Ethical Infrastructures and Evidence-Based Corporate Compliance and Ethics Programs: Policy Implications from the Empirical Evidence

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Introduction

The twenty-fifth anniversary of the promulgation of the Organizational Sentencing Guidelines (OSG) will occur in 2016. In 1991, the United States Sentencing Commission included the OSG in the Federal Sentencing Guidelines and immediately ushered in a new era for corporate compliance programs.[1] Because the OSG offers corporations an opportunity for a reduced sentence if they are convicted of a federal crime, the promulgation of the OSG led to the widespread adoption of compliance programs by corporations, and heavily influenced the structure of those programs.[2] Today, corporate compliance programs continue to gain importance in the regulation of corporate crime. The Sarbanes-Oxley Act of 2002,[3] the Department of Justice's prosecution memos and increased use of non-prosecution and deferred prosecutions agreements in the mid-2000s,[4] and the Dodd-Frank Act following the financial crisis,[5] are just a few examples of legal developments that have pushed corporations to re-evaluate their compliance programs.

Despite this growth, the proper place of compliance programs in controlling corporate crime remains controversial. Many legal commentators think the credit for compliance program

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[1] *See infra* notes 42 to 52 and accompanying text (discussing the 1991 OSG and its influence on corporate compliance programs).

[2] *Id*.

[3] *See* Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Just Might Work)*, 35 CONN. L. REV. 915, 597-98 (discussing the Sarbanes Oxley Act disclosure requirements for code of ethics for senior officers).

[4] *See infra* notes 61 to 73 and accompanying text (discussing DOJ enforcement practices, including the use of settlement agreements with corporations).

[5] The *Dodd-Frank Wall Street Reform and Consumer Protection Act* provided financial incentives for employees to report wrongdoing to the government, but this potentially interfered with compliance programs that encouraged employees to report wrongdoing internally. Jennifer M. Pacella, *Inside or Out? The Dodd-Frank's Whistleblower Program's Anti-Retaliation Protections for Internal Reporting*, 6 TEMP. L. REV. 721, 722-25 (2014); Matt A. Vega, *Beyond Incentives: Making Corporate Whistleblowing Moral in the New Era of Dodd- Frank Act "Bounty Hunting*, 45 CONN. L. REV. 483, 508 (2012).

goes too far. For example, some complain that the US Department of Justice (DOJ) gives corporations too much credit for their compliance programs when determining whether or not to bring criminal charges against the corporation.[6] Others argue that corporations are essentially being required to adopt compliance programs that are expensive but not effective.[7] A third contingent believes that the DOJ's consideration of compliance programs, including the corporation's cooperation with the government's investigation, creates perverse incentives that could actually increase the likelihood of corporate crime due to the scapegoating of employees.[8]

More recently, many legal commentators have taken the opposite view and argue that the DOJ is not giving corporations enough credit for their investments in their compliance programs. These commentators argue that an adequate compliance program should be a defense to a corporate crime charge.[9] In response to the critics that claim that corporations intentionally adopt ineffective compliance programs (so called "paper programs" or "cosmetic compliance"), they state that the "sheer size of the compliance industry" shows that corporations cannot be involved in a "bad faith attempt at intentional window dressing."[10]

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[6] *See* William S. Laufer & Alan Strudler, *Why Punish?: Corporate Crime and Making Amends*, 44 AM. CRIM. L. REV. 1307, 1316-17 (2007) (arguing that larger corporations are able to invest resources in compliance programs as a way to "buy their way out of liability.")

[7] Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 492-93 (2003).

[8] William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 54 VAND. L. REV. 1343, 1410-15 (1999). The ability to scapegoat employees creates a moral hazard problem where compliance programs (even if ineffective and created solely to appease external stakeholders) provide the corporation insurance against criminal prosecution. *Id.*

[9] *See, e.g.,* Mike Koehler, *Revisiting a Foreign Corrupt Practice Act Compliance Defense*, 2012 WISC. L. REV. 609; Ellen S. Podgor, *A New Corporate World Mandates a "Good Faith" Affirmative Defense,* 44 AM. CRIM. L. REV. 1537 (2007); Andrew Weissmann with David Newman, *Rethinking Criminal Corporate Liability*, 82 IND. L.J. 411, 414 (2007). For criticisms of a compliance defense, *see* Peter J. Henning, *Be Careful What You Wish For: Thoughts on a Compliance Defense Under the Foreign Corrupt Practices Act*, 73 OHIO ST. L.J. 88 (2012).

[10] Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 952 (2009).

At the heart of these debates is the question of whether compliance programs are effective?[11] And, if compliance programs can be effective, what makes a compliance program effective? Corporations want the government to set out clearly what actions (e.g., internal controls to implement, policies to adopt, employee trainings to conduct) they must take for the government to consider the corporation to have an effective compliance program. The government, however, states that there are "no formulaic requirements" for determining an effective compliance program.[12] This position is based on the belief that simply adopting the basic requirements of a compliance program will not be effective unless the corporation manages the organizational culture that influences employee behavior.[13]

The government has acknowledged the importance of a corporation's culture for creating an effective compliance program. In 2004, the United States Sentencing Commission amended the OSG to state that an effective "compliance and ethics program" requires a corporation to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[14] This language was added due to concerns that corporations were adopting "paper

[11] *See* Baer, *supra* note 10, at 949 (arguing that "It is an open question whether the corporate compliance industry . . . has achieved improvements in corporate culture commensurate with its costs.")

[12] CRIMINAL DIVISION OF THE U.S. DEPARTMENT OF JUSTICE AND THE ENFORCEMENT DIVISION OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, A RESOURCE GUIDE TO U.S. FOREIGN CORRUPT PRACTICE ACT 56 (2012), available at http://www.justice.gov/criminal/fraud/fcpa/guidance/guide.pdf.

[13] *Id*. at 57. *See also* David Hess, *A Business Ethics Perspective on Sarbanes Oxley and the Organizational Sentencing Guidelines*, 105 MICH. L. REV. 1781, 1795-96 (2007) (discussing how an employee whistleblowing hotline will not be effective unless the company manages employee attitudes towards the company's response to its use).

[14] U.S. SENTENCING COMM'N, U.S. SENTENCING GUIDELINES MANUAL §8B2.1 (2010).

programs." A "paper program" is a compliance program that exists on paper but is not supported by the corporate culture and therefore does not meaningfully influence employee behavior.[15]

Although there is much confusion on what is meant by a corporation's culture,[16] recently there has been a significant increase in attention to these issues. In 2015, the Wall Street Journal reported "Culture is the buzzword of the moment at banks—and a puzzle that regulators and Wall Street firms are wrestling to solve."[17] An independent investigation of Barclays after its interest rate manipulation scandal placed significant blame for that scandal (and the company's other legal problems) on the company's culture of wanting to win "at all costs," which made certain departments "hostile" to the compliance department.[18] JP Morgan Chase issued a report in which the company acknowledged its mistakes that resulted in legal problems, and outlined how it planned to strengthen its corporate culture.[19] The US Department of Treasury Financial Crimes

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[15] Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095, 1105-1106 (2006).

[16] *See* Christie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?*, 34 J. CORP. L. 679, 716-17 (2009) (noting the differences among corporate monitors on their beliefs on what makes up the company's culture or if it can even be defined).

[17] Emily Glazer & Christina Rexrode, *As Regulators Focus on Culture, Wall Street Struggles to Define It,* WALL ST J, Feb. 2, 2015, at A1.

[18] SALZ REVIEW: AN INDEPENDENT REVIEW OF BARCLAYS' BUSINESS PRACTICE 82, 88 (2013), available online at: http://www.euromoney.com/downloads/2013/Barclays-Salz-review.pdf. The Salz Report found that Barclays was a company without a common set of values. *Id*. at 81. Instead, each subunit developed their own values, which were typically based on what was important to that unit's leader. *Id*. at 81-82. The values focused on "winning and commercial drive" taken to the extreme of winning "at all costs." *Id*. at 82. In the Retail and Business Banking division, the Salz Report noted a "material shift from client focus to one that valued scale and financial performance." *Id*. at 88. Employees felt powerless to question any new financial targets due to a "culture of fear." *Id*. In addition, employees believed that "senior management did not want to hear bad news and that employees should be capable of solving problems." *Id*. at 8. Citing an internal employee survey, the Salz Report notes that "A significant proportion of employees in the investment bank . . . said that they were 'reluctant to report problems to management,' and that they did not feel able to 'report unethical behaviour without fear of reprisal.'" *Id*. at 157-58. This prevented management and the board from having the information they needed to react to developing problems at the bank.

[19] JP MORGAN CHASE & CO., HOW WE DO BUSINESS – THE REPORT 5 (2014) available online at: http://files.shareholder.com/downloads/ONE/4090721795x0x799950/14aa6d4f-f90d-4a23-96a6-53e5cc199f43/How_We_Do_Business.pdf

Enforcement Network (FinCEN) issued an advisory stating that recent anti-money laundering enforcement actions demonstrated that "the culture of an organization is critical to its compliance."[20] In the United Kingdom, the Financial Reporting Council (FRC) stated that one of the five areas its governance team will focus on in 2015 is company culture and "how best to assess culture and practices and embed good corporate behaviour throughout companies."[21] The chairman of the FRC wrote an opinion article titled "Why it's time boards faced up to the corporate culture challenge."[22]

Despite this increased attention to corporate culture and creating a "culture of compliance" within corporations, compliance programs and culture are often treated separately rather than as two sides of the same coin. Corporations focus on the technical aspects of a compliance program and then separately address the "soft" issues of corporate culture. This view has been fostered by discussions within the academic literature that corporations can implement their compliance program through either a "command-and-control" approach focused on surveillance and sanction,

[20] US DEPARTMENT OF TREASURY FINANCIAL CRIMES ENFORCEMENT NETWORK (FINCEN, ADVISORY: ADVISORY TO U.S. FINANCIAL INSTITUTIONS ON PROMOTING A CULTURE OF COMPLIANCE, FIN-2014-A007, Aug. 11, 2014, available online at: http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2014-A007.pdf

[21] FINANCIAL REPORTING COUNCIL, DEVELOPMENTS IN CORPORATE GOVERNANCE AND STEWARDSHIP IN 2014 23 (2015), available one at: https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-and-Stewardsh.pdf

[22] Sir Winfried Bischoff, *Why it's time boards faced up to the corporate culture challenge,* CITY AM, Jan. 12, 2015, available online at: http://www.cityam.com/206870/why-it-s-time-boards-faced-corporate-culture-challenge. Bischoff asked the question of "Where does the responsibility lie for ensuring ethical corporate behaviour, and who is accountable when culture is found to be at fault?" He answered that question by pointing to the FRC's UK Corporate Governance Code (which was revised in 2014) which places those responsibilities with the board of directors. *Id*. The Corporate Governance Code states, "One of the key roles for the board includes establishing the culture, values and ethics of the company." FINANCIAL REPORTING COUNCIL, UK CORPORATE GOVERNANCE CODE 2 (2014), available online at: https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf

or an "integrity" approach focused on values.[23] Lost in this "either/or" approach is the recognition that compliance programs and corporate culture cannot be separated; each impacts the other. A strong compliance program may be necessary to make up for a weak ethical culture,[24] and over time may help create a strong ethical culture.[25] A weak compliance program can push a corporation towards a weak ethical culture.[26]

This Article explains why there is this gap in our understanding of how compliance programs and corporate culture are related, and the harms this lack of understanding can cause in practice. Bringing together the latest research in behavioral and organizational ethics, this Article presents a model of an organization's ethical infrastructure. This model integrates, rather than separates, the ideas of compliance and an ethical corporate culture. It shows how a corporation must align it compliance program and corporate culture to create an ethical infrastructure that has legitimacy in the eyes of employees. Without legitimacy, the program will be ineffective, and potentially create more unethical behavior than before the program was rolled-out. A so-called "paper program" is not necessarily a "bad faith attempt at intentional window dressing,"[27] but may be a program that is misaligned with the company's culture and has lost legitimacy. This model shows that a corporation—even one acting in good faith—that adopts the technical aspects of a

[23] *See infra* note 138 to 147 and accompanying text (describing Paine's two approaches to implementing a compliance program).

[24] Kristin Smith-Crowe et al., *The Ethics "Fix": When Formal Systems Make a Difference*, J. BUS. ETHICS (forthcoming), at *2.

[25] Muel Kaptein, *Ethics Programs and Ethical Culture: Next Steps in Unraveling their Multi-Faceted Relationship*, 89 J. BUS. ETHICS 261, 277 (2009).

[26] *See infra* notes 225 to 248 and accompanying text (presenting academic research finding that a weakly implemented compliance program can cause the program to lose legitimacy with employees, and ultimately lead to an increase in wrongdoing).

[27] Baer, *supra* note 10, at 952.

compliance program but does not attend to the organization's informal systems and ethical climate will not be successful in encouraging ethical behavior.

The ethical infrastructure model can be incorporated into the OSG with two short amendments that have the potential to catalyze significant positive change. The changes will help provide clarity and legitimacy to the issue of corporate culture for compliance officers, boards of directors, executives, prosecutors, and others. Although the literature on behavioral ethics is too voluminous to discuss here,[28] this Article uses current research directly related to the ethical infrastructure model to inform those groups and push forward an understanding of corporate compliance and corporate culture as an interrelated evolving journey, rather than a final end state.

This Article proceeds by discussing the evolution of compliance and ethics programs under United States law in Part I. This includes a discussion of the criticisms of the OSG, and the Sentencing Commission's response to those criticisms. In Part II, the Article shows that although corporations have enacted changes in response to the OSG's amendments, significant hurdles still stand in the way for corporations to integrate their compliance programs with their corporate culture. Part III presents the ethical infrastructure model and the empirical support for this model from the latest research in behavioral and organizational ethics. This includes a discussion of the factors that influence when a compliance program can increase intrinsic, moral motivation for employees to comply with the law and company rules, rather than simply provide extrinsic motivation. This part also discusses the harmful effects of a weakly implemented compliance program. Finally, Part IV proposes two amendments to the OSG to provide a foundation for

[28] For overviews of different aspects of this literature, *see, e.g.*, Robert Prentice, *Behavioral Ethics: Can it Help Lawyers (and Others) to be Their Best Selves?*, 29 ND J. L. ETHICS & PUB POL'Y 35 (2015); Max H. Bazerman and Francesca Gino, *Behavioral Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty*, 8 ANN. REV. L. & SOC. SCI. 85 (2012).

incorporating the ethical infrastructure model into current conceptions of compliance and ethics programs.

I. The Evolution of Compliance and Ethics Programs under United States Law

The use of corporate compliance programs to manage legal risks developed under various areas of the law until the OSG provided a more centralized focus in 1991. Prior to 1991, compliance programs developed to manage legal risks in specific areas, such as antitrust law, bribery of foreign officials, insider trading, and fraud in the defense contracting industry.[29] As described below, in the almost twenty-five years since the OSG, compliance programs have continued to evolve and take on greater importance in the law.

A. The Emergence of Compliance Programs under US Law

Spurred by anti-trust litigation in the early 1960s, Corporations adopted compliance programs to help protect against legal violations.[30] Although the compliance programs would not provide a legal defense against liability, high-profile enforcement actions encouraged corporations to adopt the programs to manage their legal risks.[31] These programs spread quickly, and were credited with

[29] *See* John D. Copeland, *The Tyson Story: Building an Effective Ethics and Compliance Program*, 5 DRAKE J. AGRIC. L. 305, 313-18 (2000); Ford & Hess, *supra* note 16, at 689-90 Joan T. A. Gabel et al., *Letter vs. Spirit: The Evolution of Compliance into Ethics*, 46 AM. BUS. L.J. 453, 457-462 (2009); Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1578-96 (1990).

[30] Pitt & Groskaufmanis, *supra* note 29, at 1578-82.

[31] *Id*. at 1580.

preventing many antitrust violations by increasing employees' understanding of antitrust law enforcement.[32]

Another early catalyst for compliance programs was the Foreign Corrupt Practice Act of 1977 (FCPA).[33] In addition to criminalizing the use of corrupt payments to foreign officials to obtain business, the FCPA also requires corporations to maintain accurate accounting records and to adopt appropriate internal controls to ensure that the corporation is not making corrupt payments.[34] These internal control provisions led to many corporations adopting codes of conduct and other aspects of modern-day compliance programs.[35]

The next major development occurred in the mid-1980s when President Reagan appointed a commission to investigate allegations of fraud in the defense industry.[36] The commission's report included the recommendation that the defense contractors should seek to self-regulate through the adoption of codes of conduct, internal controls, and other compliance program mechanisms.[37] In addition, to encourage better self-regulation, the Department of Defense stated that it would consider the quality of a contractor's compliance program, including self-disclosure of wrongdoing, as a mitigating factor in any debarment decision that followed a criminal conviction.[38]

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[32] *Id*. at 1581.

[33] *Id*. at 1582 (1990). Prior to the FCPA, litigation in antitrust law in 1960s spurred the spread of compliance programs focused on antitrust matters. *Id*. at 1578-82.

[34] *Id*. at 1585.

[35] *Id*. at 1585.

[36] Copeland, *supra* note 29, at 315-16. As part of its investigation, the commission conducted a survey to better understand the general public's opinion of the defense industry. The survey showed that fifty percent of Americans believed that that the government lost half of its defense budget to fraud and waste. *Id*.

[37] Ford & Hess, *supra* note 16, at 689-90; Pitt & Groskaufmanis, *supra* note 29, at 1594-95.

[38] Ford & Hess, *supra* note 16, at 690; Pitt & Groskaufmanis, *supra* note 29, at 1595.

Also in the 1980s, after several insider trading scandals involving major Wall Street investment banks, Congress passed the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA).[39] The Act required broker-dealers to adopt policies and procedures to prevent the use on nonpublic information, and to enforce and regularly update those policies and procedures.[40] The Act also sought to incentivize banks to adopt more rigorous compliance programs by increasing the potential penalties for the bank under control person liability.[41]

B. The Organizational Sentencing Guidelines of 1991

The greatest incentive for corporations to adopt compliance programs came in 1991 when the US Sentencing Commission amended the Federal Sentencing Guidelines to include what are commonly known as the Organizational Sentencing Guidelines (OSG) or the Federal Sentencing Guidelines for Organizations (FSGO).[42] The intent of the inclusion of the OSG in the Federal Sentencing Guidelines was to reduce the discretion of individual judges and have an administrative

[39] Pitt & Groskaufmanis, *supra* note 29, at 1589-90.

[40] *Id*. at 1591.

[41] Marc. I. Steinberg & John Fletcher, *Compliance Programs for Insider Trading*, 47 SMU L. REV. 1783, 1788-89 (1994).

[42] The Sentencing Reform Act of 1984 created the United States Sentencing Commission and gave it authority to develop and promulgate guidelines for federal district court judges to use to determine sentences for those convicted of federal crimes. 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, 205-207 (1993). In 1987, the Commission promulgated guidelines for the sentencing of individual offenders, and then turned its attention to the sentencing of organizations. Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 IOWA L. REV. 697, 699-701 (2002).

body create a uniform sentencing policy.[43] The OSG, however, has gone beyond that and has had a far-reaching impact on organizations.[44]

The OSG adopted what may be termed a "carrots and sticks" approach.[45] The OSG created a carrot by giving a convicted organization a significantly reduced fine if the organization had adopted an effective compliance program.[46] If the organization had not adopted a compliance program, however, it would not receive a mitigated sentence and would be placed on probation.[47]

Not surprisingly, the promulgation of the OSG was followed by a significant increase in the adoption of compliance programs.[48] The OSG also directly influenced the structure and content of compliance programs by stating what was required for a court to consider the organization to have an effective compliance program. The OSG listed seven basic requirements (the "seven steps") that were purposefully not overly detailed to provide corporations with some flexibility.[49] Briefly, those seven requirements were:[50]

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[43] Nagel & Swenson, *supra* note 42, at 207.

[44] Murphy, *supra* note 42, at 698-99.

[45] Nagel & Swenson, *supra* note 42, at 228.

[46] *Id*. at 237; *see also* Dove Izraeli & Mark Schwartz, *What Can We Learn From the U.S. Federal Sentencing Guidelines for Organizational Ethics?*, 17 J. BUS. ETHICS 1045, 1047 (1998) (LISTING VARIOUS SURVEYS SHOWING THE LARGE PERCENTAGE OF CORPORATIONS THAT EITHER ADOPTED A COMPLIANCE PROGRAM OR SIGNIFICANTLY IMPROVED THEIR COMPLIANCE PROGRAM UPON AWARENESS OF THE 1991 OSG).

[47] Nagel & Swenson, *supra* note 42, at 237. The OSG also rewarded organizations for post-offense activity, such as disclosing the offense to the government and cooperating in the government's investigation. *Id*.

[48] *See* Gary R. Weaver et al., *Corporate Ethics Practices in the Mid-1990's: An Empirical Study of the Fortune 1000*, 18 J. BUS. ETHICS 283, 286 & 289 (1999) (NOTING PERIODS OF SIGNIFICANT INCREASES IN THE ADOPTION OF CODES OF ETHICS AND ETHICS OFFICES, FOR EXAMPLE, IN YEARS FOLLOWING THE OSG).

[49] Matthew J. Merrick, *Sentencing Commission Takes on Corporate Crime*, 8 FED. SENT. R. 238, 238 (1996).

[50] Murphy, *supra* note 42, at 703-704; Molly E. Joseph, *Organizational Sentencing*, 35 AM. CRIM. L. REV. 1017, 1027-31 (1998).

1. The corporation must establish standards and procedures designed to reduce the risk of criminal conduct.
2. The compliance program must be overseen by high-level personnel.
3. The corporation should not grant substantial discretionary authority to any individual that has a propensity to engage in criminal conduct.
4. The organization's standards and procedures must be communicated to all employees.
5. The corporation must enforce its program, and may ensure compliance with its standards and procedures through monitoring and auditing systems, and means for employees to report wrongdoing without risk of retribution.
6. The organization must consistently enforce its standards.
7. Any violation of the program should be followed with appropriate disciplinary action and updating of the program as necessary.

The Sentencing Commission did not intend for those seven steps to be the final say on compliance programs.[51] Instead, the Sentencing Reform Act expected to Commission to monitor its guidelines for areas of improvement and to amend the guidelines as necessary.[52] As discussed below, the Commission has amended the OSG twice,[53] and this Article argues that the Commission should do so again based on the relevant empirical research.[54]

[51] Nagel & Swenson, *supra* note 42, at 251-52.
[52] Id.
[53] *See infra* notes **Error! Bookmark not defined.** to 119 and accompanying text.
[54] *See infra* Part IV.

C. *Caremark* and the DOJ Prosecution Practices

In the late 1990s, the Delaware courts and the Department of Justice (DOJ) took actions that further increased the importance of the OSG and its seven steps for an effective compliance program. In 1996, in the case of *In re Caremark International Inc. Derivative Litigation*, the Delaware Chancery Court stated that the board of directors has an obligation to ensure that the corporation has systems in place to monitor its compliance with the law.[55] Furthermore, the board should strive to take advantage of the mitigated sentence for an effective compliance program offered by the OSG.[56] These statements, though dicta,[57] established the idea that there is an "affirmative duty on a board to create some kind of compliance mechanism."[58] Although a director's actual potential for liability under *Caremark* may be very low,[59] the ruling helped keep corporate compliance programs on corporate boards' agendas.[60]

In 1999, Deputy Attorney General Eric Holder issued a memorandum outlining a policy for federal prosecutors to follow when making charging decisions against corporations.[61] The factors for prosecutors to consider included the nature and seriousness of the offense, the

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[55] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

[56] *Id*.

[57] Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967, 973 (2009).

[58] Charles M. Elson & Christopher J. Gyves, *In re Caremark: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 691 (2004).

[59] Paul E. McGreal, *Corporate Compliance Survey*, 69 BUS. LAW. 107, 120 (2013-14) (stating that "a board *Caremark* duty is relatively low"). In the *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362 (Del. 2006), the Delaware Supreme Court approved the *Caremark* claim and indicated that a director would have liability if they failed to establish any form of compliance program or knowingly failed to correct a specific program with an existing compliance program. *Id*. at 120-22.

[60] Elson & Gyves, *supra* note 58, at 692; Baer, *supra* note 10, at 967.

[61] Julie R. O'Sullivan, *How Prosecutors Apply the "Federal Prosecutions of Corporation" Charging Policy in the Era of Deferred Prosecutions, and What that Means for the Purposes of Federal Criminal Sanction*, 51 AM. CRIM. L. REV. 29, 37 (2014).

pervasiveness of wrongdoing within the corporation, the corporation's history of similar conduct, and the corporation's voluntary disclosure of the wrongdoing.[62] In addition, the memo required prosecutors to consider the "existence and adequacy of the corporation's compliance program."[63] The memo encouraged prosecutors to "determine whether a corporation's compliance program is merely a 'paper program' or whether it was designed and implemented in an effective manner."[64] The memo specifically directed prosecutors to the OSG for a review of compliance program factors to consider.[65] In addition, the memo encouraged prosecutors to look at the pervasiveness of misconduct in the organization and its past history of misconduct as evidence that management created a "corporate culture that encouraged, or at least condoned, such conduct, regardless of any compliance programs."[66] The charging memo went through various iterations under subsequent Deputy Attorneys General until it was published in the United States Attorney's Manual.[67] However, guidance on compliance programs and the discussion of corporate culture has not changed.[68] Overall, due to the DOJ's charging policy, corporations would not just receive a reduced sentence for having an effective compliance in program in place, but could avoid prosecution altogether.

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[62] MEMORANDUM FROM ERIC H. HOLDER, JR., DEPUTY ATTORNEY GEN., U.S. DEP'T OF JUSTICE, TO ALL COMPONENT HEADS & U.S. ATTORNEYS 3 (June 16, 1999), available at http://www.justice.gov/criminal/fraud/fcpa/docs/response2-appx-k.pdf.

[63] *Id*.

[64] *Id*. at 8.

[65] *Id*. at 8 and 13 n.5.

[66] *Id*. at 5.

[67] U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL § 9-28.000 (2008), *available at* http://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations.

[68] O'Sullivan, *supra* note 61, at 36-43. The main changes to the charging policy related to limiting prosecutors' requests for attorney-client privilege waivers and prosecutors considering the corporation's payment of an employee's attorney fees as lack of cooperation. *Id.*

The ability to avoid prosecution became a more attainable option when the DOJ increased their use of settlement agreements with corporations.[69] These agreements, known as either deferred prosecution agreements (DPAs) or non-prosecution agreements (NPAs), allow corporations to avoid prosecution in exchange for an agreement to admit the wrongdoing, pay a specified fine, and adopt various reform measures, such as an improved compliance program designed to prevent recurrence of the offense.[70]

These settlement agreements are controversial. Some critics believe that these settlement agreements cause corporations to admit to wrongdoing even when prosecutors have weak cases.[71] Others view them as too lenient, and believe that corporations should be prosecuted.[72] Either belief, however, encourages corporations to attempt to adopt at least the appearance of an effective compliance program. If a corporation is pressured into a settlement agreement (even if unfairly, as some critics claim), an effective compliance program may allow it to receive more favorable terms, such as not being required to hire an independent monitor. If, as other critics claim, the settlement agreements are too readily agreed to by prosecutors, then a corporation will want to be able to

[69] These DOJ began to use these settlement agreements in the mid-1990s, and increased their use in the early 2000s. For an early history of deferred prosecution agreements, *see* F. Joseph Warin & Jason C. Schwartz, *Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants*, 23 J. CORP. L. 121, 123-32 (1997).

[70] For an overview of deferred prosecution and non-prosecution agreements, including their history and range of settlement terms, see Wulf A. Kaal & Timothy A. Lacine, *The Effect of Deferred and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993–2013*, 70 BUS. LAWYER 61 (2014); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-110, DOJ HAS TAKEN STEPS TO BETTER TRACK ITS USE OF DEFERRED AND NON-PROSECUTION AGREEMENTS, BUT SHOULD EVALUATE EFFECTIVENESS (2009), *available at* http://www.gao.gov/new.items/d10110.pdf.

[71] Cindy R. Alexander & Mark A. Cohen, *The Evolution of Corporate Criminal Settlements: An Empirical Perspective on Non-Prosecution, Deferred Prosecution, and Plea Agreements*, 52 AM. CRIM. L. REV. 537, 539-40 (2015).

[72] *Id.* at 538-39.

point to its compliance program to help it take advantage of this option to avoid prosecution under the DOJ's charging policy.

In addition to encouraging the adoption of compliance programs, settlement agreements also influence the structure of those programs. Because the settlement agreements are available to the public, the terms of each settlement agreement provides new information to corporations on what the DOJ views as an effective program.[73] Overall, boards' fiduciary duties and the DOJ's enforcement practices have made compliance programs a central element of corporate governance, and an element that must be continually monitored and updated.

D. Criticisms of the OSG and Enforcement Practices

During the time of the increased use of settlement agreements, commentators criticized the DOJ's, and other government agencies', consideration of corporations' compliance programs in their enforcement decisions. Some of this criticism was fueled by the corporate scandals of Enron, WorldCom, Tyco, and others, that occurred after the OSG. Rather than respond to these scandals with an even increased emphasis on compliance programs, these critics wanted to challenge "the belief that pouring more resources into internal compliance structures will cure what ails corporate America."[74]

[73] *See* White & Case, LLP, *New Guidance for Compliance Programs in Recent Deferred Prosecution Agreement*, July, 2011, at 1, available at http://www.jdsupra.com/legalnews/new-guidance-for-compliance-programs-in-79151 (stating that "Settlement agreements, non-prosecution agreements and deferred prosecution agreements have been primary sources of guidance from the US Department of Justice ("DOJ") on the components of an effective corporate compliance program.").

[74] Krawiec, *supra* note 7, at 489. More colorfully, Bowman argues:

Professor Krawiec, for example, voiced concerns that the reliance on compliance programs in enforcement decisions leads to an under-deterrence of corporate misconduct because corporations can easily mimic having an effective compliance program—and thus receive the benefits offered by prosecutors—without actually reducing its level of misconduct (because the adopted compliance program is in fact ineffective).[75] Krawiec also argued that compliance programs lead to a waste of corporate resources because all corporations are adopting compliance programs that meet the OSG's requirements even if (1) there is no evidence the programs work; and (2) the corporation is committed to preventing misconduct but does so through other means.[76]

Krawiec's arguments were based on her claim that there is no evidence that compliance programs are effective.[77] At the time of her writing, however, there was limited empirical evidence on the effectiveness of compliance programs. First, Krawiec pointed to the lack of evidence that adopting a code of ethics reduced misconduct.[78] This criticism is somewhat misleading, however, as the OSG has never simply required the adoption of a code of ethics, and instead, requires the presence of the other features of an effective compliance program. Second, Krawiec reviewed the research on OSG compliance programs, but she was only able to identify three studies on

> [T]he portion of the organizational sentencing guidelines devoted to compliance programs seems awfully like a legal Potemkin village. It looks great as the Tsarina sails by on her barge. It has made a bundle of money for the compliance officers and outside consultants who have been busily constructing the facade. But there is precious little evidence that all this scurrying about on the riverbank has moved either the barons or the serfs of corporate life to commit less crime.

Frank O. Bowman III, Drifting Down the Dnieper with Prince Potemkin: Some Skeptical Reflections About the Place of Compliance Programs in Federal Criminal Sentencing, 39 WAKE FOREST L. REV. 671, 674-75 (2004) (citations omitted).

[75] Krawiec, *supra* note 7, at 491-92.

[76] *Id*. at 492-93.

[77] *Id*. at 510.

[78] *Id*. at 511-12.

compliance programs and those studies did not find support for the hypothesis that compliance programs reduce corporate misconduct.[79]

Professor Laufer also focused on the idea that corporations could mimic an effective compliance due to prosecutors' inability to distinguish "paper programs" from compliance programs that were implemented in good faith.[80] Laufer pointed out that the inability of regulators to identify truly effective compliance programs "is made far much worse by the fact that corporations are all too aware of this fact."[81] This problem allows corporations to receive favorable treatment from prosecutors by hiding behind their compliance programs and placing blame on the employees that committed the acts.[82] Thus, corporations have no incentive to try to actually improve their compliance programs.[83] Instead, corporations have an incentive to treat compliance programs as insurance; the corporation purchases compliance program structures sufficient to insure that "employee infidelity will be viewed as an individual, rather than a corporate act."[84] Corporations will "purchase" the minimum level of compliance necessary to shift blame of misconduct onto its employees.[85] Not only does this encourage the adoption of "paper programs"—that is, compliance programs that exist primarily on paper and not in practice—but it

[79] *Id*. at 512-14.

[80] William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1343, 1390-91 (1999).

[81] *Id*. at 1418.

[82] *Id*. at 1371-72.

[83] *Id*.

[84] *Id*. at 1402-3.

[85] *Id*. at 1403.

may actually increase misconduct, as the corporation now has insurance against that risk of loss due to liability for the misconduct.[86]

E. The 2004 and 2010 Amendments to the OSG

The Sentencing Commission made significant amendments to the OSG in 2004.[87] The hearings that led these changes were motivated by the corporate scandals of Enron, Worldcom, Tyco, and others. These scandals strongly suggested that the existing approach to self-regulation through compliance programs was not working and changes needed to be made.

At the hearing for the 2004 amendments, some experts pushed the Commission to go farther than it did in 1991 by including consideration of ethics. One such proponent was Dov Seidman, the CEO of Legal Research Network (LRN), a compliance and ethics consulting company. Seidman expressed the need for the OSG to encourage corporations to create a culture that

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[86] *Id*. at 1405-6. This is the moral hazard problem that potentially arises with any purchase of insurance. *Id*. Laufer describes managerial support for misconduct as "winking." *Id*. at 1410-15. That is, management professes a commitment to ethics, but "winks" at misconduct by knowingly tolerating it and/or implicitly rewarding employees that engage in such behavior. *Id*. In summary, Laufer describes the process as follows:

> The purchase of compliance sufficient to shift the risk of liability and loss, in certain firms, has the effect of decreasing levels of care. Decreased levels of care with a top management that winks fosters an environment of tacit acceptance of illegalities. This acceptance, coupled with the constant pressure on middle management to produce results, has led to increased deviance throughout the corporate hierarchy. The purchase of compliance for purposes of liability shifting and cost internalization results in a redefinition of this deviance. Acts that were once held to be those of the firm, now remain those of individual employees.
>
> *Id*. at 1415 (footnotes omitted).

[87] U.S. Sentencing Commission, *Report of the Ad Hoc Advisory Group on the Organizational Sentencing Guidelines* 35-38 & 47-48 (Oct. 7, 2003) [hereinafter Advisory Group Report], available at http://www.ussc.gov/sites/default/files/pdf/training/organizational-guidelines/advgrprpt/AG_FINAL.pdf. The decision to empanel an Advisory Group to review the OSG was made prior to the major scandals. *Id*. at 35.

encourages commitment not just to the law, but also to ethics.[88] He described the difference as instilling in employees "a commitment to doing the right thing, not simply the required thing."[89] Without the inclusion of ethics, Seidman argued, the OSG "runs the risk of its guidelines fostering the same types of corporate cultures that allowed individuals to seek out "loopholes" in the law that led to many of the recent corporate crises."[90]

In response to such criticisms, the Sentencing Commission amended the OSG to specifically refer to "compliance and *ethics* programs" (emphasis added).[91] In addition to including the term "ethics," the OSG was amended to state that an effective compliance and ethics program requires that the organization shall "(1) exercise due diligence to prevent and detect criminal conduct; and (2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[92] Subsection (1) is essentially the same as the 1991 OSG, where due diligence was described as the seven steps for an effective compliance program. Subsection (2), does two things. First, it requires the consideration of an organization's culture and not just the technical implementation of the compliance program. Second, it follows Siedman's advice, and it requires that the culture not just promote "compliance with the law," but also "ethical conduct."

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[88] *Public Hearing Before the U.S. Sentencing Comm'n* 1 (Mar. 17, 2004) [hereinafter 2004 Hearing] (testimony of Dov L. Seidman, Chief Executive Officer, Legal Research Network), available at http://www.ussc.gov/sites/default/files/pdf/amendment-process/public-hearings-and-meetings/20040317-19/Seidman-LRN.pdf.

[89] *Id*. at 2.

[90] *Id*. at 5.

[91] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a) (2010).

[92] *Id.*

Unfortunately, the 2004 OSG did not define "organizational culture." The Advisory Group Report, however, provides some additional information on the Committee's thought process. The report stated that:

> In general, organizational culture, in this context, has come to be defined as the shared set of norms and beliefs that guide individual and organizational behavior. These norms and beliefs are shaped by the leadership of the organization, are often expressed as shared values or guiding principles, and are reinforced by various systems and procedures throughout the organization.[93]

However, the Advisory Group Report went on to state that:

> It is important to note, however, that this recommendation will not impose upon organizations anything more than the law requires . . . . It is also intended to avoid requiring prosecutors to litigate and judges to determine whether an organization has a good "set of values" or appropriate "ethical standards," subjects which are very difficult, if not impossible, to evaluate in an objective, consistent manner.[94]

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[93] Advisory Group Report, *supra* note **Error! Bookmark not defined.**, at 52.

[94] *Id*. at 53. Later, the Report states:

> An organizational culture that encourages a commitment to compliance with the law includes positive actions which demonstrate that law compliance is a key value within the organization. Such a culture is demonstrated by organizational actions which encourage employees to choose lawful behaviors and to expect that their conduct will be evaluated by others within the organization in terms of how well the employees have pursued lawful conduct.

Id. at 55.

In the end, the OSG simply refers to the seven requirements for an effective compliance and ethics program as also promoting "an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[95]

The Commission also made significant changes to those seven requirements for an effective compliance and ethics program.[96] One of the most important changes was to specify the roles of organizational leadership.[97] First, the "governing authority" (for a corporation, that would be the board of directors) must be "knowledgeable" about the program and should "exercise reasonable oversight with respect to the implementation and effectiveness" of the program.[98] Second, a specific individual (or individuals) within "high-level personnel" (e.g., an executive or head of a major business function[99]) "shall be assigned overall responsibility for the program."[100] Finally, a specific person should be given day-to-day operational responsibility for the program.[101] For a

[95] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b).

[96] For a review of the changes, *see* Paul Fiorelli & Ann Marie Tracey, *Why Comply? Organizational Guidelines Offer a Safer Harbor in the Storm*, 32 J. CORP. L. 467, 482-89 (2007); David Hess et al., *The 2004 Amendments to the Federal Sentencing Guidelines and Their Implicit Call for a Symbiotic Integration of Business Ethics*, 11 FORDHAM J. CORP. & FIN. L. 725, 740-46 (2006); Julie R. O'Sullivan, *Some Thoughts on Proposed Revisions to the Organizational Guidelines*, 1 OHIO ST. J. CRIM. L. 487, 504-14 (2004).

[97] Hess et al., *supra* note 96, at 741.

[98] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(A) (2010).

[99] The commentary defines "high-level personnel" as:

> individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest.

U.S. SENTENCING GUIDELINES MANUAL § 8B1.2, commentary note 3.

[100] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(B) (2010).

[101] *Id*. at § 8B2.1(b)(2)(C).

large organization, this would be the Chief Ethics and Compliance Officer (CECO).[102] The OSG also requires that this individual report on the program's effectiveness to "high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority."[103] The organization should grant this individual with "adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup."[104]

A second important change related to an organization's responsibility to promote and enforce its program. As with the 1991 OSG, the organization should enforce the program through "appropriate disciplinary measures" for those engaging in criminal conduct, as well as those that "fail[]to take reasonable steps to prevent or detect criminal conduct."[105] Under the 2004 OSG, however, the organization should not just focus on sanctioning those engaging in misconduct, but also provide incentives for employees to follow the program.[106]

A third important change was the general requirement that the organization periodically assess the risk of criminal conduct and modify the program as needed.[107] Under the 1991 OSG, the organization was only required to modify its program in response to a failure. The change makes explicit what the Commission thought was implied in the 1991 OSG.[108] In addition, the provision was intended to avoid the problem of a "paper program"; by requiring the organization to evaluate

[102] Hess et al., *supra* note 96, at 742.

[103] U.S. SENTENCING GUIDELINES MANUAL §8B2.1(b)(2)(C).

[104] *Id.*

[105] *Id.* at §8B2.1(b)(6).

[106] *Id.* The Advisory group report referred to these as "positive incentives." Advisory Group Report, *supra* note **Error! Bookmark not defined.**, at 86.

[107] U.S. SENTENCING GUIDELINES MANUAL §8B2.1(c) (2010).

[108] O'Sullivan, *supra* note 96, at 504.

the program's effectiveness, the organization would not be able to let the program "gather dust in desk drawers."[109]

The Commission believed that the changes would "lead to a new era in corporate compliance."[110] Under the 2004 OSG, the minimum seven steps for an effective compliance and ethics program, and "the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law" are as follows:[111]

(1) "The organization shall establish standards and procedures to prevent and detect criminal conduct."

(2) The governing authority should have knowledge of the program and "exercise reasonable oversight with respect to the implementation and effectiveness . . . ." Overall responsibility for the program should be assigned to "high-level personnel" and the person will day-to-day responsibility for the program should "be given adequate resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority."

(3) No person should be placed "within the substantial authority personnel of the organization" if they have engaged in illegal activities or other conduct inconsistent with the program.

(4) Conduct effective training programs for individuals at all levels of the organization, including agents.

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[109] *Id*. at 506.

[110] News Release, *U.S. Sentencing Comm'n, Commission Tightens Requirements for Corporate Compliance and Ethics Programs* 1 (May 3, 2004), available at http://www.ussc.gov/news/press-releases-and-news-advisories/may-3-2004.

[111] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b).

(5) The organization should ensure employees are following the program by "monitoring and auditing to detect criminal conduct," test the effectiveness of the program, and ensure that employees are aware of mechanisms to "report or seek guidance regarding potential or actual criminal conduct without fear of retaliation."

(6) The company should use incentives to ensure compliance with the program, and use "appropriate disciplinary measures" for "engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct."

(7) In response to any criminal conduct that is detected, the company should modify the program as necessary to prevent similar conduct in the future.

The Sentencing Commission again amended the OSG in 2010. Those changes, however, did not directly change the seven requirements for an effective compliance and ethics program. Indirectly, the amendments elevated the importance of having a Chief Ethics and Compliance Officer (or similar role).[112] Prior to the amendments, the organization would be denied favorable treatment for having an effective compliance and ethics program in place at the time of the wrongdoing if high level personnel (or a person with "substantial authority") "participated in, condoned, or was willfully ignorant of the offense."[113] Under the amendments, the organization would not be denied the favorable treatment if it can show all of the following:

[112] The 2010 Amendments made two significant changes. The first change is discussed in the text of this Article. The second made changes to the commentary with respect to how an organization should respond to wronging. Paul E. McGreal, *Corporate Compliance Survey*, 66 Bus. Lawyer 125, 125-26 (2010). Under the amendments, the organization should not just modify its compliance program, but should also consider other responses, such as providing restitution to the victims and self-reporting the wrongdoing to authorities. *Id*. at 126. This article will not further discuss these amendments.

[113] *Id*. at 127.

1. "[T]he individual or individuals with operational responsibility for the compliance and ethics program have direct reporting obligations to the governing authority or an appropriate subgroup thereof."

2. The organization discovered the offense through the compliance and ethics program before it was discovered (or reasonably likely to be discovered) by an external party.[114]

3. "[T]he organization promptly reported the offense to the appropriate governmental authorities."[115]

4. "[N]o individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense."[116]

Thus, whereas the seven requirements of a compliance and ethics program indicated that the CECO should have "direct access" to the governing authority (e.g., the board of directors) or a subgroup thereof,[117] the 2010 Amendments encourage corporations to give the CECO direct reporting obligations. The commentary defines "direct reporting" as when the "individual has express authority to communicate personally to the governing authority or appropriate subgroup thereof (A) promptly on any matter involving criminal conduct or potential criminal conduct, and (B) no less than annually on the implementation and effectiveness of the compliance and ethics program."[118] Thus, the CECO should not just have the ability to report misconduct to the board

[114] *Id*. at § 8C2.5(f)(3)(c)(ii).

[115] *Id*. at § 8C2.5(f)(3)(c)(iii).

[116] *Id*. at § 8C2.5(f)(3)(c)(iv).

[117] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(c).

[118] *Id.* at § 8C2.5, commentary note 11.

of directors, but should have formal, written authority to provide in-person reports to the board (or subcommittee) on a regular basis.[119]

Overall, the 2004 and 2010 amendments to the OSG sought to prevent the adoption of "paper programs" by including an organization's culture as a part of a compliance and ethics program, and by elevating the role of the CECO and requiring greater involvement by the board of directors and certain executives. As seen in the next Part, however, these changes did not go far enough and require further amendments to achieve their goals.

II. The More Compliance Programs Change, the More They Stay the Same

Since OSG started a sea change in compliance programs across corporate America in 1991, it has undergone significant changes to encourage corporations to look beyond simply putting policies and procedures on paper, and to encourage corporations to consider the culture that influences ethical behavior and to empower the CECOs that run those programs. In response, corporations are making changes. For example, recent surveys of compliance professionals show that CECOs are gaining greater access to the CEO and board of directors.[120] However, despite these structural changes, there appears to be no change in the level of corporate misconduct.[121]

According to one large-scale survey, since 2000, between 41% and 55% of employees indicate that they have observed misconduct within their organizations within the last twelve

[119] McGreal, *supra* note 112, at 128.

[120] DELOITTE & COMPLIANCE WEEK, IN FOCUS: 2015 COMPLIANCE TRENDS SURVEY 8 (2015), available online at: http://www2.deloitte.com/content/dam/Deloitte/us/Documents/regulatory/us-aers-reg-crs-2015-compliance-trends-survey.pdf. This survey received 364 responses from compliance professionals. *Id*. at 3.

[121] *See* Baer, *supra* note 10, at 950 (arguing that "employee malfeasance—including the very types of wrongdoing that created the corporate crises in Enron and Worldcom—is on the rise.")

months, and between 8% and 14% have felt pressure from within the organization to compromise the company's standards.[122] This misconduct is not just the actions of a few rogue employees scattered throughout the various corporations. In 53% of the cases of observed misconduct, the respondent indicated that the misconduct was committed by multiple people or was a company-wide problem.[123] In addition, the respondents are not just seeing one-off instances of poor conduct. In 26% of the cases, the misconduct was identified as an "ongoing pattern," and in an additional 41% of cases the misconduct was identified as happening over multiple incidents.[124] Despite this widespread misconduct, over the past 13 years of this survey, between 37% and 47% of employees do not report the misconduct that they have observed.[125]

Clearly, the above survey results should be considered more anecdotal than definitive. However, a closer look at the current state of compliance suggests that compliance programs at many organizations are at-risk of being "paper programs" (either intentionally or unintentionally). Among the concerns, some claim that corporations are not providing the compliance department

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[122] ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY OF THE U.S. WORKFORCE 14 (2014), available online at http://www.ethics.org/downloads/2013NBESFinalWeb.pdf. Although the percentage of employees observing misconduct typically increases as the economy improves, between the surveys of 2011 and 2013, the economy improved but the level of observed misconduct declined. *Id*. at 15. The survey asked employees about 26 specific categories of misconduct, such as discrimination, violations of health or safety standards, stealing, falsifying expense reports, and breaching customer privacy. *Id*. at 41-42.

[123] *Id*. at 21. 41% of respondents indicated that the behavior was committed by multiple people, and 12% indicated that it was company-wide. *Id*. Other surveys find similar results. Tenbrunsel and Thomas conducted a survey with over 1200 respondents from the US and UK financial service/banking industry. ANN TENBRUNSEL & JORDON THOMAS, THE STREET, THE BULL AND THE CRISIS: A SURVEY OF THE US & UK FINANCIAL SERVICES INDUSTRY 10 (2015). Among their results, they found that 47% of respondents believe that their competitors use unethical or illegal competitive tactics and that 34 percent of respondents earning over $500,000 annually have witnessed wrongdoing. *Id*. at & 5.

[124] Ethics Resource Center, *supra* note 122, at 20-21. In addition, 43% of the misconduct was committed by senior leaders (24%) or middle managers (19%). *Id*. at 20.

[125] *Id* at 26. Of those that do report misconduct, since 2001, over 20% report experiencing some type of retaliation for reporting the misconduct. *Id*. For those that do report misconduct, 82% reported it to their supervisor. *Id*. at 30. Only 16% used a hotline and only 15% reported to an ethics officer. *Id*.

with sufficient resources.[126] To make up for the lack of resources, the CECO must leverage the resources of other departments, which may only be successful if the CECO has sufficient clout within the organization.[127]

Another concern is that the compliance department is not sufficiently involved in shaping a corporation's culture. The compliance department most commonly has responsibility for compliance training, oversight of the organization's code of conduct, the whistleblower hotline, and compliance investigations.[128] Few compliance departments, however, have responsibility for assessing the organization's culture.[129] And, if no one in the organization has responsibility for this assessment, then it does not get done, and at best gets replaced by general reports.[130]

A recent academic study shows the challenges faced by CECOs to implement compliance programs.[131] A significant problem is that many executives, managers, and employees believe that they are ethical people, and therefore do not need the assistance of the compliance department in being ethical.[132] If executives and managers hold these beliefs, then that message trickles down through the whole organization and the CECOs have a significant challenge getting buy-in from any employee.[133] Executives and managers can also hinder the program's effectiveness by making exceptions to the compliance and ethics program's policies.[134] By making exceptions, rather than

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[126] DELOITTE & COMPLIANCE WEEK, *supra* note 120, at 5.

[127] *Id*. at 5.

[128] *Id*. at 10.

[129] *Id*.

[130] *Id*.

[131] Linda Klebe Trevino et al., *Legitimating the Legitimate: A Grounded Theory Study of Legitimacy Work Among Ethics and Compliance Officers*, 123 ORG. BEHAVIOR & HUMAN DECISION PROCESSES 186 (2014).

[132] *Id*. at 191 and 194.

[133] *Id*. at 194.

[134] *Id*.

applying policies consistently, the program loses its legitimacy and any hope at effectiveness.[135] Overall, as observed by CECOs, there is resistance to the need for their role, which severely limits their ability to act effectively.[136]

Thus, despite a CECO's best efforts to try to meaningfully implement a compliance program by promoting an ethical corporate culture, those changes will not occur without the support and commitment of the corporation's executives and board of directors. Although some executives and board members will give that support due to their commitment to ethical behavior,[137] to make systematic change across corporate America corporate management needs greater guidance than currently given by the OSG.

Currently, managers' understanding of how corporations can choose to implement their compliance programs is shaped heavily by Lynn Sharp Paine's groundbreaking work that categorized compliance programs as either focused on deterrence or on motivating employees to do the right thing because it is the right thing to do. [138] In her article, after noting the importance of compliance programs and the need to educate managers and employees on their legal

[135] *Id*. *See* also *infra* notes 225 to 248 and accompanying text (discussing how a compliance and ethics program loses legitimacy and the harms that causes to the program).

[136] Consistent with the Trevino et al. study just discussed in the text, one CECO outlined why there is resistance to the CECO position despite the growth in importance of compliance programs. Patrick J. Gnazzo, *The Chief Ethics and Compliance Officer: A Test of Endurance*, 116 BUS. & SOCIETY REV. 533 (2011). First, management believes that everyone wants to do the right thing. *Id*. at 542. Second, executives and the board of directors do not understand the CECO's role and what functions the CECO should be managing. *Id*. at 544. Third, is a belief that everyone in the organization should have the responsibility to do the right thing, which can develop into the belief that management is not responsible for the actions of others (as they have their own responsibility to do what is right). *Id*. at 545. Fourth, management believes that the CECO's role will run counter to the organization's goals of efficiency and effectiveness. *Id*. at 547.

[137] Trevino et al., *supra* note 132, at 195-96.

[138.] Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar.-Apr. 1994, at 106, 110–11.

requirements,[139] Paine argued that many compliance programs placed too much emphasis on "threat of detection and punishment."[140] She argued that programs focused only on penalties for noncompliance, and have "unrealistic" standards that ignore the "root causes of misconduct" in the organization, will be viewed as "nothing more than liability insurance for senior management."[141] An integrity strategy (as opposed to simply a "compliance" strategy), on the other hand, seeks "to create an environment that supports ethically sound behavior, and to instill a sense of shared accountability among employees."[142] Rather than viewing legal requirements as a "constraint imposed by external authorities," managers must work to make ethical behavior and legal compliance a "positive aspect of organizational life."[143] According to Paine, an integrity strategy has the same basic structural features as a compliance strategy (e.g., codes of conduct, training, mechanisms to investigate potential wrongdoing, hotlines, audits, and internal controls), but it goes deeper into the organization's operating patterns and requires the involvement of all managers.[144] Ultimately, she argued, it must be a management driven process, not a lawyer driven process.[145] In short, a compliance program based on an integrity strategy focuses on a "commitment to ethical values," as opposed to the more basic goal of "prevent criminal misconduct."[146] The OSG Advisory Committee Report noted the influence of Paine's article, and

[139] *Id*. at 109 (noting that "employees can be frustrated and frightened by the complexity of today's legal environment" and "even managers who claim to use the law as a guide to ethical behavior often lack more than a rudimentary understanding" of the law).

[140] *Id*. at 110.

[141] *Id*. at 111.

[142] *Id*. at 111.

[143] *Id*.

[144] *Id*.

[145] *Id*. at 113.

[146] *Id*. at 113 & 117. Paine further states that "In the end, creating a climate that encourages exemplary conduct may be the best way to discourage damaging misconduct. Only in such an environment do rogues

favorably cited it as a reason for requiring corporations to promote an ethical corporate culture in the 2004 amendments.[147]

Over time, however, the discussion of Paine's compliance versus integrity approaches to compliance programs has evolved to the point where her ideas have been taken to an extreme. Paine's criticisms of relying heavily on monitoring and sanctioning have been taken by some to mean that integrity-based compliance program should attempt to minimize the use of formal monitoring of employees' behavior.[148] Based on academic research findings, a concern developed that too much monitoring would cause employees to feel untrustworthy (and thus start to act untrustworthy), or that acting for extrinsic reasons would "crowd out" intrinsic reasons for following the company's standards.[149] In either case, the program could become counter-productive. Other commentators believed that an integrity-based program's focus on a corporation's ethical culture was an attempt to judge whether the corporation adopted appropriate ethical values and was not directly related to preventing criminal conduct.[150]

The result of these concerns, as well as a general lack of understanding of corporate culture, is that the technical side of compliance programs often runs parallel to culture issues, rather than

really act alone." *Id*. at 117. This concept of using the compliance program to encourage employees to "do the right" thing, as opposed to a program that focuses only on preventing misconduct is illustrated through a quote by former SEC Chair, Richard Breeden, "It is not adequate ethical standard to aspire to get through the day without being indicted." *Id*. at 111.

[147] Advisory Group Report, *supra* note **Error! Bookmark not defined.**, at 51.

[148] *See*, e.g., Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 COLUM. BUS. L. REV. 71, 105 (2002) (noting that employees may only accept a "threshold" level of monitoring and that "ethics-or integrity-based systems will often deliberately be designed in such a way that they look particularly leaky."); Maurice E. Stucke, *In Search of Effective Ethics & Compliance Programs*, 39 J. CORP. L. 769, 818-19 (2014) (stating that a corporation choosing to utilize an integrity-based system over a command-and-control system may elect to replace employee monitoring with an honor code system).

[149] *See infra* notes 184 to 189 and accompanying text (discussing intrinsic and extrinsic motivation).

[150] O'Sullivan, *supra* note 96, at 509-10.

treating compliance and culture as two sides of the same coin. In addition, there is the tendency to see compliance and ethics programs as either effective or ineffective based on a one-time analysis. An alternative view sees compliance and ethics programs as dynamic; an evolving journey with progress and setbacks.[151] Thus, instead of asking if the corporation is "done" implementing a compliance program, the appropriate question is "where is the culture of the organization headed?"

The 2004 and 2010 amendments to the OSG are important steps in encouraging the development of truly effective compliance programs and integrating compliance and culture. However, those amendments do not provide sufficient guidance to corporations—especially the executives and members of the boards of directors of those corporations—to understand what their compliance department should be doing and how other departments in the corporation can support those efforts. The next Part presents a model that shows how the compliance program and the organization's corporate culture are related, and can either support or work against each other. Recent behavioral ethics research provides support for this model and additional insights.[152] If incorporated into the OSG, this model will assist in granting legitimacy to the work of the CECO and provide guidance to executives and board members on where to focus their attention (and what to evaluate) to determine if their corporation has an effective compliance and ethics program. The framework presented here provides guidance to these individuals to understand the linkage between culture and compliance, but does not unnecessarily dictate an approach that would encourage a check-the-box approach to compliance. In short, it helps reframe compliance as a

[151] *See* Baer, *supra* note 10, at 956 (noting that under a "new governance" approach to compliance, "regulators and regulated entities would treat compliance problems . . . as a symptom of a continuing problem to be addressed over time, rather than as a cultural failure that could be "cured" by some combination of prosecutorial threat and internal ethics remediation.")

[152] *See infra* Part III.B.

managerial issue, not solely a legal issue,[153] and does so in a way that places the focus on behavioral ethics, not judging the ethical values of a company.

III. A Corporation's Ethical Infrastructure

A. Overview of the Ethical Infrastructure Model

Tenbrunsel and colleagues developed the concept of an organization's ethical infrastructure.[154] This model is relatively straightforward, which makes it easy to see the relationships between the three systems in the model. In addition, it moves us away from the either/or approach of compliance-based versus integrity-based programs, and provides a comprehensive view of organizational factors that influence ethical behavior.

An organization's ethical infrastructure consists of three systems: a formal system, which is embedded within an informal system, which is embedded within the organization's climate.[155] The formal and the informal systems both consist of communication, surveillance, and sanctioning systems, as briefly described below:[156]

- *Formal System:*

[153] Paine, *supra* note 138, at 113.

[154] Ann E. Tenbrunsel et al., *Building Houses on Rocks: The Role of the Ethical Infrastructure in Organizations*, 16 SOC. JUST. RESEARCH 285 (2003).

[155] *Id*. at 286-87.

[156] *Id*. at 286.

- *Communication*: This includes the explicit guidelines for how employees should perform their jobs in an ethical manner, including codes of conduct, training programs, and written performance standards.[157]
- *Surveillance:* This is the organization's official policies and procedures on how it will monitor employees and how employees can report wrongdoing.[158]
- *Sanctioning:* This includes the formal rewards and punishments of the organization, including performance evaluations and promotions, as well as the sanctions for wrongdoing.[159]

- *Informal System*:
  - *Communication:* This is the "water cooler" conversations and other informal interactions that convey the organization's ethical norms.[160] Informal communications also includes the "tone at the top," as set by leadership's actual behavior (not leadership's official policies).
  - *Surveillance:* This is the observation of an employee's behavior by his or her peers or supervisors, with any violations of ethical norms handled outside of, or in addition to, the organization's official policies and procedures.[161]

[157] *Id*. at 287 & 289.

[158] *Id*. at 287 & 290-91.

[159] *Id*. at 287 & 290-91.

[160] *Id*. at 291.

[161] *Id*. at 292.

- *Sanctioning*: Examples of informal sanctions include ostracism, negative social interactions, and group pressure.[162]

The third system of the ethical infrastructure is the organizational climate. An organization's climate is the employees' shared perceptions of the organization as it relates to any particular aspect of the organization.[163] As opposed the formal and informal systems that are based on tangible events (e.g., company policies, actual treatment by other employees), the climate is based on how employees perceive the totality of all those various actions and events.[164]

For the ethical infrastructure model, Tenbrunsel and colleagues consider the organizational climate towards three issues: ethics, respect, and procedural justice.[165] With respect to ethics, the organizational climate determines what type of behavior is expected of employees and supported by the organization.[166] Although those in the compliance field more commonly refer to an organization's culture, the management literature distinguishes between an ethical climate and an ethical culture. The organization's ethical climate relates to employees' perceptions of what is or is not unethical behavior in that organization.[167] That is, what is or is not the "right" way to act in that organization.[168] Ethical culture, on the other hand, relates to those factors in the organization that "impede unethical behavior and encourage ethical behavior."[169] As operationalized in

[162] *Id*. at 292.

[163] *Id*. at 294.

[164] *Id*. at 296.

[165] Id. at 294.

[166] Id. at 294.

[167] Muel Kaptein, *Understanding Unethical Behavior by Unraveling Ethical Culture*, 64 HUMAN RELATIONS 843, 845 (2011).

[168] Jennifer J. Kish-Gephart et al., *Bad Apples, Bad Cases, and Bad Barrels: Meta-Analytic Evidence About Sources of Unethical Decisions at Work*, 95 J. APPLIED PSYCH. 1, 6 (2010).

[169] Kaptein, *supra* note 167, at 845.

research, researchers have found a strong correlation between these two constructs.[170] Overall, ethical climate relates to the organization's expected behavior with respect to ethical issues, and the ethical culture relates to behavioral control.[171]

The climate for respect refers to the extent to which employs are "shown consideration, and treated with dignity."[172] The climate for procedural justice is the employees' perceptions "of the fairness of the procedures used to make decisions" in the organization.[173] Respect and procedural justice are important because fair treatment by the organization encourages employees to reciprocate in their behavior towards the organization and its rules.[174] In addition, respectful treatment from the organization encourages thoughtful consideration of the welfare of others, as opposed to focusing only on self-interest.[175]

Understanding that the formal system is embedded in the informal system, which is all embedded in the organizational climate, is important for understanding how the ethical infrastructure actually impacts employees' ethical behavior.[176] With respect to influencing behavior, the more deeply embedded system is the more influential system. Thus, the formal

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[170] Sean R. Martin et al., *Blind Forces: Ethical Infrastructures and Moral Disengagement in Organizations*, 4 ORG. PSYCH. REV. 295, 300 (2014).

[171] Kish-Gephart et al., *supra* note 168, at 7.

[172] Tenbrunsel et al., *supra* note 154, at 294.

[173] *Id*. at 294.

[174] *Id*. at 295. The authors acknowledge the strong "conceptual overlap" between the climates for respect and procedural justice, but keep them as separate concepts in their model because "respect for the individual is a construct that has been overlooked in the organizational ethics literature and, thus, deserves its own special treatment." *Id*. at 296.

[175] *Id*. at 295.

[176] "The authors modeled ethical infrastructure as three concentric circles—starting with the innermost circle of formal systems, followed by informal systems, and then encompassed by the outermost circle, organizational climates—that simultaneously support and influence each other." Martin et al., *supra* note 170, at 300.

system is weaker than the informal system, which is weaker than the organizational climate.[177] The informal system is stronger than the formal system because the informal system better reflects the reality of what the employee is facing.[178] For example, a formal code of conduct or the lessons from a training session can be easily trumped by a conflicting message from the employee's informal environment (e.g., group pressures). The organizational climate is stronger than the informal system because it is the employees' perceptions of what type of behavior is appropriate and expected in that environment. Because the systems are embedded, the overall strength of the ethical infrastructure depends on how consistent the three systems are with each other.[179] Thus, a strong formal program that is inconsistent with the informal system and organizational climate will not be an effective compliance program.[180]

[177] Tenbrunsel et al., *supra* note 154, at 299-300. The authors state:

> More specifically, we argue that formal systems are weaker than informal systems because the principles that are conveyed through formal systems are less entrenched in an employee's organizational experience and hence the furthest removed from that individual; similarly, informal systems are weaker than organizational climate because the principles conveyed through informal systems are less rooted in the organizational experience and hence further removed from the individual than those conveyed through the relevant climates.

Id. at 300.

[178] *Id*. at 300.

[179] *Id*. at 302.

[180] *Id*. at 303 (stating, "If they are to be effective, formal ethical systems must reside in informal reinforcements and organizational climates that are solid. If not, the formal systems acts more like a Band-Aid than an antibiotic, addressing the symptoms, but not the underlying causes.")

B. An Evidence-Based Approach to Compliance Programs: The Empirical Evidence in Support of the Ethical Infrastructure Model

In addition to helping us better understand the link between compliance and culture, the ethical infrastructure model helps us understand recent behavioral ethics research that relates to the problems identified above from the extreme interpretations of Paine's compliance versus integrity approaches.[181] For example, this model helps us understand the research showing when sanctions work to increase intrinsic moral motivation and support Paine's integrity approach. The model also shows the research behind which values in an organization's climate matter for implementing an effective compliance and ethics program. As discussed below, employee perceptions of fairness in the organization is not judging the organization as a "good" or "bad" organization, but is empirically shown to be an important factor in determining the likelihood that employees follow the law and the company's rules. Therefore, the climate for procedural justice must be understood and managed as part of an effective compliance and ethics program. The following subsections highlight these and other research findings.

1. When Sanctions Work

Viewing compliance programs as the formal system within the organization's ethical infrastructure helps us understand when a company's formal surveillance and sanction practices help promote ethical behavior. As discussed above, Paine's distinction between a compliance-based program and an integrity-based program has created confusion on the use of sanctions—

[181] *See supra* notes 148 to 150 and accompanying text.

suggesting that they may crowd out intrinsic motivations.[182] Recent research suggests that the relationship between extrinsic motivation and ethical behavior is more complicated.[183]

One of the most well known studies on crowding out demonstrates how the over-simplification of extrinsic versus intrinsic motivation can provide misleading advice. In a study on day cares, researchers found that the imposition of a fine for parents that picked their children up late actually increased the number of late pick-ups rather than reduced the number, as was the intention of the day care's managers in imposing the fine.[184] The reason, according to the authors, was that the imposition of the fine (an extrinsic motivation) caused parents to view being late as price to be paid instead of viewing a late pick-up as the breaking of a promise to show up on time (an intrinsic motivation).[185] For compliance programs, managers interpreted these findings as implying that the use of extrinsic motivation tactics will crowd out employees' intrinsic motivation to follow the rules.[186] Thus, to use a sanctioning system, the organization will need to devote even more resources to monitoring employee behavior to make up for the decreased internal motivation to follow the rules.[187]

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[182] *See supra* 148 to 150 and accompanying text.

[183] *See infra* notes 184 to 200 and accompanying text (reviewing recent research on extrinsic motivation).

[184] Uri Gneezy & Aldo Rustichini, *A Fine is a Price*, 29 J. LEGAL STUD. 1, 5-8 (2000).

[185] *Id*. at 13-15.

[186] *See* Gerald E. Ledford, Jr., et al, *Negative Effects of Extrinsic Motivation on Intrinsic Motivation: More Smoke than Fire*, 22 WORLDATWORK JOURNAL 17, 17 (2013), stating:

> A recurring theme in the popular management literature is that extrinsic rewards diminish intrinsic motivation, and this problem is so serious that it can render extrinsic incentives for performance of any kind as ineffective or even counterproductive.

[187] Tom R. Tyler, *Promoting Employee Policy Adherence and Rule Following in Work Settings: The Value of Self-Regulatory Approaches*, 70 BROOKLYN L. REV. 1287, 1295 (2005).

A deeper analysis, however, shows that the relationship is more complex and there are fundamental questions of when extrinsic motivations crowd out intrinsic motivations and when they are "mutually reinforcing."[188] A wide variety of factors influence the result, such as a person's starting level of interest of in the activity (i.e., level of intrinsic motivation) and if the extrinsic motivation is a reward or a punishment.[189] Thus, generalizing from studies such as the day care study is not necessarily useful. Instead, we should interpret those results along with studies involving ethical issues in an organization setting. This is where the ethical infrastructure model is useful.

In a study on business ethics, Professor Mulder argues that in certain situations sanctions can increase individuals' moral concerns related to that issue, as opposed to "crowding out" those concerns.[190] Under her model, a sanctioning system will increase "moral concerns" (intrinsic motivation) if the employee perceives the sanction as retribution, as opposed to compensation for the damaged caused.[191] Mulder identifies various factors that influence when an employee is more likely to view a sanction as retribution rather than simply compensation. First, a severe (as opposed to a mild) sanction "will more easily trigger retributive concerns" because it is more likely to communicate that the authority figure views the behavior as morally wrong.[192] Second, a non-

[188] Yuval Feldman, *The Complexity of Disentangling Intrinsic and Extrinsic Compliance Motivations: Theoretical and Empirical Insights from the Behavioral Analysis of Law*, 12 J. L. & POLICY 11, 14 (2011). An additional fundamental question is determining which motivations fall under extrinsic motivation and which motivations fall under intrinsic motivation. *Id* at 18-19.

[189] *Id*. at 26.

[190] Laetitia B. Mulder, *The Two-Fold Influence of Sanctions on Moral Concerns*, in PSYCHOLOGICAL PERSPECTIVES ON ETHICAL BEHAVIOR AND DECISION MAKING 169, 170 (David DeCremer, ed., 2009).

[191] *Id*. at 171-72.

[192] *Id*. at 172-73. The sanction must still be fair, as too severe of a penalty may be viewed as unfair and illegitimate, and the employee may not accept the retributive message. *Id*. at 176.

financial penalty (a loss of privileges, for example) is more likely to be viewed as retributive.[193] Third, if the sanctioned behavior is relatively rare in the local group, then it is more likely to be retribution.[194] Thus, if it is common for members in the group to engage in the behavior and receive a small financial penalty as a result, then the employee is likely to view the penalty as compensatory and moral concerns will not be engaged. Finally, if the authority makes the immoral aspects of the behavior salient to the employee (and how the action is disapproved by others for those reasons), then the employee will view the sanction as retribution.[195]

Importantly, that sanctioning system operates within the organization's ethical infrastructure. To receive the retributive message based on the above factors, the employee must accept the moral authority of the person giving the sanction.[196] Influenced by the work of Professor Tom Tyler, Mulder argues that an employee will accept the moral message of the sanction if the employee trusts the authority and the sanction is administered through a procedurally fair system.[197] Trust and procedural justice increase the legitimacy of the retributive sanction and raises

[193] *Id*. at 173.

[194] *Id*. at 174.

[195] *Id*. at 174-75.

[196] *Id*. at 175.

[197] *Id*. at 175. *See* also, Laetitia B. Mulder et al., *Sanctions and Moral Judgments: The Moderating Effect of Sanction Severity and Trust in Authorities*, 39 EURO. J. SOC. PSYCH. 255, 265 (2009) (presenting the results of three empirical studies showing the importance of trust in the sanctioning authority, as lack of trust may cause the person sanction to question the motivation of the authority (e.g., imposing a sanction due to self-interest) or question the ability of the authority to judge the morality of the action).

moral concerns.[198] Subsequent research confirms these conclusions.[199] Thus, only in the presence of a climate for procedural justice will appropriately structured formal sanctions increase moral concerns. In addition to formal sanctions, the effectiveness of informal sanctions to cause an individual to update their moral judgment from their transgression will also depend on the organization's climate.[200] As shown by these studies and discussed further in the next subsection, the organization's climate for procedural justice (in which both the formal and informal systems are embedded) is important for understanding the effectiveness of a compliance program.

2. The Organizational Climate

The ethical infrastructure model considers the organizational climate towards three issues: ethics, respect, and procedural justice.[201] With respect to the ethical climate, researchers have identified five different types of ethical climates.[202] When faced with an ethical dilemma, the climate of the organization tells an employee what is appropriate to consider as follows:

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[198] Mulder, *supra* note , at 176. Mulder summarizes the implications of her findings as:

> [M]erely installing a sanctioning system may often not be enough: It may be necessary to make clear to individuals *why* the sanctioned behavior is immoral (for example, because it harms others or the collective) and, preferably, the feeling should be created that most other people do not show the behavior and disapprove of it. Also, it should be made clear that the sanction is not a payment that softens the consequences of one's behavior. . . . [T]he sanction should be severe enough that so that is shows disapproval, but not so severe that it is perceived as unreasonable and illegitimate.
>
> *Id*. at 176-77.

[199] *See* Peter Verboon & Marius van Dijke, *When Do Severe Sanctions Enhance Compliance? The Role of Procedural Fairness*, 32 J. ECON. PSYCH. 120, 127 (2011) (stating "Severe sanctions increased compliance with the authority more than mild sanctions, but this effect was found only when authorities acted in a fair manner. . . . [T]his effect results because followers morally evaluate the enacting authority higher.")

[200] Danielle E. Warren & Kristin Smith-Crowe, *Deciding what's right: The role of external sanctions and embarrassment in shaping moral judgments in the workplace*, 28 RESEARCH ORG. BEHAVIOR 81, 97-99 (2008) (discussing the need for the sanctioned individual to identify with the source of the sanction in order to update his or her moral judgment of the action that provoked the informal sanction).

[201] Tenbrunsel et al., *supra* note 154, at 297.

[202] Linda Klebe Trevino et al., *(Un)ethical Behavior in Organizations*, 65 ANNUAL REV. PSYCH. 635, 640 (2014).

- *Instrumental climate:* Employees will only consider their own self-interest or the interest of the organization.
- *Caring climate:* Employees will consider the needs of others.
- *Independence climate*: Employees believe they should use their own values as a guide.
- *Rules climate*: The rules of the organization determine how to handle any dilemma faced by an employee.
- *Laws and Codes Climate*: Society's standards dictate the appropriate behavior for employees.

Research has supported the influence of ethical climates on ethical behavior. In 2010, Kish-Gephart and colleagues conducted what is called a meta-analysis of thirty years of research on unethical behavior in organizations.[203] The results showed that a self-interested climate increased unethical behavior, while caring, rules, and laws and codes climates reduced unethical behavior.[204]

The work of Tom Tyler shows the importance of an organization's climate for procedural justice (or, procedural fairness) and how it influences the organization's formal and informal systems. With respect to employee compliance in organizational settings, research has shown that

[203] Kish-Gephart et al., *supra* note 168, at 1. The authors' research included 136 different studies. *Id*. at 10. In addition to examining the organizational environment, the authors also examined individual differences (including demographics (e.g., age and gender) and psychological differences (e.g., philosophical orientation, locus of control)) and the characteristics of the moral issue at hand (e.g., proximity to the harm, magnitude of consequences). *Id* at 2-5.

[204] *Id.* at 21. The authors referred to self-interested climates as egoistic, a caring climate as benevolent, and the rules and law climates as principled. *Id*. at 6. The authors excluded the independence climate as it focused on individuals following their own beliefs. *Id. See also* Aditya Simha & John B. Cullen, *Ethical Climates and Their Effects on Organizational Outcomes: Implications From the Past and Prophecies for the Future*, 26 ACAD. MGMT. PERSPECTIVES 20, 27 (2012) (stating that "The essential theme emerging from this stream of research is that benevolent and principled climates (i.e., caring, independence, rules, and law and code) are the climates associated with positive outcomes, and egoistic climates (i.e., instrumental) are associated with a whole host of negative outcomes.")

procedural justice is more important that outcome fairness.[205] The climate for procedural justice in an organization involves two aspects. First, that the decision-making process is fair (e.g., the employees have some voice in the process, rules and policies are followed consistently for all organization members, and decisions are made transparently).[206] Second, that there is fairness in interpersonal treatment. [207] This aspect is similar to the climate of respect under the ethical infrastructure model.[208]

Tyler's research shows that when the organization operates in a procedurally fair manner, then employees will believe in the legitimacy of management's authority and believe that their values match the values of the organization.[209] This, in turn, causes voluntary compliance with the organization's rules, and is significantly more effective in eliciting rule compliance than an approach based on risk of punishment.[210]

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[205] Tom Tyler et al., *The Ethical Commitment to Compliance: Building Value-Based Cultures*, 50 CAL. MGMT. REV. 31, 33 (2008).

[206] *Id*. Legitimacy is the "belief that authorities, institutions, and social arrangements are appropriate, proper, and just" and "when it is possessed, leads people to defer voluntarily to decisions, rules, and social arrangement." Tom R. Tyler, *Psychological Perspectives on Legitimacy and Legitimation*, 57 ANNUAL REV. PSYCH. 375, 376 (2006). Tyler states that the research on organizations shows that "those authorities who exercise their authority fairly are more likely to be viewed as legitimate." *Id*. at 380. *See* also *Id*. at 392 (stating "The findings reviewed consistently suggest that the legitimacy of authorities and institutions is linked to the fairness of the procedures by which they exercise their authority") and 394 (stating "legitimacy derives from judgments about how those others exercise authority, judgments not based upon the favorability or even the fairness of the decisions the authorities make, but upon beliefs about what are fair or ethical procedures for exercising authority.")

[207] Tyler et al, *supra* note 205, at 33 & 37 (describing this factor as "the manner in which people are treated while decisions are being made include whether processes are dignified and the people in them are treated politely, whether people's rights are respected, and whether the authorities involved are sincerely trying to do what is right for all of the people in the situation'")

[208] *See supra* note 172 and accompanying text.

[209] Tyler et al, *supra* note 205, at 34 & 36.

[210] *Id*. at 34-35. These findings are consistent with Tyler's work on why people follow the law more generally. *See* Tom R. Tyler, *Legitimacy and Criminal Justice: The Benefits of Criminal Justice*, 7 OHIO ST. J. CRIM. L. 307, 315 (2009) (stating "people are more likely to obey the law if they think it is legitimate and/or consistent with their values").

Additional research confirms the importance of the organization's climates for procedural justice and respect for encouraging ethical behavior.[211] For example, Trevino and Weaver found that employees observed less unethical conduct in their organizations and were more likely to report observed wrongdoing if they had a general perception that their organization treated employees fairly. [212] Consistent with Tyler, fair treatment included employees' perceptions that the organization consistently follows through on its ethics program (e.g., following up on reports of unethical behavior and disciplining those that violate the company's policies).[213] Overall, recent research in behavioral ethics shows the direct importance of the climates for ethics, procedural justice, and respect, in influencing employee behavior.

3. The Importance of Local Managers

Much of the discussion about compliance programs has focused on the "tone at the top."[214] That is, the ethical tone for the organization set by company executives. The academic literature, however, shows that the tone set by local managers is equally important. Employees' interactions

[211] A review of the behavioral ethics literature published in 2006 stated that "individual's expectations for fairness . . . produce expectations in observers that those who violate ethical expectations will be disciplined . . . . Failure to satisfy the "fairness heuristic" . . . is likely to lead to self-protection and possibly unethical behavior" (citations omitted). Linda K. Trevino et al., *Behavioral Ethics in Organizations: A Review*, 32 J. OF MGMT. 951, 966 (2006).

[212] Linda Klebe Trevino & Gary R. Weaver, *Organizational Justice and Ethics Program "Follow-Through": Influences on Employees' Harmful and Helpful Behavior*, 11 BUS. ETHICS Q. 651, 663-65 (2001).

[213] *Id.* The authors believe these results show that "ethics/compliance management should be more tightly coupled with the management of the broader organizational culture to improve employees' perceptions of fairness in the organization in general and in the ethics/compliance program." *Id.* at 667.

[214] *See, e.g.*, D. Daniel Sokol, *Policing the Firm*, 89 Notre Dame L. Rev. 785, 814 (2013); Gregory V. Page et al., *The "Tone at the Top": Can It Mitigate C-Suite Personal Liability?*, 63 FOOD DRUG L.J. 723, 731 (2008).

with local managers heavily influence the climate of the organization (in which both of the other systems are embedded) and the informal system.

The work by Tyler and colleagues discussed above on an organization's climates for procedural justice and respect show that the employee's perception is determined by treatment at the workgroup level as well as from the tone at the top.[215] The formal rules of the organizations on how decisions are to be made and how employees are to be treated also influence the climate. [216] However, how the managers interacting with employees actually make their decisions and personally treat the employees are equally important.[217]

In addition to influencing perceptions of justice, research shows that interactions in the informal system with local managers influence ethical decision-making. For example, Kaptein explored a variety of factors that could influence the effectiveness of a company's code of conduct.[218] The strongest influence on reducing unethical behavior was how well both senior management and local management lived up to the code of conduct.[219] Kaptein measured managements' influence by asking employees if their managers were viewed as "positive role models as regards the [code of ethics], set reasonable performance targets . . . that promote compliance with the [code], do not authorize violations of the [code] to meet business goals, are approachable if employees have questions about or report violates of the [code], are aware of the

[215] Tyler et al, *supra* note 205, at 35.

[216] Steven L Bader & Tom R. Tyler, *A Four-Component Model of Procedural Justice: Defining the Meaning of a "Fair" Process*, 29 PERSONALITY & SOC. PSYCH. BULLETIN 747, 749 & 755-56 (2003).

[217] *Id.*

[218] Muel Kaptein, *Toward Effective Codes: Testing the Relationship with Unethical Behavior*, 99 J. BUS. ETHICS 233, 234-38 (2011).

[219] *Id*. at 245.

extent to which employees violate and comply with the [code], and respond appropriately when they become aware of any violations of the [code]."[220]

Other research confirms Kaptein's findings on the importance of these interpersonal interactions at the local level. For example, people are more likely to behave ethically when they have the opportunity to discuss the ethical aspects of the questionable behavior, as opposed to being surrounded by discussions only related to self-interest.[221] Employees are more likely to internally report instances of observed wrongdoing if they are surrounded by ethical co-workers in addition to ethical leadership.[222] Overall, the ethical infrastructure model shows the need to monitor and manage these interpersonal interactions at the local level in the informal system to have an effective compliance and ethics program. These interactions both influence the climate of the organization and directly impact ethical behavior.

4. Lost Legitimacy: Understanding the Double-Edged Sword of "Mandated" Compliance Programs

Corporations adopt or modify their compliance programs due to government pressure. Due to the incentives of the OSG and the consideration of compliance programs under the DOJ's prosecution manual,[223] compliance programs are essentially "mandated" by the government. The

[220] *Id*. at 241.

[221] Trevino et al. 2014, *supra* note 243, at 643.

[222] David M. Mayer et al., *Encouraging Employees to Report Unethical Conduct Internally: It Takes a Village*, 121 ORG. BEHAVIOR & HUMAN DECISION PROCESSES 89, 100 (2013)

[223] *See supra* notes 61 to 68 and accompanying text.

ethical infrastructure model shows how these "mandated" programs can lead not just to ineffective programs (and a waste of resources), but also be counter-productive programs.[224]

Tenbrunsel and colleagues argued that the relationship between the ethical infrastructure of the organization and ethical behavior is not linear, but curvilinear.[225] That is, consider a graph where the Y-axis (vertical axis) is unethical behavior and the X-axis (horizontal axis) starts at no ethical infrastructure and moves to a weak infrastructure and then to a stronger infrastructure. As we move from no infrastructure to a weak infrastructure, the amount of unethical behavior will increase. As the infrastructure gets stronger, then the amount of unethical behavior will decrease. This inverted U-shape results because a weak ethical infrastructure is expected to lead to more unethical behavior than an organization having no infrastructure. The reason for this, according to the authors, is because the organization's infrastructure encourages individuals to "no longer rely on their values; rather they look to the organization to decide what is ethical."[226] If there is an ethical infrastructure but it is weak, then the individuals receive the message that "the ethical principles or values in question are relatively unimportant."[227]

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[224] Laufer also argues that compliance programs can be counter-productive. *See supra* notes 80 to 86 and accompanying text. However, his argument is based on a moral hazard argument. *Id.* The argument here is based on lost legitimacy of the program, which can occur even with managers that have no intention to undermine the compliance program. *See infra* notes 246 to 248 and accompanying text.

[225] Tenbrunsel et al., *supra* note 154, at 297.

[226] *Id*. at 297. The authors further explain: "When there is no infrastructure in place, individuals are more likely to perceive the ethical dimensions of the decision and hence are more likely to behave ethically. When a strong ethical infrastructure is in place, individuals behave ethically because the organization is telling them that they have to do so. However, when a weak infrastructure is in place, individuals do not perceive the ethical dimensions of the situation nor do they sense any deep ethical conviction from the organization. Consequently, ethical behavior is least likely when an ethical infrastructure is weak." *Id* at 299.

[227] *Id*. The authors also state, "Perhaps one of the worst things that can happen is for an organization to put in figureheads and systems that are only weakly supported. Perhaps even worse is to initiate an ethics program only to abandon it, or decrease its importance, at a later point in time because attention shifts

An organization that uses a "paper program" is an organization that has a weak ethical infrastructure. Under institutional theory in organization studies, a corporation's adoption of a "paper program" is referred to as being "decoupled" from the organization. Decoupling occurs when an organization faces pressure to adopt certain practices to gain or to maintain legitimacy with external audiences, but those practices conflict with other goals of the organization.[228] In response, the organization adopts the practices, but does not fully implement those practices.[229] It is important to remember that this does not mean that the entire organization fails to implement the compliance program, but it may be that only certain departments within the organization fail to implement the practices.[230]

An in-depth case study by MacLean and Behnam showed the dangers of decoupling.[231] Their research subject was a large mutual life insurance company that engaged in certain deceptive sales practices that were banned in every state.[232] Although the company made strong statements against the practices and developed a compliance program to prevent the practices, the compliance program contained a loophole that allowed employees to easily work around the controls that prevented the practices.[233] With respect to the formal communication, surveillance, and

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elsewhere. Such weak, or weakened, efforts may send a signal that ethical considerations are actually unimportant, thus increasing, rather than decreasing unethical behavior." *Id*. at 304.

[228] Tammy L. MacLean & Michael Behnam, *The Dangers of Decoupling: The Relationship Between Compliance Programs, Legitimacy Perceptions, and Institutionalized Misconduct*, 53 ACAD. MGMT. J. 1499, 1500 (2010).

[229] *Id*. at 1500-1501.

[230] *See* id. (stating "decoupled compliance structures may either manifest themselves as public of programs that do not exist in practice, or as programs that exist in practice but are disconnected from important, on-going, line-related organizational functions").

[231] *Id*.

[232] *Id*. at 1502.

[233] *Id*. at 1507. In short, the compliance program used a 90-day window from the sale of a policy to monitor activity that would indicate use of this deceptive sales practice ("churning"). *Id*. Employees, however,

sanctioning systems, the sales personnel only received compliance training once a year (which was the minimum required under federal regulations),[234] the monitoring of sales practices was very limited compared to the monitoring of sales results,[235] and if the company did find wrongful sales practices, the typical punishment was a warning letter (and not the progressive disciplinary actions stated in formal policy).[236] In the informal system, managers made fun of violations rather than punishing the behavior.[237] Due to this lack of meaningful implementation, employees viewed the compliance program as a "self-protection mechanism for senior executives."[238] Those in the compliance department viewed their meetings as "empty rituals."[239] Those outside the compliance department viewed the compliance program as a "hassle" and "a system to beat."[240]

The program had lost legitimacy with the employees. The ineffective compliance program was not simply a waste of the company's resources, but helped lead to the "institutionalization of organizational misconduct."[241] Looking at the situation through the lens of the ethical infrastructure model, the continued existence of a compliance program that was widely known to be ineffective had an impact on the informal system and the organization's ethical climate. The

quickly learned that they could wait 91 days from a sale to engage in the wrongful practice and the system would not catch their activity. *Id.*

[234] *Id*. at 1507.

[235] *Id*. at 1509. In addition, it would not be uncommon for the audit or compliance department to be told to "slow down" an investigation into wrongful practices. *Id*. at 1509-10.

[236] *Id*. at 1509-10.

[237] *Id*. at 1509.

[238] *Id*. at 1510.

[239] *Id*. at 1511.

[240] *Id.*

[241] *Id*. at 1516.

widely ignored compliance program sent a message to employees on what was expected behavior and this message was reinforced through informal interactions among the organizational members.

Larger scale empirical studies have reached similar conclusions. An important early study on compliance programs found that if employees developed a cynical perception of the company's compliance program and believed that it served only to protect top management from blame for any wrongdoing, then the organization suffered from more unethical behavior and employees were less likely to report any observed wrongdoing.[242] Recent reviews of the empirical business ethics literature found that after controlling for other factors related to an organization's ethical climate and culture, the mere existence of an ethics code actually has a positive effect on unethical behavior.[243] Although this may simply mean that those respondents to the surveys in the studies were more aware of what should be considered unethical behavior than respondents from companies without a code,[244] it also suggests that without a supportive ethical culture "employees can view the mere existence of a code as a negative sign that the code represents window dressing only, thus producing a cynical response that leads to more unethical behavior."[245] In a more recent study, MacLean and colleagues conclude from their survey-based research that "When organizational members perceive ethics programs as merely window dressing they may also

[242] Linda Klebe Treviño et al., *Managing Ethics and Legal Compliance: What Works And What Hurts*, 41 Calif. Mgmt. Rev. 131, 136-40 (1999). The authors' conclude that having a program that is perceived as protecting top management "may be worse than having no program at all." *Id*. at 140.

[243] Linda Klebe Trevino et al., *(Un)ethical Behavior in Organizations*, 65 ANNUAL REV. PSYCH. 635, 639 (2014); Kish-Gephart et al., *supra* note 168, at 21.

[244] In survey-based research, the researchers typically measure unethical behavior in an organization by whether or not the employee has observed unethical behavior in the last twelve months. Thus, a code of conduct helps an employee understand and identify unethical behavior, and therefore the employee may become more aware of unethical behavior happening in the organization. This employee is then more likely to report on the survey that he or she has observed wrongdoing than an employee that is less aware that certain conduct is occurring or that it violates company policy.

[245] Trevino et al., *supra* note 202, at 639.

perceive the organization as lacking integrity, demonstrating inconsistency between its words and deeds . . . thus leading to negative perceptions."[246]

Importantly, a compliance program's loss of legitimacy is not necessarily due to an organization's intentional, bad faith decision to adopt a "paper program." Instead, hurdles and misunderstandings within the organization can prevent compliance programs from being implemented appropriately. For example, the research discussed above shows that despite the increased attention placed on compliance programs in the last few years, many CECOs still face challenges in gaining support from other members of the organization.[247] Organizational members resist the CECO's efforts for a variety of reasons, such as believing that ethics is something each individual has learned before entering the workforce (and that it is "very, very odd" to have someone from the business teaching ethics), without a crisis facing the organization the issues of ethics and compliance are a very low priority, senior managers typically view themselves as an expert in ethics, the program is viewed as a "check the box" activity, or the program is viewed as conflicting with other business goals.[248] To the extent that the program is not appropriately implemented for any of these reasons, the legitimacy of the program is slowly chipped away, which can have negative consequences for the organization.

[246] Tammy MacLean et al., *When Organizations Don't Walk Their Talk: A Cross-Level Examination of How Decoupling Formal Ethics Programs Affects Organizational Members*, 128 J. BUS. ETHICS 351, 354 (2015) (CITATIONS OMITTED FROM THE QUOTE).

[247] *See supra* notes 131 to 136 and accompanying text.

[248] Trevino et al., *supra* note 131, at 191-94.

IV. Policy Implications

A. Amending the OSG

The OSG must be reformed to ensure that compliance and ethics programs are focused on managerial issues, not simply legal issues.[249] From a managerial perspective, the goal of a compliance and ethics program is not simply to prevent a bad person from doing a bad thing, but to ensure that the organization is not pushing a good person into doing a bad thing and to create an environment that supports any person to do the right thing.[250]

Considering the latest behavioral ethics empirical research through the lens of the ethical infrastructure model, this Article provides an evidence-based account of what works in compliance and ethics management. The ethical infrastructure model best captures, in an easy to comprehend form, what corporations should be managing to ensure they are creating an effective compliance and ethics program, which requires management of the organization's culture. Thus, the OSG should be amended to include this model and give useful meaning to the phrase "organizational culture."

The OSG currently states that "To have an effective compliance and ethics program . . . an organization shall—(1) exercise due diligence to prevent and detect criminal conduct; and (2)

[249] Paine, *supra* note 138, at 113.

[250] It is important to remember that main cause of employee misconduct in many organizations is due to organizational environment. For example, KPMG surveys on integrity in the workplace regularly find that the "root causes of misconduct" in organizations are employees' perceptions that their performance would be evaluated and rewarded based only on whether or not they met their targets, and not on the means used to achieve those targets. KPMG FORENSIC, INTEGRITY SURVEY 2013 12, *available at* http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Integrity-Survey-2013-O-201307.pdf. This result has been consistent over multiple prior KPMG Integrity Surveys. *Id*. at 17.

otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[251] The following subsection then states that "(b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following: . . ."[252] The OSG then lists the seven steps for a compliance and ethics program as amended in 2004.[253] Those seven steps define the formal system of an organization's ethical infrastructure. To more meaningfully include the informal system and the ethical climate of the organization, the following two steps should be added:

> (8) Monitor the organization's informal system of communication, surveillance, and sanctions, and promote an informal system that supports the goals of the compliance and ethics program.
>
> (9) Periodically assess organizational members' perception of the organization's ethical climate.[254]

Ethical climate should be defined to include all three organizational climates in the ethical infrastructure model: ethics, respect, and procedural justice.[255] In addition, the commentary to these amendments should make clear that the organization must investigate the possibility that

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[251] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a).

[252] *Id.* at § 8B2.1(b).

[253] *See supra* note 111 and accompanying text.

[254] For a similar proposal on an organization's ethical climate (though defined differently than in this Article), *see* Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L. REV 1, 61-62 (2003).

[255] *See supra* notes 165 to 175 and accompanying text.

different subunits within the organization may develop an informal system or ethical climate that is different from the rest of the organization.[256]

B. Summary of Benefits from the Amendments

These additions would incorporate the ethical infrastructure model into the OSG and immediately give shape to the otherwise amorphous term of organizational culture. More specifically, it achieves two goals. First, it creates a framework that allows all interested parties to better understand corporate culture, to build upon the framework as our understanding deepens, and to share best practices for assessment and implementation as they develop. Second, it grants legitimacy to the consideration of these issues. By explicitly stating and then setting out more clearly what is meant by an ethical corporate culture, it removes "ethics" from being viewed as a discussion of personal values and refocuses it on understanding human behavior through behavioral ethics. This change in perspective, along with its inclusion in the OSG, grants legitimacy to having a deeper discussion of an ethical corporate culture in the boardroom, in the CECO's meetings with executives, and elsewhere throughout the organization.

For boards of directors and executives, these changes would encourage them to consider those aspects of the corporate culture that behavioral ethics research has shown influence ethical behavior. By assessing the aspects of the informal organizational system identified above and the organization's climates, and then responding to any negative influences identified, the organization would be forced to move away from any intentional or unintentional[257] check-the-box mentality

[256] *See* Baer, *supra* note 10, at 986-87 (discussing how organizations can develop multiple cultures based on geographic area or task-oriented divisions, for example).

[257] *See* Hess, *supra* note 13, at 1805-1806 (describing executives implementing compliance programs inconsistent with Paine's idea of an integrity-based program, and therefore more likely to be a paper

towards compliance. With a clearer understanding of the issues, and the legitimacy granted by the OSG, the board will be more likely, and better able, to "exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program."[258]

For CECOs, the inclusion of the ethical infrastructure model into the OSG will provide legitimacy to the work of the CECO. By including specific reference to the informal organizational system and the organization's ethical climate, the OSG gives legitimacy—that CECO's currently do not have[259]—to the CECO's efforts to assess and provide recommendations for these aspects of the organization. In addition, by making the infrastructure the responsibility of the CECO, it helps ensure that these types of assessments will get done.

For the DOJ, these changes will support prosecutors in assessing a corporation's culture under the prosecution manual. The ethical infrastructure model provides direct guidance to prosecutors on the factors they should be considering, and provides a platform to build knowledge to use in future cases. As indicated above, if corporations know that prosecutors cannot distinguish "paper programs" from real programs, then corporations will devote more effort towards being able to blame the employee for any misconduct rather than effectively preventing the misconduct.[260] In addition, prosecutors and corporations negotiating a settlement agreement will

program, as either misguided (the executives lack understanding of compliance programs and have priorities elsewhere) or misleading (the executives intentionally attempt to create only the appearance of an effective compliance program, but have no intention of supporting the full implementation of the program)).

[258] U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(a).

[259] *See supra* notes 131 to 136 and accompanying text.

[260] *See supra* notes 81 to 85 and accompanying text (discussing Laufer's view of corporations purchasing compliance as a form of insurance against receiving the blame for any misconduct by employees).

also be better able to structure the corporation's responsibilities under the settlement and set the scope of the monitor's role (if a monitorship is included in the agreement).[261]

Conclusion

The government and corporations continue to place faith in the ability of corporate compliance programs to reduce illegal and unethical behavior by managers and employees. Despite these efforts, the levels of observed unethical behavior by corporate employees has continued at a steady level over the past decade. In addition, corporate scandals continue to fill the business sections of newspapers. Although many (including the US Sentencing Commission through their amendments to the Organizational Sentencing Guidelines) have recognized the importance of a corporation's culture for controlling unethical behavior, there continues to be a wide-spread lack of understanding of the relationship between the compliance program and the corporation's culture. To help correct the problem, and reduce the number of "paper programs," this Article presents the ethical infrastructure model as a way to better understand the relationship between a corporation's formal system (e.g., compliance program), informal system (e.g., group pressures and ethical norms at the local level), and the climate of the organization. Based on the most recent empirical research on behavioral and organizational ethics, this article presents the support for this model and highlights several key insights.

[261] *See* Ford & Hess, *supra* note 16, at 731-32 (discussing the need to appropriately structure the scope of a monitor's duties under a settlement agreement, including how, if at all, the monitor is to consider issues of corporate culture).