employed by the parent company, providing reliable oversight in a logical governance fit.

Many DPAs require a company to hire a consultant charged with recommending governance changes. Terms often require the company to accept the directives except on the approval of the governmental authority. Potential changes may be extremely broad and include any number of provisions addressing every aspect of compliance and all parts of corporate governance. The AIG DPA had such a clause, which required AIG to retain a consultant and accept all changes.[386] That appears to be an enormous vesting of discretion in a person whose authority would be final and unreviewable by any third party. This is objectionable on prudential grounds. The call for prosecutorial investigation *ex ante* and articulation *ex post* should contribute a sense of competence to enable prosecutors to curtail that discretion either by accelerating the reporting and recommendation phase or by actively supervising any consultant that may remain necessary.

D. *Shareholders and Disclosure*

Another objection to including governance terms in DPAs is that shareholders should have input when DPAs—as they sometimes do—contain terms that significantly impact shareholders. In accordance with state corporation law, some of these terms require shareholder approval.

382. *See* Memorandum from Mark Jickling, Specialist in Fin. Econ., Cong. Research Serv., to the House Comm. on Oversight & Gov't Reform, Independent Consultant Reports on AIG Accounting Reforms (May 5, 2009); *see also* SEC v. AIG, 854 F. Supp. 2d 75 (D.D.C. 2012), *available at* http://pdfserver.amlaw.com/cc/KesslerFOI_opinion.pdf (granting motion to compel disclosure of the reports by journalist Sue Reisinger of *Corporate Counsel*), *rev'd* 712 F.3d 1 (D.C. Cir. 2013).

383. *See* Lisa K. Griffin, *Inside-Out Enforcement*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 110, 121–22 (Anthony S. Barkow & Rachel E. Barkow eds., 2011) (criticizing the monitor in the AIG case).

384. Arlen & Kahan, *supra* note 107, at 40 (stating the percentages at 84% from 2003–05 versus less than 35% from 2008–2010).

385. *See supra* text accompanying notes 356–358.

386. *See supra* text accompanying notes 206–211.

One way to address this valid concern is to allow shareholders to vote for inclusion of certain terms in DPAs.[387] This would draw on the usual rules of corporate law for use in the realm of criminal justice administration.

State corporation law usually vests shareholders with voting power over charter amendments that might define certain board attributes such as size and director election rules.[388] It may be desirable in some cases to consider shareholder votes on other matters typically within a board's discretion, such as committee types, meetings, and attendees; or management, such as reporting lines. A small number of topics might even require a shareholder vote under federal law, such as the approval of a company's outside auditors.

Shareholder voting would both empower shareholders—recognizing the role in corporate governance that their economic interest affords—and reveal information relevant to prosecutorial decision-making on how to proceed. Giving shareholders such a voice mutes criticism of unilateral prosecutorial or managerial action. It also enhances the integrity of the process and increases the capacity of observers to evaluate the legitimacy of its procedures and the results.

DPAs invariably require a corporate target to provide public disclosure of various kinds.[389] These disclosures routinely include the circumstances leading to the DPA and related allegations. Other DPAs call for maintaining enhanced standards relating to disclosure in the interest of increasing the corporation's transparency. Disclosure is an integral part of corporate governance and can also promote compliance.

Critics have not challenged the inclusion of disclosure terms in DPAs. It would be difficult to sustain such a critique when the disclosure concerns management's discussion and analysis of such matters as ongoing business operations and the circumstances leading to the DPA. As a matter of corporate governance, however, some restraint is advisable to assure that a DPA's disclosure requirements gel with existing corporate practices concerning disclosure, such as the form and timing of communications to shareholders. Within the framework of securities and corporate disclosure law, companies adopt varying stances on the detail of and frequency with which information is supplied to shareholders, and scholars debate the optimal level of disclosure.[390]

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387. *See* Baer, *supra* note 251, at 2.

388. *E.g.*, 205 ILL. COMP. STAT. ANN. 5/17 (West, Westlaw through P.A. 98-626 of 2013 Reg. Sess.).

389. *See* Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, 81 WASH. U. L. Q. 417, 417–18 (2003).

390. *See, e.g.*, *id.* at 417.

CONCLUSION

Prosecutors targeting corporate defendants may give insufficient consideration to corporate governance when exercising discretion over how to proceed. Yet, corporate governance factors are vital to both the process pursued and settlements reached. Prosecutors should therefore consider such variables as shareholder demographics, board orientation, executive reporting, employee incentives, and other factors that bear on how any given formal corporate governance structure operates. Prosecutors who heed governance at the outset both earn credibility to include governance terms in resolutions and are likelier to propose more effective, narrowly tailored terms. Failure to investigate first can have devastating consequences, as the Arthur Andersen and AIG cases suggest. Investigation and articulation would produce clear benefits, including increased legitimacy of DPAs *ex post*, neutralizing criticism aimed at many DPAs.

The DOJ should update its guidelines to encourage prosecutors to consider governance at the outset and to provide such explanations. Other prosecutorial leaders nationwide should follow suit. To be sure, this prescription would not necessarily guarantee better outcomes. For example, had prosecutors taken heed at AIG and viewed the governance realities starkly, they may have determined that a radical overhaul was necessary and still imposed all the same changes. Nevertheless, consideration would increase the chance of desirable outcomes. This problem reflects the challenge of working within a framework of discretion. There will always be some risk of error. While not guaranteed, this integrated approach is better than the status quo. After all, had prosecutors studied Andersen in the prescribed way, a better outcome would likely have resulted.

In short: this Article recognizes the proliferation of DPAs as a novel form of corporate criminal justice administration that would benefit from being formalized, systematized, and catalogued, rather than maintained in the black box of traditional prosecutorial discretion.

APPENDICES

A. Bristol-Myers Squibb Deferred Prosecution Agreement
B. Prosecutors’ Articulations on Bristol-Myers Squibb DPA

A. Bristol-Myers Squibb Deferred Prosecution Agreement

The following are excerpts from the DPA dated June 15, 2005, between Bristol-Myers Squibb ("BMS") and the U.S. Department of Justice, District of New Jersey (referred to as the "Office"). The DPA arose out of alleged accounting violations concerning the timing, measurement, and disclosure of transactions that had the effect of premature recognition of revenue. Appendix B excerpts prosecutorial explanations that address most of the following directly.

5. BMS has undertaken extensive reforms and remedial actions in response to the conduct at BMS that is and has been the subject of the investigation by the Office. These reforms and remedial actions have included:

(a) Retaining the Honorable Frederick B. Lacey as Independent Advisor, to conduct a comprehensive review of the implementation and effectiveness of the internal controls, financial reporting, disclosure, planning, budget and projection processes and related compliance functions of the Company, as well as to serve additional supervisory and monitoring functions described herein; . . .

(d) Making significant personnel changes . . . after the Office commenced its investigation including: (i) replacing the former Chief Financial Officer (CFO); (ii) replacing the former President of the Worldwide Medicines Group; (iii) replacing the former Controller; (iv) establishing the position of Assistant Controller for Financial Compliance and Control; (v) establishing the position of Chief Compliance Officer; (vi) establishing a position for an experienced securities regulation and disclosure lawyer who has a significant role in all BMS disclosure responsibilities;

(e) Changing its budget process, to assure that appropriate consideration is given to input and analysis from the bottom to top, and not exclusively from top to bottom, and adequately documenting that process;

(f) Forming a business risk and disclosure group that includes senior management, the Independent Advisor and counsel to the Independent Advisor;

(g) Identifying and implementing actions to improve the effectiveness of its disclosure controls and procedures and internal controls, including enhancing its resources and training with respect to financial reporting and disclosure responsibilities, and reviewing such actions with its Audit Committee and independent auditors;

(h) Implementing a formal review and certification process of its annual and quarterly reports filed with the Securities and Exchange Commission (SEC); and

(i) Providing an effective mechanism in the form of a confidential hotline and e-mail address, of which BMS employees are informed and can use to notify BMS of any concerns about wholesaler inventory levels or the integrity of the financial disclosures, books and records of BMS. . . .

8. BMS shall establish the position of non-executive Chairman of the BMS Board of Directors (the "Non-Executive Chairman"), to advance and underscore the Company's commitment to exemplary corporate citizenship, to best practices of effective corporate governance and the highest principles of integrity and professionalism, and to fostering a culture of openness, accountability and compliance throughout the Company. BMS shall retain the position of Non-Executive Chairman at least throughout the term of this Agreement.

9. BMS agrees to appoint an additional non-executive Director acceptable to the Office to the BMS Board of Directors within sixty (60) days of the execution of this Agreement.

10. The Company's CFO, General Counsel, and Chief Compliance Officer regularly shall brief and provide information to the Non-Executive Chairman, in a manner to be determined by the Non-Executive Chairman. In addition, the Non-Executive Chairman shall have the authority to meet with, and require reports on any subject from, any officer or employee of the Company.

11. BMS agrees that until at least the date of the filing of the Company's Form 10-K for the year ended 2006, it will retain an outside, independent individual or entity (the "Monitor"), selected by BMS and approved by the Office. BMS may employ as the Monitor the Honorable Frederick B. Lacey. It shall be a condition of the Monitor's retention that the Monitor is independent of BMS and that no attorney-client relationship shall be formed between the Monitor and BMS.

12. The Monitor shall: (a) Monitor BMS's compliance with this Agreement, and have authority to require BMS to take any steps he believes are necessary to comply with the terms of this Agreement; (b) Continue the review, reforms and other functions undertaken as the Independent Advisor; (c) Report to the Office, on at least a quarterly basis and between thirty and forty-five calendar days after the filing of the Company's Form 10-K for the year ended 2006, as to BMS's compliance with this Agreement and the implementation and effectiveness of the internal controls, financial reporting, disclosure processes and related compliance functions of the Company. . . . (d) Cooperate with the SEC and provide information about BMS as requested by that agency; (e) Monitor BMS's compliance with applicable federal securities laws, and in his quarterly reports make recommendations necessary to ensure that the Company complies with applicable federal securities laws; . . .

13. BMS agrees that the Chief Executive Officer (CEO), Non-Executive Chairman, and General Counsel will meet quarterly with the Office and the Monitor, in conjunction with the Monitor's quarterly reports.

14. BMS shall adopt all recommendations contained in each report submitted by the Monitor to the Office unless BMS objects to the recommendation and the Office agrees that adoption of the recommendation should not be required. The Monitor's reports to the Office shall not be received or reviewed by BMS prior to submission to the Office; such reports will be preliminary until senior management of BMS is given the opportunity, within ten (10) days after the submission of the report to the Office, to comment to the Monitor and the Office in writing upon such reports, and the Monitor has reviewed and provided to the Office responses to such comments, upon which such reports shall be considered final. . . .

17. The Non-Executive Chairman and the Compensation Committee of the Board of Directors shall set goals and objectives relevant to compensation of the CEO, evaluate the CEO's performance in light of those goals and objectives, and recommend to the Board of Directors compensation based on this evaluation.

18. BMS agrees that it will establish and maintain a training and education program, which shall be reviewed and approved by the Board of Directors, designed to advance and underscore the Company's commitment to exemplary corporate citizenship, to best practices of effective corporate governance and the highest principles of integrity and professionalism, and to fostering a culture of openness, accountability and compliance throughout the Company. . . . The Board of Directors shall communicate to the Mandatory Participants, in writing or by video, its review and endorsement of the training and education program. . . .

20. BMS shall endow a chair at Seton Hall University School of Law dedicated to the teaching of business ethics and corporate governance, which position shall include conducting one or more seminars per year on business ethics and corporate governance at Seton Hall University School of Law that members of BMS's executive and management staff, along with representatives of the executive and management staffs of other companies in the New Jersey area, may attend. . . .

22. Within thirty (30) days of the execution of this Agreement, BMS agrees to call a meeting, on a date mutually agreed upon by BMS and the Office, of its senior executives and any senior financial personnel, and any other BMS employees who the Company desires to attend, such meeting to be attended by the United States Attorney and other representatives of the Office for the purpose of communicating the goals and expected effect of this Agreement.

23. For a period of one year from the execution of this Agreement, the Non-Executive Chairman, CEO, and General Counsel shall contemporaneously monitor either in person or telephonically BMS's quarterly conference calls for analysts ("analyst calls"), and the Non-Executive Chairman shall attend and participate in any preparatory meetings held among the CEO, the CFO, the General Counsel and other members of BMS senior management in anticipation of the analyst calls. The General Counsel shall ensure that representatives of the BMS legal division are informed and consulted regarding, at a minimum, issues relating to disclosure or securities law that may arise in the course of preparing for the analyst calls.

24. The CEO and CFO shall prepare and submit to the Non-Executive Chairman, Chief Compliance Officer and the Monitor described in paragraph 11 written reports on the following subjects: (a) all non-standard transactions with major U.S. wholesalers, such written report to be submitted within fifteen (15) days of such transaction; (b) an overview and analysis of BMS's annual budget process for its major business units, including description of significant instances of any top-down changes to business unit submissions, such written report to be submitted together with the proposed budget submitted for approval to the Board of Directors; (c) sales and earnings forecasts or projections at the corporate or major business unit level which indicate a quarterly target will not be met, together with a description of steps subsequently taken, if any, to achieve the budget target, such written report to be submitted quarterly and at least ten (10) business days prior to the Company's scheduled quarterly analyst call; (d) description of significant instances in which the preliminary quarterly closing of the books of any major business unit indicated that the business unit would not meet its budget target for any sales or earnings measure.

25. BMS agrees that it shall include in its quarterly and annual public filings with the SEC and its annual report to shareholders financial disclosures concerning the following: (a)(i) for the Company's U.S. Pharmaceuticals business, estimated wholesaler/direct-customer inventory levels of the top fifteen (15) products sold by such business and (ii) for major non-U.S. countries, estimated aggregate wholesaler/direct-customer inventory levels of the top fifteen (15) pharmaceutical products sold in such countries taken as a whole measured by aggregate annual sales in such countries; (b) arrangements with and policies concerning wholesalers/direct customers and other distributors of such products, including but not limited to efforts by BMS to control and monitor wholesaler/distributor inventory levels; (c) data concerning prescriptions or other measures of end-user demand for such top fifteen (15) BMS pharmaceutical products sold within the

U.S. and in major non-U.S. countries; (d) acquisition, divestiture, and restructuring reserve policies and activity; and (e) rebate accrual policies and activity. The CEO shall, at the annual BMS shareholder meeting, report to the shareholders on these topics.

26. BMS agrees that it will continue to review and improve, where necessary, the content of its public financial and non-financial public disclosures, including periodic SEC filings, annual and other shareholder reports, press releases, and disclosures during analyst conference calls, as well as during meetings with investors and credit ratings agencies. BMS agrees that it will at all times strive for openness and transparency in its public reporting and disclosures.

27. BMS shall encourage the free flow of information between its employees and its external auditor, and encourage its CFO and senior finance personnel to seek advice from the external auditor. The CEO, CFO, General Counsel, and Chief Compliance Officer shall meet quarterly with the Company's external auditors, such meeting to occur following the closing of the Company's books for the quarter and prior to the Company's scheduled quarterly analyst call. At the quarterly meeting, the BMS attendees shall discuss business and financial reporting developments, issues and trends with the external auditor, as well as provide information to the external auditor concerning the subjects described in paragraph 24 above, and shall respond to inquiries from the external auditor.

B. Prosecutors' Articulations on Bristol-Myers Squibb DPA

The following are excerpts from the law review article, published in 2006, by prosecutors in the case of Bristol-Myers Squibb ("BMS"). The article explains some of the governance terms of the DPA excerpted in Appendix A.[391] *Far from perfect and perhaps not even optimal, it illustrates the relative ease of the exercise and suggests the potential value of articulations that, together, furnish considerable systemic benefits. The article also explains some of the background of the investigation, including highlights of the company's governance profile reflecting a degree of* ex ante *consideration of important factors.*

One issue we faced was how to reverse Bristol-Myers' failures to disclose facts underlying its channel stuffing, accruals for rebates, and manipulation of reserves. The deferred prosecution agreement deals with the most obvious aspect of this problem by mandating specific disclosures in Bristol-Myers' public filings with the SEC and its annual report to shareholders [quoting ¶ 25 as follows]:

Bristol-Myers agrees that it shall include in its quarterly and annual public filings with the SEC and its annual report to shareholders financial disclosures concerning the following: (a)(i) for the Company's U.S. Pharmaceuticals business, estimated wholesaler/direct-customer inventory levels of the top fifteen (15) products sold by such business and (ii) for major non-U.S. countries, estimated aggregate wholesaler/direct-customer inventory levels of the top fifteen (15) pharmaceutical products sold in such countries taken as a whole measured by aggregate annual sales in such countries; (b) arrangements with and policies concerning wholesalers/direct customers and other distributors of such products, including but not limited to efforts by Bristol-Myers to control and monitor wholesaler/distributor inventory levels; (c) data concerning prescriptions or other measures of end-user demand for such top fifteen (15) Bristol-Myers pharmaceutical products sold within the U.S. and in major non-U.S. countries; (d) acquisition, divestiture, and restructuring reserve policies and activity; and (e) rebate accrual policies and activity. The CEO shall, at the annual Bristol-Myers shareholder meeting, report to the shareholders on these topics.

Requiring specific disclosures, however, is somewhat akin to treating the symptoms of a disease and not its causes. Therefore, we sought a more fundamental change in Bristol-Myers' attitude toward the investing public. To that end, the deferred prosecution agreement [in ¶ 26] includes Bristol-Myers' commitment "that it will at all times strive for openness and transparency in its public reporting and disclosures"

391. These selections are from Christie & Hanna, *supra* note 7, at 1053–58.

and "that it will continue to review and improve, where necessary, the content of its public financial and non-financial public disclosures, including periodic SEC filings, annual and other shareholder reports, press releases, and disclosures during analyst conference calls, as well as during meetings with investors and credit ratings agencies."

The deferred prosecution agreement also calls for Bristol-Myers to utilize the expertise of its outside auditors on disclosure and accounting matters [quoting ¶ 27 as follows]:

Bristol-Myers shall encourage the free flow of information between its employees and its external auditor, and encourage its CFO and senior finance personnel to seek advice from the external auditor. The CEO, CFO, General Counsel, and Chief Compliance Officer shall meet quarterly with the Company's external auditors . . . prior to the Company's scheduled quarterly analyst call. At the quarterly meeting, the Bristol-Myers attendees shall discuss business and financial reporting developments, issues and trends with the external auditor, as well as provide information to the external auditor concerning the subjects described in paragraph 24, and shall respond to inquiries from the external auditor.

By including provisions relating to transparency, our intent was to address both specific failings uncovered in the investigation and an equally disturbing corporate culture that favored secrecy over openness. For example, by requiring regular quarterly meetings among senior management and their independent auditors, our expectation is that if future law breaking were to occur, it would be much more difficult for top management and the auditors to claim ignorance. The goal is that Bristol-Myers should report all material facts, good and bad, to the investing public. With respect to unfavorable news, Bristol-Myers must get into the habit of disclosure, not concealment; if there is a question about whether or not to disclose something, the deferred prosecution agreement clearly calls for more information, not less.

Perhaps the most difficult issue to address in this matter was reforming Bristol-Myers' corporate governance in ways that would give some assurance that the failures [we found] would not be repeated. At the very least, Bristol-Myers' remaining top management failed to detect and prevent the wrongdoing [we found]. Yet federal prosecutors must tread warily in the area of corporate governance. Plainly, federal prosecutors have no business telling corporate executives what business judgments to make or otherwise intruding into business decisions. It was clear to us, however, that Bristol-Myers' board of directors and top executives had to be more involved in governing the company and therefore more accountable to all its stakeholders. This greater involvement of top management, together with a healthy dose of outside oversight, would provide confidence that Bristol-Myers will not repeat past sins.

Bristol-Myers, like many U.S. companies, had historically allowed its top leader to hold both positions of chairman of the board of directors and chief executive officer (CEO). This structure undoubtedly has its own benefits and risks: a strong chair/CEO is quite likely a more efficient structure than splitting those jobs, yet it provides fewer checks and balances. We determined there were three options to deal with the failure of the CEO and the board of directors to address the wrongdoing that occurred on their watch. The first was to leave the governance structure intact and hope the other provisions of the deferred prosecution agreement (along with the presence of the federal monitor) would solve the problem. The second alternative was to demand the resignation of the chairman and CEO for failure to discover and address the wrongdoing. The third was a hybrid of the first two options, which was formulated during negotiations with corporate counsel. The reasoning behind this provision was two-fold: to have an active, experienced non-executive chairman act as an effective check on the CEO; and to insure that the CEO's office would not act as a bottleneck for information between the corporate officers and the board of directors. We believed this change would enhance the openness and effectiveness of the governance of Bristol-Myers. Eventually, management agreed with our assessment.

The Bristol-Myers deferred prosecution agreement requires the company to split the roles of board chair and chief executive [quoting ¶ 8]:

Bristol-Myers shall establish the position of non-executive Chairman of the Bristol-Myers Board of Directors (the "Non-Executive Chairman"), to advance and underscore the Company's commitment to exemplary corporate citizenship, to best practices of effective corporate governance and the highest principles of integrity and professionalism, and to fostering a culture of openness, accountability and compliance throughout the Company. Bristol-Myers shall retain the position of Non-Executive Chairman at least throughout the term of this Agreement.

This approach, we feel, provides maximum board involvement in and accountability for Bristol-Myers' business decisions, including its public disclosures. The deferred prosecution agreement deliberately avoids any temptation to micro-manage the role of the non-executive chairman. Instead, it sets forth aspirational goals for the company and mandates information sharing with the non-executive chairman. [The article here quotes ¶ 10.] It also gives the non-executive chairman a limited role in preparing for and monitoring quarterly conference calls with Wall Street analysts and investors. [The article here quotes ¶ 23.] The Board selected James D. Robinson III, a long-time Bristol-Myers

Director, to fill this role.

In addition to splitting the roles of board chair and chief executive, the deferred prosecution agreement also requires Bristol-Myers to appoint an additional non-executive Director acceptable to the U.S. Attorney's Office. Our aim was to bring fresh blood and a new perspective to the board of directors; our preference for someone with a law enforcement background was made clear. Accordingly, Bristol-Myers selected, and the U.S. Attorney's Office approved, Louis J. Freeh, a former federal judge, federal prosecutor, and Director of the FBI, as the additional director.

Our conclusions regarding these governance issues were informed by meetings with both the CEO and the entire board of directors. The U.S. Attorney, along with the other prosecutors on the investigation, met a number of times with the CEO. One of the purposes of these meetings was to gain insight into the way management actually worked at Bristol-Myers. That knowledge helped us to intelligently and comprehensively negotiate a deferred prosecution agreement that dealt with the real problems at Bristol-Myers. The CEO gave us a real insider's view of how these events unfolded from his perspective.

We questioned the CEO regarding his relationship with his other senior officers, the board of directors, and his external auditors. We were attempting to find out every detail we could as to why the governance structures at Bristol-Myers had failed. By the very nature of the questions, these conversations were at times contentious. We discovered, however, that one of the root causes of the failures was the lack of timely and relevant information reaching all the decision makers at the top of the corporate chain of command. This led us to the conclusion that alternative information pipelines had to be opened in addition to the pipeline into the CEO's office. This further reinforced our conviction that the splitting of the chairman and CEO positions was a good idea.

Once we decided that the separation of the chairman and CEO's position was advisable, we felt that a meeting with the entire board of directors was necessary. We traveled to a regularly scheduled board meeting in Wilmington, Delaware and engaged in a ninety-minute open exchange with the Board. It was an opportunity to discuss previous conduct, and our ideas for future remediation, with the board. The Board shared with us their concerns about a deferred prosecution agreement and the potential effect on their business plans. Most importantly, we were able to gauge the commitment of the Board to real change in governance. The meeting also gave us the chance to assess each board member in light of our desire to potentially find a non-executive chairman who had a deep knowledge of Bristol-Myers and a real desire to be an agent of change of the corporate culture, which created these issues in the first place.

These corporate governance changes, along with the other governance measures Bristol-Myers adopted prior to the deferred prosecution agreement are no guarantee of perfectly smooth sailing during the term of the agreement. Regardless, this increased internal accountability should go a long way toward achieving the goal of good corporate citizenship. We believed, however, that more was needed from outsiders to insure compliance with the agreement and a change in corporate culture.

The maxim "trust but verify" applies in deferred prosecution agreements. From the prosecutor's point of view, it would be highly irresponsible to allow a corporation whose prosecution is being deferred to go unsupervised during the deferral period. Bristol-Myers, to its credit, recognized at the inception of the investigation, and long before we began to negotiate the terms of the deferred prosecution agreement, that outside help would benefit the company. The company retained as an independent advisor the Honorable Frederick B. Lacey, a former U.S. Attorney and federal judge in the District of New Jersey, and gave him a broad mandate to review the company's internal controls, financial reporting, disclosure, compliance, and budget processes. We requested, and Bristol-Myers agreed, to expand Judge Lacey's role to become the independent federal monitor at Bristol-Myers.

The independent monitor has wide authority to oversee Bristol-Myer's compliance with the deferred prosecution agreement and strengthen its ongoing remediation efforts. [The DPA at ¶ 12] charges the monitor to perform the following tasks, among others:

(a) Monitor Bristol-Myers' compliance with this Agreement, and have authority to require Bristol-Myers to take any steps he believes are necessary to comply with the terms of this Agreement; (b) Continue the review, reforms and other functions undertaken as the Independent Advisor; (c) Report to the Office, on at least a quarterly basis . . . as to Bristol-Myers' compliance with this Agreement and the implementation and effectiveness of the internal controls, financial reporting, disclosure processes and related compliance functions of the Company; (d) Monitor Bristol-Myers' compliance with applicable federal securities laws, and in his quarterly reports make recommendations necessary to ensure that the Company complies with applicable federal securities laws.

The monitor's power is also significantly bolstered by his authority to make recommendations that Bristol-Myers must adopt "unless Bristol-Myers objects to the recommendation and the Office agrees that adoption of the recommendation should not be required." A strong, independent monitor is in a far better position to ride herd over a mammoth corporation than any U.S. Attorney's Office or Probation

Office. Independent monitors are visible, on-site reminders that compliance with the terms of a deferred prosecution agreement is mandatory, not optional. Monitors are able to observe and understand the business they oversee, along with its personnel and processes, in ways that federal prosecutors never could or should. If the company views their monitor as a force for positive change and not as an unwanted burden, all sides benefit.

The central role of Judge Lacey in ensuring successful adherence to the spirit and letter of the deferred prosecution agreement by no means ends the role of the U.S. Attorney's Office in this matter. The agreement makes it clear that all participants—Bristol-Myers, the independent monitor, and the U.S. Attorney's Office—should treat the agreement as an opportunity to work together toward the common aim of making Bristol-Myers a model corporate citizen. The agreement provides for regular communication among the parties, requiring Bristol-Myers' CEO, non-executive chairman, and general counsel to meet quarterly with the U.S. Attorney's Office and the monitor. [¶ 13] The quarterly meetings are an opportunity to discuss the monitor's quarterly reports and any other issues and concerns that may arise, to keep the lines of communication open, and to remind all of the importance of compliance with the agreement and the serious consequences breach of the agreement would have for the company, its shareholders, and employees.

The regular quarterly meetings have already proven to be useful and interesting. Prior to each meeting, we are provided with a 400–500 page quarterly progress report by the independent monitor. The report provides updates on Bristol-Myers' business operations, new legal issues arising in any of its operating entities, compliance with the deferred prosecution agreement, and a forward-looking section on issues Bristol-Myers will confront in the next quarter. We also exchange draft agendas prior to meeting so that all topics of interest to both parties are addressed. The attendees at the meeting include the non-executive chairman, the chief executive officer, the general counsel, the U.S. Attorney, his counsel, and the Assistant U.S. Attorneys who prosecuted the matter. The independent monitor presides at the meeting. To further emphasize the post-deferred prosecution agreement sense of partnership between the parties, the site of the meeting is alternated between our offices and [those of] Bristol-Myers. . . .

In addition, to impress upon Bristol-Myers' top managers and finance personnel the seriousness of the company's situation, the deferred prosecution agreement also provides [in ¶ 22] for "a meeting . . . of its senior executives and any senior financial personnel, and any other Bristol-Myers employees who the Company desires to attend, such meeting to be attended by the United States Attorney and other representatives of the Office for the purpose of communicating the goals and expected effect of this Agreement." . . .

The deferred prosecution agreement recognized that Bristol-Myers had taken steps to change its budget process, to assure that appropriate consideration is given to input and analysis from the bottom to top, and not exclusively from top to bottom, and to adequately document that process. The agreement requires that Bristol-Myers management keep informed about its budget process and the perils of top-down budgeting, but does leave budgeting to Bristol-Myers management. [The DPA at ¶ 24] provides for high-level reporting on issues that will reflect whether the old culture of hitting the numbers at all costs still lingers. It provides as follows:

The CEO and CFO shall prepare and submit to the Non-Executive Chairman, Chief Compliance Officer and the Monitor described in paragraph 11 written reports on the following subjects: (a) all non-standard transactions with major U.S. wholesalers, such written report to be submitted within fifteen (15) days of such transaction; (b) an overview and analysis of Bristol-Myers' annual budget process for its major business units, including description of significant instances of any top-down changes to business unit submissions, such written report to be submitted together with the proposed budget submitted for approval to the Board of directors; (c) sales and earnings forecasts or projections at the corporate or major business unit level which indicate a quarterly target will not be met, together with a description of steps subsequently taken, if any, to achieve the budget target, such written report to be submitted quarterly and at least ten (10) business days prior to the Company's scheduled quarterly analyst call; (d) description of significant instances in which the preliminary quarterly closing of the books of any major business unit indicated that the business unit would not meet its budget target for any sales or earnings measure.

The agreement [¶ 18] also requires Bristol-Myers to develop and implement a "training and education program, which shall be reviewed and approved by the board of directors, designed to advance and underscore the Company's commitment to exemplary corporate citizenship, to best practices of effective corporate governance and the highest principles of integrity and professionalism, and to fostering a culture of openness, accountability and compliance throughout the Company." . . .

Many of the remedial measures in the deferred prosecution agreement—the top-level structural and governance changes, the reporting by senior management, and the training and education programs for key financial and legal personnel—are designed to spread knowledge and responsibility for doing the right thing throughout the Bristol-Myers organization.

[The following paragraph appeared as footnote 29 in the article, addressing ¶ 29 of the DPA.] Another step taken by Bristol-Myers to try to change the corporate culture was the endowment of a chair in business ethics at Seton Hall University School of Law. The professor occupying that endowed chair is required to conduct an annual ethics seminar for Bristol-Myers management and other interested industry members. The idea for endowing the chair originated with counsel for Bristol-Myers. The only requirement from our Office was that the chair was endowed at a New Jersey law school. Rutgers University School of Law already had a chair in business ethics endowed by Prudential. Bristol-Myers, after the signing of the deferred prosecution agreement, entered into discussions with the Dean of Seton Hall Law School and formally endowed the chair in December 2005.