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# Corporate Policing and Corporate Governance: What Can We Learn From Hewlett-Packard's Pretexting Scandal?

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**CORPORATE POLICING AND CORPORATE  
GOVERNANCE: WHAT CAN WE LEARN FROM  
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## **CORPORATE POLICING AND CORPORATE GOVERNANCE: WHAT CAN WE LEARN FROM HEWLETT-PACKARD'S PRETEXTING SCANDAL?<sup>1</sup>**

*Miriam Hechler Baer*

### **Abstract**

When Hewlett-Packard (HP) announced in September 2006 that its Board Chairman, Patricia Dunn, had authorized HP's security department to investigate a suspected Board-level press leak and that the investigation included tactics such as obtaining HP Board members' and reporters' telephone records through false pretenses (conduct known as "pretexting"), observers vehemently condemned the operation as illegal and outrageous. In congressional testimony, however, Dunn defended the investigation as "old fashioned detective work." Although Dunn would later claim that she was unaware of key aspects of the investigation, her description was not so far off. The police routinely rely on deception to investigate and apprehend wrongdoers. Although it is tempting to view HP's pretexting episode as a one-time scandal, the episode illuminates a more important, largely unexplored, conflict between corporate policing and corporate governance.

This Article analyzes the tension between the board's competing responsibilities of overseeing its internal corporate police and implementing the norms and structures that presumably create ethical (and therefore "good") corporate governance. As the HP scandal aptly demonstrates, law enforcement techniques that rely primarily on deception are likely to conflict with corporate governance norms such as trust and transparency. After outlining the problem, the Article considers its broader policy implications.

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## Introduction

When Hewlett-Packard (HP) announced in September 2006 that its Board Chairwoman, Patricia Dunn, had authorized HP's security department to investigate a suspected Board-level press leak, and that the investigation included tactics such as obtaining HP Board members' telephone records through false pretenses (conduct known as "pretexting"), observers vehemently condemned the operation as illegal and outrageous.<sup>2</sup>

Testifying before Congress shortly after HP disclosed its pretexting operation (which successfully identified George Keyworth as the leaking Board member), Dunn defended her actions and those of HP's compliance department as "old fashioned detective work."<sup>3</sup> Although Dunn would later claim that she was unaware of key aspects of the investigation, her description was not so far off. Public law enforcement (what we commonly think of as "the police") has enjoyed a long history of relying on differing levels of deception to investigate and apprehend wrongdoing.<sup>4</sup> Although it is tempting to view HP as a singular instance where investigators acted rashly, and executives (particularly the Board's chair) failed to grasp what they were doing, the episode provides a salient example of the ways in which corporate law enforcement techniques clash with the very corporate governance norms that the board has been charged with implementing.

Perhaps as an offshoot of the growing view of corporations as mini-republics<sup>5</sup>, academics and lawmakers have come to embrace the idea that corporations should have a "law enforcement" branch, which often resides

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<sup>2</sup> Peter J. Henning, *Did Email Cause a Disconnect for HP Lawyers?*, <http://www.law.com>, September 27, 2006.

<sup>3</sup> "[I] was told that phone records were one of the key techniques being used in the investigation, along with 'relationship mapping' and what struck me as old-fashioned detective work. I did not find it objectionable that suspected leakers might be followed to see if they were meeting with reporters." Patricia C. Dunn, Submission to Subcommittee on Investigations, House Energy and Commerce Committee, September 28, 2006 at 19, available at <http://energycommerce.house.gov/reparchives/108/Hearings/09282006hearing2042/Dunn.pdf>

<sup>4</sup> The FBI began using undercover investigations as early as 1910 and dramatically increased its reliance on them as law enforcement tactic throughout the 1970s and 1980s. Katherine Goldwasser, *After Abscam: An Examination of Congressional Proposals to Limit Targeting Discretion in Federal Undercover Investigations*, 36 EMORY L.J. 75, 77 n.10 (describing growth of "undercover tactics to conduct criminal investigations").

<sup>5</sup> "Like the vassal whose power overshadows the king's, these companies act similarly to traditional nation-states in some ways. They have tremendous economic power, establish security forces, engage in diplomatic, adjudicatory and 'legislative' activities, and influence monetary policy." Allison D. Garrett, 60 ME. L. REV. 129, 132 (2008). Compare with Usha Rodriguez, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1390 (2006) (criticizing analogy between shareholder and citizen participation).

within the corporation's compliance program.<sup>6</sup> Compliance programs generate internal codes and policies for the corporation; educate employees on those internal codes and policies (as well as federal and state law); and most important, detect and report wrongdoing to the board of directors, and where appropriate, to outside authorities.<sup>7</sup>

Government officials often presume that corporate compliance programs can more cheaply and effectively regulate corporate employees than outside regulators. The in-house lawyers who supervise compliance programs them are often referred to as "private Attorneys General."<sup>8</sup> Companies that fail to employ "effective" compliance programs risk future prosecution by the federal government for crimes committed by their employees,<sup>9</sup> as well as more punitive sentences if they are subsequently convicted.<sup>10</sup> Prudent officers and board members must therefore make sure that a compliance program "exists"<sup>11</sup> and that it is "effective." As a result, companies have, over the least several decades, spent considerable time and money developing corporate security and compliance programs, staffing them with ex-prosecutors, retired policemen and federal agents, and modifying them on the basis of advice from various compliance "consultants."<sup>12</sup>

Yet those who rely on compliance programs to root out crime and wrongdoing have given little thought to extent to which corporate law enforcement is likely to rely on deception, and to the corollary that the details of corporate policing may not match up so easily with the bedrock norms of corporate governance: loyalty, trust<sup>13</sup> and transparency.<sup>14</sup>

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<sup>6</sup> See Elizabeth E. Joh, *Conceptualizing the Private Police*, 2005 UTAH L. REV. 573, 615 (2005) (describing and categorizing growth of private police, including corporate security).

<sup>7</sup> For a general overview of corporate compliance, see the ABA's Corporate Compliance Committee's *Corporate Compliance Survey*, 60 Bus. Law. 1759 (2005).

<sup>8</sup> See Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U.L.REV. 311, 342 (2007).

<sup>9</sup> See Memorandum from Paul McNulty, Deputy Attorney General to U.S. Attorneys, *Principles of Federal Prosecution of Business Organizations*, available at [http://www.usdoj.gov/dag/speech/2006/mcnulty\\_memo.pdf](http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf) ("McNulty Memo") Prior to McNulty's memo, Larry D. Thompson, the predecessor Deputy Attorney General had issued a similar memo requiring corporations to employ effective compliance programs in exchange for prosecutorial leniency in charging entities criminally for violations by corporate employees. See also United States Sentencing Guidelines Manual ch. 8 (2004) ("Organizational Sentencing Guidelines") (court should consider whether company employed effective compliance program).

<sup>10</sup> See United States Sentencing Guidelines Manual ch. 8 (2004).

<sup>11</sup> *In re Caremark Int'l Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362 (Del. 2006).

<sup>12</sup> See Kimberly Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487 (2003). See also Tanina Rostain, *The Emergence of "Law Consultants,"* 75 FORDHAM L. REV. 1397 (2006).

<sup>13</sup> See Lynn Stout and Margaret Blair, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001) (arguing that internal

Society tolerates public law enforcement's use of deception because it believes these techniques are both necessary and effective.<sup>15</sup> Deception is instrumental in both identifying and incapacitating current criminals, and in deterring potential perpetrators from engaging in any criminal act at all.<sup>16</sup> Even if observers question the use of deceptive interrogation tactics or undercover stings, law enforcement agencies have so fully appropriated deceptive techniques in policing that deception has become a behavioral norm throughout the law enforcement community.<sup>17</sup>

Deception has a less vaunted history in corporate law. Although the Delaware Supreme Court has adopted the view that directors have an obligation to monitor employees by ensuring the existence of an effective compliance program, it came to this conclusion relatively recently.<sup>18</sup> Perhaps the Court's uneasiness with imposing this duty on the Board

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behavioral norms may better restrain misconduct in firms than contractarian or external regulatory approaches); Renee M. Jones, *Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance*, 92 IOWA L. REV. 105 (2006) (contending that personal accountability for directors is necessary to counteract other psychological phenomena which permit directors to engage in socially undesirable conduct).

<sup>14</sup> Although disclosure is a presumed norm, not all shareholders welcome it. See Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L. J. 285 (2005)

<sup>15</sup> "Undercover informants, those willing to pose as co-schemers, accomplices, or confidants of criminal suspects, are the lifeblood of innumerable investigations and prosecutions. They offer police and prosecutors the prospect of gaining admissible, incriminating and extremely persuasive evidence: damning statements that suspects make to those whom they mistakenly trust." Steven D. Clymer, *Undercover Operatives and Recorded Conversations: A response to Professors Shuy and Lininger*, 92 CORNELL L. REV. 847 (2007). See also Bruce Pringle, Comment, *Present and Suggested Limitations on the Use of Secret Agents and Informers in Law Enforcement*, 41 U. COLO. L. REV. 261 (1969) ("most authors ultimately conclude that informers and secret agents are a necessary component of law enforcement"). Ileana Saros, *The Undercover Operation: Indispensable Tool of Law Enforcement*, 9 CRIM. JUST. Q. 27 (1985) (prosecutor arguing that undercover operations are necessary to pierce the "veil of secrecy" surrounding various crimes).

<sup>16</sup> See Bruce Hay, *Sting Operations, Undercover Agents, and Entrapment*, 70 MO. L. REV. 387 (2005).

<sup>17</sup> "Virtually all interrogations – or at least virtually all successful interrogations – involve some deception." Laurie Magid, *Deceptive Police Interrogation Practices: How Far is Too Far?*, 99 MICH. L. REV. 1168, 1168 (2001) (prosecutor's observations and arguments in favor of using certain levels of deception in interrogations).

<sup>18</sup> See *Graham v. Allis-Chalmers*, 188 A.2d 125, 130 (Del. 1963) ("absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists"). The Delaware Supreme Court repudiated *Graham* in *Stone v. ex rel AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006) (holding that "director oversight liability" applies when directors fail to assure "a reasonable information and reporting system exists" within the company), quoting *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 971 (Del.Ch.1996).

stemmed from the fact that monitoring and compliance often entail surveillance and deception.<sup>19</sup> Deception is in direct tension with the common norms associated with corporate governance, loyalty, trust and transparency. On one hand, the board must set an appropriate “tone at the top” that creates a “compliant” corporate culture. At the same time, the board has become a *de facto* police commissioner, with all of the investigatory powers – and ethical quandaries – that accompany such power.

This Article analyzes the tension between the board’s competing responsibilities of overseeing its internal policing apparatus and implementing the norms and structures that presumably create an atmosphere of “good corporate governance.” As the HP incident aptly demonstrates, law enforcement techniques that rely primarily on deception are most likely to conflict with the norms frequently heralded as the basis of good governance.

To date, this tension has not been explored by academics or lawmakers.<sup>20</sup> Using the HP pretexting episode as a backdrop, this Article explores the outlines of this problem and suggests broader policy implications for further consideration.

## **I. The Origins of HP’s Pretext Woes**

HP’s leak problems extended as far back as January 2005, when the Wall Street Journal reported deliberations within HP’s Board that related to its unhappiness with HP’s embattled CEO and Board Chairwoman, Carylton (“Carly”) Fiorina and the company’s failure to digest Compaq.<sup>21</sup> Shortly after the Wall Street Journal article, at Fiorina’s urging, the Board’s nominating and governance committee directed HP’s outside law firm,

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<sup>19</sup>The 1963 Delaware Supreme Court described corporate compliance as a “system of espionage.” Graham, 188 A.2d at 130.

<sup>20</sup> Although a few authors have examined several issues raised by private policing, none of have addressed implications for corporate governance. See David A. Sklansky, *Private Police and Democracy*, 43 AM. CRIM. L. REV. 89 (2006) (raising concerns that private policing undermines democracy) and Sklansky, *The Private Police*, 46 U.C.L.A. L. REV. 1165, 1167 (1999) (noting that scholars “have tended to ignore private security”); Elizabeth E. Joh, *The Paradox of Private Policing*, 95 J. CRIM. L. & CRIMINOLOGY 49 (2004) (citing dearth of analysis on topic of private policing).

<sup>21</sup> Pui-Wing Tam, *Hewlett-Packard Board Considers a Reorganization*, Wall St. J., January 4, 2005 at A1.

Wilson Sonsini, to interview suspected board members.<sup>22</sup> This investigation, however, did not identify the leaker.<sup>23</sup>

Following an unsuccessful attempt to convince Fiorina to alter her strategic vision, HP's Board dismissed Fiorina in February 2005. In the wake of Fiorina's dismissal, Patricia Dunn became HP's non-executive Chairman (a newly created position), and in March 2005, Mark Hurd became HP's CEO.

Since Fiorina's initial investigation "had come to naught," Dunn concluded that further investigation was necessary to identify the person who had leaked information to the press.<sup>24</sup> Dunn then turned to HP's internal security personnel, who in turn relied on an outside private investigator who had worked closely with HP for years.<sup>25</sup> According to Dunn, she had intermittent contact with this investigator during the spring and early summer of 2005. Dunn notified the rest of the Board of this investigation (nicknamed "Project Kona") in March 2005.<sup>26</sup> Although Dunn knew that Project Kona involved the accessing of telephone records, she contended that HP's private investigator informed her that such access was a "standard component" of HP investigations and that the records were obtained legally.<sup>27</sup> This first investigation directed by Dunn (Project Kona I) terminated in August 2005 with no conclusive results.

Several months later, in January 2006, the leak issue resurfaced. An article that praised HP's new strategy appeared in CNET and discussed confidential information available only to HP's Board.<sup>28</sup> The CNET article reignited the leak investigation, now famously known as "Project Kona II". Recognizing the potential legal problems that board-level leaks could pose for HP, Dunn immediately initiated a new investigation of the leak and expressed her urgency to HP's general counsel, Ann Baskins.<sup>29</sup> The second and far more intrusive investigation, extended from January through March

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<sup>22</sup> John Markoff, *Ex-Chief of HP Pursued Leaks Too*, NY TIMES, October 5, 2006 at \_\_; James B. Stewart, *The Kona Files; The World of Business*, The New Yorker, Feb. 19, 2007 at \_\_.

<sup>23</sup> Submission of Patricia Dunn to the Sub-Committee on Investigations, House Energy and Commerce Committee, September 28, 2006, ("Dunn Submission") at 2.

<sup>24</sup> Dunn Submission, *supra* note \_\_ at 2.

<sup>25</sup> Dunn Submission, *supra* note \_\_ at 9-10 (describing contacts with Ron Delia).

<sup>26</sup> Dunn Submission, *supra* note \_\_ at 13.

<sup>27</sup> "I asked Mr. Delia at every point of contact for his representation that everything being done was proper, legal and fully in compliance with HP's normal practices. I did this because it is the role of directors to ask questions and seek such representations from the right people. Indeed, reliance on representations from trusted sources is a bedrock concept in board governance for the express reason that directors cannot directly supervise management's actions." Dunn Submission, *supra* note \_\_ at 12-13.

<sup>28</sup> Dawn Kawamoto and Tom Krazit, *HP Outlines Long-term Strategy*, CNET, January 23, 2006, [http://news.com.com/HP+outlines+long+term+strategy/2100-1014\\_3-6029519.html](http://news.com.com/HP+outlines+long+term+strategy/2100-1014_3-6029519.html).

<sup>29</sup> Dunn Submission, *supra* note \_\_ at 17.

2006. Among other things, the investigation featured the following techniques:

- Reviewing the company email accounts, company phone records and computer hard drives of every member of HP's "Executive Council";
- Hiring a private investigation firm, which in turn subcontracted out the job of obtaining private telephone records of select Board members and nine journalists, including Dawn Kawamoto, the CNET reporter who had written the January 2006 article;
- Surreptitiously following Kawamoto and suspected Board members in public (and apparently searching through their trash);
- Setting up a "sting" in which investigators sent Kawamoto an email containing fake tips about HP and an attachment whose tracking software would trace the email's path after it reached Kawamoto's computer.<sup>30</sup>

The investigation was monitored and supervised by HP's chief compliance officer and attorney, Kevin Hunsaker. Hunsaker reported to Baskins, who, with Hunsaker, periodically advised Dunn of the progress of the investigation.<sup>31</sup> Dunn would later contend that as a non-executive chairwoman, she exercised no control over the investigation that she initiated.<sup>32</sup>

After investigators identified George Keyworth as the source of the CNET leak, Dunn and Baskins sought outside counsel from HP's law firm, Wilson Sonsini, on how they should handle the matter and whether it should go before the governance sub-committee or the entire Board.<sup>33</sup> Prior to the Board's May 18, 2006 meeting, the chair of the Board's Audit Committee, Robert Ryan, asked Keyworth if he was the source of the January 2006 CNET article; Keyworth admitted that he was.<sup>34</sup> Ryan subsequently disclosed that Keyworth was the leak during the Board's subsequent meeting. After Keyworth addressed the Board, it met separately to consider whether to ask for Keyworth's resignation.<sup>35</sup> During the deliberations, another of the Board's members, the well-known venture

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<sup>30</sup> Report of Kevin T. Hunsaker, "Unauthorized Disclosure Investigation," May 24, 2006, at 3-4, available at <http://www.thesmokinggun.com/archive/0929061hp2.html>.

<sup>31</sup> Dunn Submission, *supra* note \_\_ at 18.

<sup>32</sup> Patricia Sellers, *The Survival of Pattie Dunn*, FORTUNE, June 11, 2007 at 110.

<sup>33</sup> Dunn Submission, *supra* note \_\_ at 21-22; Stewart, *supra* note 23 at \_\_ (during a meeting, "Baskins and Sonsini said that it would be improper to keep the information from the full board [Dunn was debating whether to send the information first to the governance or audit committees].).

<sup>34</sup> During this conversation, Keyworth allegedly indicated that he would have readily admitted this had anyone directly asked. Stewart, *supra* note 23 at \_\_ (reporting that Keyworth's response was, "Why didn't you just ask me?").

<sup>35</sup> Stewart, *supra* note 23 at \_\_.

capitalist Thomas Perkins, stormed out of the meeting and announced his resignation from the Board.<sup>36</sup> Over the next six weeks, Perkins and HP's outside counsel, Larry Sonsini, debated: (a) the manner by which HP had conducted the investigation; (b) the investigator's attempts to obtain information regarding Perkins' personal phone line; and (c) HP's obligation to disclose Perkins' reasons for leaving HP.<sup>37</sup>

As a result of Perkins protests, HP's pretexting investigation became public in early September 2006.<sup>38</sup> Keyworth admitted that he was the CNET source, contending that he spoke to CNET with HP's best interests at heart, and resigned on September 12, 2006.<sup>39</sup> Almost immediately after the investigation became public, HP's tactics triggered inquiries by Congress, the SEC, and simultaneous state and federal criminal investigations.<sup>40</sup>

With the exception of Mark Hurd, none of the HP executives who participated in the investigation fared particularly well, although their criminal cases ended with more of a whimper than a bang.<sup>41</sup> The California Attorney General's office initially indicted on felony charges Dunn, Hunsaker and the investigators who either approved or engaged in pretexting.<sup>42</sup> Eventually, the AG's office reduced the felony charges to misdemeanors and a court ultimately through out Dunn's charge. Hunsaker and two former investigators pled no-contest and the court hearing their

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<sup>36</sup> Dunn Submission, *supra* note \_- at 25-26. Perkins and Dunn have provided different accounts of what sparked Perkins' ire. According to Perkins, he objected both to the investigator's tactics and to Dunn's decision to bring the matter before the entire Board and embarrass Keyworth. See Stewart, *supra* note 23 at \_\_\_. Dunn, however, contends that Perkins never alluded to the investigation itself during the Board meeting, and was referring solely to Perkins' request "to cover up the name of the leaker." Stewart, *supra* note 23 at \_\_\_, quoting Dunn's oral testimony before the Transcript of Hearing of Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, September 28, 2006, available at

[http://www.washingtonpost.com/wp-srv/business/documents/HP\\_hearing09282006.html](http://www.washingtonpost.com/wp-srv/business/documents/HP_hearing09282006.html).

<sup>37</sup> See Letter From Thomas Perkins to HP Board of Directors, September 5, 2006, attaching June 28, 2006 email correspondence with Larry Sonsini and Letter from AT&T to Thomas Perkins, August 11, 2006 (detailing how Perkins' personal phone records were accessed by the creation of an online account and the use of Perkins' Social Security Number), all available at <http://www.thesmokinggun.com/archive/0905061hp1.html>.

<sup>38</sup> See SEC filing 8K, September 6, 2006.

<sup>39</sup> See HP News Release, September 12, 2006, available at <http://www.hp.com/hpinfo/newsroom/press/2006/060912b.html>. The source of the 2005 Wall Street Journal article was never identified.

<sup>40</sup> Jim Hopkins and Jon Swartz, *Investigations Continue at HP; Scandal Gets Scrutiny From Several Fronts*, USA TODAY, October 5, 2006, at B. 1.

<sup>41</sup> Hurd apologized profusely and characterized Kona II as a "rogue investigation." See Testimony of Mark Hurd, Transcript of Hearing of Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, September 28, 2006, available at [http://www.washingtonpost.com/wp-srv/business/documents/HP\\_hearing09282006.html](http://www.washingtonpost.com/wp-srv/business/documents/HP_hearing09282006.html).

<sup>42</sup> Peter Carey, *HP Insiders Charged with Felonies*, Knight Ridder Tribune Business Press, Oct. 4, 2006 at 1.

case agreed to dismiss their charges in exchange for 96 hours of community service.<sup>43</sup> A fifth investigator, who personally handled the pretexting for HP and used Social Security Numbers to obtain the actual phone records, pled guilty to federal felony charges in Colorado.<sup>44</sup> Apart from criminal liability, however, Dunn, Hunsaker and Baskins lost their jobs and suffered reputational harm. In later interviews, Perkins portrayed Dunn as inexperienced in technology, overly motivated by compliance details and acting in accordance with personal dislike of some of her fellow board members.<sup>45</sup>

One of the greater mysteries of the HP scandal was that its lawyers apparently concluded not only that pretexting was legal, but also ethical and desirable. Unfortunately, the internal HP documents that HP's lawyers provided do not reflect deep consideration of how either Baskins or Hunsaker reached such a conclusion.<sup>46</sup>

According to the Wilson Sonsini memo prepared recounting Hunsaker's legal inquiry, Hunsaker initially based his legal opinion on "about an hour's worth of online research."<sup>47</sup> In an email to Ann Baskins after the pretexting investigation was well under way, Hunsaker also reported that he had secured the reassurances of the Florida company to which HP had subcontracted the investigation, and on third-party communications between an HP security officer and a small law firm that had conducted "extensive research on this issue."<sup>48</sup> Hunsaker, however, apparently did not communicate directly with this law firm. Nor did Hunsaker (or Baskins) solicit the opinion of more well-known firms, such as Wilson Sonsini. Hunsaker's facile examination of these issues was

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<sup>43</sup> Jessica Guyunn, *Final Charges Dropped in HP 'Pretexting' Case*, SF Chron, June 29, 2007 at D1. The court commented that in its opinion, "the conduct amounted to boardroom politics and a betrayal of trust and honor rather than criminal activity." *Id.*

<sup>44</sup> Jordan Robertson, *Plea Deal Advances HP's Case*, Houston Chronicle, Jan. 13, 2007, at 3. The investigator, Bryan Wagner, worked solely at the direction of companies that HP has contracted with for the investigation. As a result, HP's employees had far less control over, and knowledge of, the techniques that Wagner used to obtain the telephone records.

<sup>45</sup> Suzy Jagger, Interview with Tom Perkins, Times (UK), November 5, 2007 (complaining that Dunn was more interested with corporate governance and "box-checking" than with the company's underlying business and technology concerns).

<sup>46</sup> See K. Lee Blalack II and Cristina C. Arguedas, Letter to Committee on Energy and Commerce, September 28, 2006, available at [http://www.sfgate.com/chronicle/pictures/2006/09/29/mn\\_doc.pdf](http://www.sfgate.com/chronicle/pictures/2006/09/29/mn_doc.pdf) (hereinafter "Letter to Committee").

<sup>47</sup> Bahram Seyedin-Noor and Trevor Lain, Draft Memorandum of Interview of Kevin Hunsaker, August 21, 2006 at paragraph 41, available at [http://www.sfgate.com/chronicle/pictures/2006/09/29/mn\\_doc.pdf](http://www.sfgate.com/chronicle/pictures/2006/09/29/mn_doc.pdf)

<sup>48</sup> See Email dated May 1, 2006 from Kevin Hunsaker to Ann Baskins, attached to Letter to Committee, at HP 04028. The law firm, Bonner, Kiernan, Trebach and Crociata, happened to share office space with Ron Delia, the private investigator that HP had hired to direct the pretexting investigation.

particularly striking in contrast to the concerns that were raised by two lower-level HP security employees.<sup>49</sup>

Had Hunsaker rigorously analyzed the issue, he still might have concluded that pretexting, depending on how it was achieved and for particular purposes, might fall outside the technical purview of either state or federal criminal law.<sup>50</sup> The Gramm-Leach-Bliley Act, the federal law on pretexting, pertained solely to attempts to obtain false information from “financial institutions” which the FTC itself admitted did not include telephone companies.<sup>51</sup>

Nevertheless, regardless of the technicalities, Hunsaker *should* have recognized that the risk of criminal, civil, and professional liability (not to mention the potential reputation effect) was rapidly shifting. By the end of January 2006, several wireless carriers and at least one state attorney general had filed well-publicized lawsuits against several data brokers for pretexting phone companies.<sup>52</sup> In February 2006, the Electronic Privacy Information Center (EPIC), a privacy advocacy group, had sent a letter to state bar associations arguing that an attorney’s use of pretexted records violated several provisions of the ABA Model Rules.<sup>53</sup>

Also in February 2006, the Federal Trade Commission had publicly warned that although pretexting did not violate the Gramm-Leach-Bliley Act, the agency nevertheless intended to bring law enforcement action against telephone pretexters for “deceptive and unfair practice[s] under Section 5 of the FTC Act.”<sup>54</sup> During the same month, the Federal Communications Commission also signaled concern with pretexting by requiring telephone carriers to increase protection of their customers’ personal information.

Finally, numerous states, such as California, had enacted laws aimed at protecting personal customer and employee information maintained by corporations. Specifically, California prohibited unauthorized access to

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<sup>49</sup> See Stewart, *supra* note 23 at \_\_ (discussing reservations HP security officers Fred Adler and Vince Nye, who concluded in an email to Hunsaker that pretexting “is very unethical at the least and probably illegal”).

<sup>50</sup> Damon Darlin and Matt Richtel, *Fuzzy Laws Come Into Play in the H.P. Pretexting Case*, NEW YORK TIMES, Sept. 19, 2006 (citing difficulties in proving culpability under either state or federal laws).

<sup>51</sup> See 15 U.S.C. 6821 *et. seq.*

<sup>52</sup> David Gusow, *Verizon Lawsuit Says Phony Callers are Committing Fraud*, St. Petersburg Times, January 30, 2006 (reporting lawsuits by Verizon Wireless, Sprint Nextel and the Florida Attorney General).

<sup>53</sup> <http://epic.org/privacy/iei/attyltr22106.html>

<sup>54</sup> One might have concluded that the FTC’s statement was aimed at brokers who obtained telephone records under pretext and then sold that information to someone else at a profit.

customer records from utilities.<sup>55</sup> This last point was particularly important because HP was headquartered in California. There is no indication, however, that Hunsaker considered civil or criminal liability under California's laws.

Although its stock price fared well despite the scandal, the company did not escape completely unscathed.<sup>56</sup> HP agreed to pay approximately \$14 million in fines to the State of California and implement changes in its corporate governance, which was indeed ironic given the fact that the "criminal conduct" emanated from HP's compliance personnel.<sup>57</sup> Meanwhile, the CNET and other reporters who were the source of the investigation sued HP and others individually for violating their privacy, as did the telephone carriers whose information had been obtained without proper authorization. On February 14, 2008, the New York Times reported that HP had settled the civil litigation with the Times and three BusinessWeek magazine journalists for an undisclosed sum.<sup>58</sup> Civil cases filed by the other affected journalists, are, as the date of this Article's publication, still pending.<sup>59</sup>

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<sup>55</sup> See Cal. Penal Code 538.5 (criminalizing fraud in obtaining customer records from public utilities).

<sup>56</sup> James B. Stewart, *The Kona Files*, THE NEW YORKER, Feb. 19, 2007 at 152 (noting HP's financial strength throughout the pretexting scandal).

<sup>57</sup> HP also settled charges, without monetary penalty, with the SEC for failing to disclose the reasons for Perkins' resignation from the Board in May 2006. Therese Poletti, *Hewlett Packard Probe by SEC is Settled*, Knight Ridder Tribune Business News, May 24, 2007 at 1.

<sup>58</sup> Matt Richtel, *Hewlett Packard Settles Spying Case*, February 14, 2008, available at <http://www.nytimes.com/2008/02/14/business/media/14hp.html?st=cse&sq=hewlett+packard&scp=1> (reporting HP's settlement with the New York Times and three Business Week journalists).

<sup>59</sup> *Id.*

## II. Tracking the Move from Governance to Policing, and from Compliance to Deception

Much of the criticism leveled at HP following the announcement of its conduct focused on the deceptive nature of its investigation and the fact that one board member had used the company's investigative powers to investigate her colleagues surreptitiously.<sup>60</sup> Criticizing the entire operation, Congresswoman Diana Degette opined that the House Energy Committee's hearing was not about pretexting *per se*, but rather:

[A]bout how the Hewlett-Packard way became synonymous with digging through people's trash, setting up bogus e-mails, which were approved at the highest levels of the company, and stinging unsuspecting reporters.... [and] how a computer company suddenly found itself in the business of trailing and photographing board members across the globe or surveilling journalists using ex-FBI agents who sat in cars and watched as if their subjects were busy making truck bombs.<sup>61</sup>

During the same hearing, Patricia Dunn explained that although she never intended HP's investigators to engage in illegal conduct, she saw nothing inherently wrong with the investigators' conduct:

The fact is that I believe that these methods may, in fact, be quite common not just at Hewlett-Packard, but at companies around the country. Every company has a security department. Every company of consequence has people who do detective-type work in order to ferret out the sources of nefarious activities.<sup>62</sup>

Dunn's point was that the deceptive nature of HP's investigation was neither unusual nor surprising. Companies *do* rely on security

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<sup>60</sup> Professor Viet Dinh, a former DOJ official who advised Tom Perkins during the HP scandal, opined: "[I]t was unconscionable for a chairman to spy on her own directors." Dinh, *Dunn and Dusted*, Wall St. J., Sept. 26, 2006 at A. 14.

<sup>61</sup> Statement of Diana Degette, Transcript of Hearing of Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, September 28, 2006, available at [http://www.washingtonpost.com/wp-srv/business/documents/HP\\_hearing09282006.html](http://www.washingtonpost.com/wp-srv/business/documents/HP_hearing09282006.html).

<sup>62</sup> Testimony of Patricia Dunn, Transcript of Hearing of Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, September 28, 2006, available at [http://www.washingtonpost.com/wp-srv/business/documents/HP\\_hearing09282006.html](http://www.washingtonpost.com/wp-srv/business/documents/HP_hearing09282006.html). See also Dunn Submission, *supra* note \_- at 19 (describing the investigatory methods as "old-fashioned detective work").

departments to police their employees and, like any police force, they *do* use deceptive practices to accomplish these ends.<sup>63</sup>

Although Dunn's defense was hardly a winner ("everybody does it" does not go very far in public hearings), the underlying contention that deceptive misconduct requires deceptive policing was at least facially reasonable. After all, HP had experienced a problem with Board member(s) leaking information to the press (although the CNET article that triggered the second Kona investigation was largely positive). Board level leaks are undesirable because they enable board members to avoid accountability while secretly manipulating public attention.<sup>64</sup> Earlier attempts to identify the leaker through direct questioning had turned up no information. If the leaker was unwilling to come forward, how else was HP supposed to identify him if not through deception?<sup>65</sup>

It may be tempting, as Mark Hurd did, to ascribe the worst aspects of the HP investigation to rogue investigators and poor judgment.<sup>66</sup> It is even more tempting to forget about the pretexting incident altogether since most of the pretexting-episode's architects have left HP. The scandal is instructive, however, in that it demonstrates the unexplored conflict between corporate policing and corporate governance, and the manner in

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<sup>63</sup> See discussion *infra* at \_\_\_\_.

<sup>64</sup> "[Boardroom] leaks are terrible and pernicious. They can undermine a company's planning and its proposed courses of action before they're ever tested in the crucible of the marketplace. They may prevent frank discussion if board members think their statements will become public fodder. It's unquestionably wrong for corporate directors to use the media to vent their disapproval of, or disagreement with, various corporate initiatives." Harvey Pitt, *Looking for Leaks in All the Wrong Places*, Forbes.com, September 19, 2006, available at [http://www.forbes.com/leadership/2006/09/19/leadership-pitt-hp-lead-govern-cx\\_hc\\_0919-pitt.html](http://www.forbes.com/leadership/2006/09/19/leadership-pitt-hp-lead-govern-cx_hc_0919-pitt.html) (arguing that Dunn should have sought to minimize risk of future leaks by increasing board's collegiality). See also Simon A. Rodell, Note, *Plumbing in the Board Room: Plugging Boardroom Leaks Through a Good Faith duty of Confidentiality*, 59 FLA. L. REV. 631, 646 (2007) (arguing for a director "duty of confidentiality" in part because media leaks "manipulate boardroom actions").

<sup>65</sup> Pitt suggests that Dunn could have asked all directors, "at a face-to-face meeting, to make their telephone and email records available to a third party investigator." Pitt, *supra* note 64. Had several directors refused on principle to provide such information, however, the investigation would have proceeded no further. Moreover, Pitt's direct-confrontation method would not prevent a director from handing over incomplete information (ie, telephone records for one phone line, without disclosing the existence of another). For a discussion of other deceptive, but legal practices, that HP's investigators could have employed, see Daniel Fisher, *Get Hunt and Liddy on the Phone*, FORBES.com, October 2, 2006, available at <http://www.forbes.com/forbes/2006/1002/040.html>.

<sup>66</sup> Hurd described the operation as a "rogue investigation" that went against the company's "values." Mark Hurd, prepared statement before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, September 28, 2006 at 2, available at <http://energycommerce.house.gov/reparchives/108/Hearings/09282006hearing2042/Hurd.pdf>.

which this conflict has fallen on the shoulders of the corporate board. On one hand, society has erected a set of regulations and policies that tell corporations to “police” themselves or otherwise suffer significant (and in some instances, life-ending) penalties. On the other hand, we have simultaneously informed the corporate world that corporate governance is best achieved by incorporating norms such as loyalty, trust and transparency.

The conflict between corporate policing and corporate governance is rooted in a separate conflict between two competing theories of corporate governance: a “classical” structural approach to corporate governance that seeks to reduce agency costs through implementation of structures, and a far more normative “cultural” theory of corporate governance that relies on social norms to prevent wrongdoing.

Part A begins by setting out these paradigms of corporate governance and suggests that each of the two paradigms influenced the Sarbanes-Oxley Act of 2002 (“Sarbox”). Whereas some characteristics of Sarbox fall comfortably in the classical governance category, others, such as the whistleblowing protection laws and disclosure rules on corporate codes, are aimed at encouraging social norms such as loyalty and trust.

Part A also explores how cultural governance proponents failed to consider the daily reality of corporate policing, particularly the methods by which corporations were likely to implement compliance programs in light of the government’s emphasis on reporting and discipline as criteria for reduced liability.<sup>67</sup>

Part B explores some of the rarely-mentioned limitations of corporate policing. In order to properly perform its function, the corporate compliance program must obtain reliable information from the company’s officers and employees. Overt policing methods, however, encourage avoidance of detection by those who fear that they will lose their job or be reported to authorities. Accordingly, to detect wrongdoing, the corporate investigator must rely on a technique well-developed by public law enforcement agents: deception. As corporate compliance programs become more responsible for finding instances of wrongdoing and sanctioning employees for such wrongdoing, we must consider the extent to which corporate investigators will rely on the types of “old fashioned detective

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<sup>67</sup> The criminal liability of corporate entities has been well debated. See Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U L. REV. 687 (1997); Andrew Weissman with David Newman, *Rethinking Criminal Corporate Liability*, 82 IND. L.J. 411 (2007) (arguing for duty based liability); Daniel R. Fischel & Alan O. Sykes, *Corporate Crime*, 25 J. LEGAL STUD. 319 (1996) (questioning the imposition of corporate criminal liability)

work” that Patricia Dunn cited in her defense of HP’s board leak investigation.

Finally, Part C discusses how deception-fueled corporate policing may affect corporate culture and thereby undermine the very goals of “good” corporate governance that Sarbox’ drafters and supporters were so intent on bringing about. From this perspective, the HP pretexting scandal is not merely a blip in corporate history, but rather a bellwether of the tensions that may arise as corporate compliance programs integrate well-known policing methods.

## **A. Alternate Theories of Corporate Governance**

Although “corporate governance” has become a fairly popular topic of both scholarly and media discussion throughout the last decade, it does not always carry the same meaning. Although most commentators agree that Enron, Worldcom and similar scandals provided evidence of “bad” corporate governance, the academic world’s proposed solutions to this problem emanate from widely different perspectives. Although the debate is sometimes spun as an argument between more or less regulation, a deeper look at the literature suggests a far wider gap in approach. There are, in fact, two identifiable paradigms of corporate governance, and those two paradigms have led scholars to prescribe vastly different solutions to the problem of corporate malfeasance.

### **1. Classical Corporate Governance**

Classically, scholars have used the term “corporate governance” to refer to the manner by which power and responsibility is allocated between the corporation’s managers and shareholders.<sup>68</sup> Under the classical approach, “good governance” refers to the legal structures (fiduciary duties, voting rights and disclosure requirements) that enable shareholders to better protect their investment by reducing agency costs. Shareholders, officers and board members alike are all presumed to be rational actors.

In the standard narrative of corporation law, dispersed and relatively powerless shareholders rely on the company’s board of directors to monitor the company’s officers.<sup>69</sup> Although shareholders may register their disapproval of how management is running the company either by selling their stock or, in some limited instances, voting, the directors have the

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<sup>68</sup> “I take the phrase ‘governance’ to mean the collection of law and practice that regulates the conduct of those in control of a business organization.” Lawrence Cunningham, *Comparative Corporate Governance and Pedagogy*, 34 GA. L. REV. 721 (2000).

<sup>69</sup> ADOLF A. BERLE, JR. AND GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932)

responsibility and power to manage the affairs of the company.<sup>70</sup> Because of the potential agency costs that emanate from the separation of ownership and control, the government (used here to refer to all levels of government) protects shareholders by mandating and regulating periodic disclosure of the company's financial performance and by imposing on directors the fiduciary duties of loyalty and care.<sup>71</sup> The government supports these obligations even further by attaching civil, and increasingly criminal, sanctions for failure to adhere to them.

Within this narrative, discussions of corporate governance focus almost exclusively on the relationship between the shareholders who own the company, the senior executives who run it, and the directors interposed between the two groups. The "governance" at issue is the sum of structures most likely to reduce information and agency costs caused by the separation of ownership and control.<sup>72</sup> Shareholders will maintain their investment in the market if they receive reliable information from management.<sup>73</sup> The term "trust" as used in this paradigm, often refers to the shareholder's trust in the capital markets; it is not a relational concept *per se*. Rules requiring "strong monitors" and "transparent" financial reporting are intended to bring about this systemic version of trust.<sup>74</sup> Within this paradigm, the debate revolves around the effectiveness of certain structures and the type of discipline – government regulation or private markets – that best reduces agency costs and creates a reliable market.<sup>75</sup>

Classical discussions of corporate governance coincide with the more primal debate over between the communitarian view of the corporation and the contention that the corporation is no more than a nexus-of-contracts<sup>76</sup> which exists primarily for the benefit of its shareholders.<sup>77</sup>

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<sup>70</sup> See DEL. CODE TIT. 8 § 141(a) (2006).

<sup>71</sup> *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362 (Del. 2006).

<sup>72</sup> "Every theory of corporate governance is, at heart, a theory of power. In this view, the corporation is a nexus of power relationships beyond being a nexus of contracts. The corporate setting is rife with agency relationships in which certain parties have the ability (power) to unilaterally affect the interests of other parties notwithstanding preexisting contractual arrangements." Amir Licht, *Maximands of Corporate Governance*, 29 DEL. J. CORP. L. 649, 653 (2004).

<sup>73</sup> "The basic and simple notion is that if a country's legal regime provides more investor protection, investors will be more willing to invest. That willingness will, in turn, translate into: companies being able to raise money more quickly and cheaply; into deeper and more liquid capital markets; and ultimately into economic growth." Robert A. Prentice and David B. Spence, *Sarbanes-Oxley As Quack Corporate Governance: How Wise is the Received Wisdom*, 95 GEO. L.J. 1843, 1861 (2007).

<sup>74</sup> *Id.* at 1858-59 (arguing that "capital markets are improved by vigorous securities regulation featuring mandatory disclosure requirements, insider trading prohibitions, strong public enforcement, and provision of private remedies for defrauded investors").

<sup>75</sup> Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act*, 28 J. CORP. L. 1 (2002).

<sup>76</sup> FRANK L. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

Many nexus adherents agree that corporate governance is important but reject much of the government's recent regulation as unnecessary, ineffective or overly costly.<sup>78</sup>

Classical governance debates start with the same presumption: that good governance provides the corporation's shareholders with accurate financial information about their investment and, with a few exceptions, seeks to increase that investment. Within this group, scholars are likely to disagree over the source, specificity and content of governance rules. The debate thus focuses on the relative merits and drawbacks of institutions such as markets, state courts and legislatures, or Congress and administrative agencies.<sup>79</sup>

Many of the reforms set forth in the Sarbanes-Oxley Act of 2002<sup>80</sup> ("Sarbox") and in policies and regulations promulgated by the SEC, the DOJ and the United States Sentencing Guidelines, comfortably rest within the classical governance paradigm. They seek to deter socially undesirable conduct through a combination of structural changes, increased internal and external monitoring and detection, and the addition of heightened sanctions as a threat to those who fail to follow the law.<sup>81</sup> By shifting more power to independent directors, as well as external regulators and prosecutors, the reforms improve the government's ability to deter and identify wrongdoing before shareholders are unduly harmed, and to exact retribution (both financial and harsher penalties) in those instances in which harm has already occurred.<sup>82</sup> Corporate governance improves because the law

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<sup>77</sup> *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919). For an argument that *Dodge* did not stand for such a broad rule, see Stout and Blair, *supra* note \_\_\_ at 301-02 (arguing that court's decision reflected special duties shareholders owe each other in close corporations).

<sup>78</sup> See, e.g. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005); Henry N. Butler and Larry E. Ribstein, *The Sarbanes-Oxley Debacle: WHAT WE'VE LEARNED; HOW TO FIX IT* (2006);

<sup>79</sup> For debates over regulation versus private ordering, see Romano, *supra* note \_\_; Ribstein, *supra* note \_\_. For discussions of state versus federal regulation of corporations, see Roberta Karmel, *Realizing the Dream of William O. Douglas – The Securities and Exchange Commission Takes Charge of Corporate Governance*, 30 DEL. J. CORP LAW. 79 (2005) ("The SEC's new activism with respect to corporate governance can thus be analyzed as the latest maneuver in a long running battle between federal and state authorities over the regulation of public corporations."); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573 (2005).

<sup>80</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 779 (codified as amended in, *inter alia*, sections of 15 and 18 U.S.C.).

<sup>81</sup> "[W]histleblower statutes, Department of Justice policies, Securities and Exchange Commission rules, U.S. Sentencing Guidelines, and American Bar Association ethical rules for attorneys ... mean that more corporate wrongdoing will come to law enforcement's attention." Pamela H. Bucy, *Trends in Corporate Criminal Prosecutions*, 44 AM. CRIM. L. REV. 1287 (2007).

<sup>82</sup> "Sox's corporate governance provisions were aimed at restoring faith in the capital markets by protecting investors, primarily by improving the accuracy and reliability of

transfers power to some groups (independent directors and employees); and away from others (managers); and places significant monitoring responsibility on yet a third group (lawyers and auditors). These changes presumably work by: (a) reducing the opportunities to engage in wrongdoing; (b) reducing the benefits of ignoring others' wrongdoing; and (c) increasing the likelihood that wrongdoers – and poor monitors -- will be detected and sanctioned either formally, informally or both.

## 2. The Cultural Theory of Corporate Governance

A separate theory of corporate governance describes good governance from the perspective of culture and ethics.<sup>83</sup> This view of corporate governance resides comfortably within the body of literature that views the corporation descriptively and prescriptively as a singular entity or community, with responsibilities to stakeholders other than shareholders.<sup>84</sup> Under the organizational paradigm of the corporation, “governance” is not merely a debate over certification requirements or board member independence, but also includes substantial consideration of the corporation’s culture and the appreciation (or lack thereof) of ethical norms<sup>85</sup> throughout the company and its board.<sup>86</sup>

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financial reporting and by preventing corporate frauds.” Prentice and Spence, *supra* note \_\_\_ at 1868.

<sup>83</sup> See Elletta Sangrey Callahan, Terry Morehead Dworkin, Timothy Fort, Cindy A. Schipani, *Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment*, 40 AM. BUS. L. J. 177, 179 (2002).

<sup>84</sup> *Id.* See also William Arthur Wines and J. Brooke Hamilton III, *Observations on the Need to Redesign Organizations and to Refocus Corporation Law to Promote Ethical Behavior and Discourage Illegal Conduct*, 29 DEL. J. CORP. L. 43, 78-79 (“the modern publicly traded corporation cannot be explained by the classical model of property and contract. Such corporations should be treated as the distinct creatures they are”).

<sup>85</sup> The term “norm” has been defined generally as a practice that people follow regardless of the existence of a formal rule or regulation demanding such conduct. See Edward Rock and Michael Wachter, *Norms and Corporate Law*, 149 U. PA. L. REV. 1607 (norms “represent those behavioral rules and standards that are primarily, if not exclusively, enforced by the parties themselves”). Others have attempted to categorize norms. See, e.g. Mel Eisenberg, *Corporate Law and Social Norms*, 69 COLUM. L. REV. 1253 (1999) (describing three categories of norms: behavioral, customary and obligatory); Michael P. Vandenberg, *Beyond Elegance: A testable Typology of Social Norms in Corporate Environmental Compliance*, 22 STAN. ENVTL. L. J. 55 (2003) (describing various substantive and procedural norms).

<sup>86</sup> See Douglas M. Branson, *Teaching Comparative Corporate Governance: The Significance of “Soft Law” and International Institutions*, 34 GA. L. REV. 669, 670 (2000) (theorizing that “[s]elf-regulation, peer pressure from within the national or international director fraternity, and a stronger, more universal sense of what business ethics require may have the potential to become strong determinants of director and executive behavior”).

Corporate culture, in turn, refers to the organization's commonly held beliefs, "which are based on shared values, assumptions, attitudes and norms."<sup>87</sup> More concretely, the ethical behavior that the company expects of and promises its employees, is "reflected by the corporation's mission statement and code of ethics, the criteria for business decisions, the words and actions of leaders, the handling of conflicts of interest, the reward system, the guidance provided to employees concerning dealing with ethical issues, and the monitoring system."<sup>88</sup> Under this paradigm, well governed organizations are those companies that rely on their official policies and reporting structures to communicate and affirm abstract notions of fairness and honesty.<sup>89</sup>

Unlike the classical notion of governance, the cultural component of corporate governance focuses very little on the relationship between management and the shareholder. It is far more interested in the "company" as an organization and the relationship between management and the company's rank-and-file employees.<sup>90</sup> Moreover, it defines that relationship in normative terms. There is a proper way in which employees ought to act with each other and with the outside world other than maximizing the wealth of the company's owners.<sup>91</sup>

Thus, compliance is not solely the result of an individual's rational cost-benefit calculation, but rather a form of behavior that comes about through complex social interactions within a given group, guided by commonly shared and understood norms such as trust and honesty, which

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<sup>87</sup> Lynn 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. J. 1, 3 (2003).

<sup>88</sup> *Id.*

<sup>89</sup> For a more skeptical view of how norms function in corporate governance, see Marcel Kahan, *The Limited Significance of Norms for Corporate Governance*, 149 U.P.A. L. REV. 1869 (2000).

<sup>90</sup> See Regan, *supra* note \_\_ at 970-979 (focusing on the organization's relationship with its employees and how that relationship effects compliance). See also Dickerson, *supra* note\_- at 549-50; Backer, *supra* note \_\_ at 370-71.

<sup>91</sup> See David Hess, Robert S. McWhorter and Timothy L. Fort, *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, 747 (2005) (organizations seeking more ethical cultures must foster "three related but distinct kinds of trust" among employees). According to Hess *et al*, compliance exists when employees harbor Hard Conviction, Real Confidence and Good faith. *Id.* Hard Conviction is the "trust" that results from strong laws that deter the rational employee from engaging in wrongdoing. Real Confidence "is about people living up the promises they made, being honest, treating others fairly, and producing products and services that are of high enough quality to satisfy customers." *Id.* at 749. Finally, "Good Faith" is an intrinsic "passion" to do more than is required in order to achieve a type of "moral excellence." "To inspire individuals to do more than they are required by duty to do, organizations should aim to create job satisfaction for employees, to provide good leadership, and to be perceived as achieving justice within the organization." *Id.* at 752.

the organization in turn has nurtured and inspired.<sup>92</sup> The creation of the organization's ethical culture is generated both by the company's directors and officers (who set the "tone at the top"), by its lawyers and accountants<sup>93</sup>, and by the multitude of mid-level managers who interact with rank-and-file employees.<sup>94</sup> Once established, the norms that characterize the company's culture presumably do a better job of restraining wrongdoing than the tripartite combination of monitoring, detection and sanctions.<sup>95</sup> At the very least, norms supplement the law's deterrent force.<sup>96</sup>

Cultural governance theory places great emphasis on employee voice and participation. As employees increase their voice within the corporation, wrongdoing becomes more unlikely, in part because employees feel constrained to do the right thing and in part because information flows more freely up and down the corporate ladder.<sup>97</sup> Governance is no longer a structural issue of how to dole out power between shareholders, managers and directors. Instead, it morphs into a workplace issue whereby competing concerns are mediated and resolved by the organization and its culture-building mechanism, the corporate compliance program.<sup>98</sup>

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<sup>92</sup> *Id.* See also Amitai Etzioni, *Social Norms: Internalization, Persuasion, and History*, 34 LAW & SOC'Y REV. 157, 163 (2000) (explaining that social norms shape conduct not merely as an additional cost or benefit, but also by "ensuring that certain preferences will never be formed in the first place, while others will be strongly held"). A norm that is merely an additional external cost (reputational sanctions that accompany jail sentences, for example) is an "environmental" norm that employees will ignore when the likelihood of detection is low. "Intrinsic" norms, by contrast, create compliance regardless of the likelihood of detection because "adherence is a source of intrinsic affirmation." *Id.*

<sup>93</sup> For a discussion of the corporate lawyer's role in generating and maintaining ethical norms within the corporation, see generally Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS L. J. 989 (2007).

<sup>94</sup> Linda Klebe Trevino, *Out of Touch: The CEO's Role in Corporate Misbehavior*, 70 BROOK. L. REV. 1195, 1201-02 (2005); ROBERT JACKALL, *MORAL MAZES: THE WORLD OF CORPORATE MANAGERS* (1988).

<sup>95</sup> Etzioni, *supra* note \_ at 164 ("compliance when based on intrinsic forces such as guilt is less costly and more stable than that based on extrinsic forces such as shame"), citing Dan M. Kahan, *Social Influence, Social Meaning and Deterrence*, 83 VA.L. REV. 349 (1997); See also Tom Tyler, *WHY PEOPLE OBEY THE LAW* (1990); Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1818 (2007) ("compliance decisions are based at least as much on the perceived legitimacy of the law and prevailing norms in local context as any deliberate risk calculation").

<sup>96</sup> Raymond Paternoster & Sally Simpson, *Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime*, 30 LAW & SOC'Y REV. 549, 554 (1996) (empirical study of social norms' deterrent effect on crime); David A. Skeel, Jr., *Shaming in Corporate Law*, 149 U. PA. L. REV. 1811, 1862 (2001). For an argument that enforcement supplements normative appeals for compliance, see Leandra Lederman, *The Interplay between Norms and Enforcement in Tax Compliance*, 64 OH. ST. L. J. 1453, 1462 (2003).

<sup>97</sup> Moberly, *supra* note \_\_ at 1111.

<sup>98</sup> See Richard Reuben, *Democracy and Dispute Resolution: Systems Design and the New Workplace*, 10 HARV. NEGOT. L. REV. 11, 14 (2005) (suggesting that the "democratic

Whereas the classical governance approach relies on a combination of institutional structures, incentives and sanctions to deter wrongdoing (implicitly presuming rational actors who engage in cost benefit analyses), cultural governance theory relies on education, mediating institutions, and a more democratic workplace in which employees' comments are solicited and valued.<sup>99</sup> Thus, in the cultural governance paradigm, the corporate compliance program<sup>100</sup> acts as a neutral third party that mediates employee concerns and seeks out and corrects problems when they are still new and presumably more easily solved.<sup>101</sup> Similarly, whistleblowing is portrayed as a positive development because it improves information flow within the firm and signals employees that their voices are important and valued.<sup>102</sup>

Although they tend not to focus on sanctions as a means for improving corporate culture, cultural governance theorists nevertheless claim that companies should "reward" ethical conduct and discipline unethical behavior.<sup>103</sup> Although much of the cultural governance literature fails to define the type and method of sanction that corporations should apply, one might infer that the purpose of the sanction should be to educate the corporation's stakeholders and reinforce norms such as trust and

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character of dispute resolution at the governance level" may help transform corporations into more democratic workplaces for rank-and-file employees); Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*, 105 COLUM. L. REV. 319, 374-75 (2005) (praising Sarbanes-Oxley, particularly its whistleblowing provisions, as a means of increasing "employee voice").

<sup>99</sup> Callahan et al, refer to their model as "Business as a Mediating Institution" or "BMI."

Like quality management, which strives to address problems before they become unmanageable, BMI anticipates that organizations will create opportunities for employees to join structured, problem-solving groups that empower individuals to share insights to address issues or, better yet, resolve them before they become dilemmas requiring a response from upper management. Such open, participatory problem-solving by those most directly affected by an issue also reduces the likelihood of crises that might lead to external whistleblowing.

Callahan, et al, *supra* note \_\_ at 186.

<sup>100</sup> I use the term "compliance" simply because that has become the commonly used phrase in corporations. See *Corporate Compliance Survey*, 60 BUS. LAW. 1759 (2005). Some scholars, most notably Lynn Sharp Paine, have criticized organizations whose self-regulatory programs seek "compliance" over "integrity" as a means of deterring wrongful conduct. See Lynn Sharp Paine, *Managing for Organizational Integrity*, 72 HARV. BUS. REV. 106 (Mar./Apr. 1994). My use of the term is broader and intended to be value-neutral.

<sup>101</sup> Callahan et al, *supra* note \_\_ at 186.

<sup>102</sup> *Id.* at 195-96. Moberly, *supra* note \_\_ at 1152 (increased opportunities for whistleblowing can improve overall decision-making); Dallas, *supra* note \_\_ at 33 (praising confidential employee reporting hotlines).

<sup>103</sup> See Dallas, *supra* note \_\_ at 34 (stating that "ethical behavior should be rewarded and unethical behavior punished"); Regan, *supra* note \_\_ at 974: "Virtually any program, of course, needs to have sanctions available to penalize wrongdoers."

loyalty.<sup>104</sup> After all, the compliance program presumably achieves this result by creating a more transparent and procedurally just workplace.<sup>105</sup>

The cultural corporate governance discussion parallels much of the law and social norms debate within the field of criminal law.<sup>106</sup> Law enforcement approaches based solely on the “deterrence” model seek to deter rational perpetrators by increasing sanctions and the likelihood that they will be caught.<sup>107</sup> “Deterrence routines ... require intrusive, tough-minded inspections, stringent prosecution of even minor-violations, expedited sanctioning procedures, and other deterrence-based actions familiar to students of deterrence theory.”<sup>108</sup> Normative approaches, by contrast, focus on those factors that cause individuals to obey the law even when there is little possibility that formal sanctions will arise from such conduct.<sup>109</sup> Normative approaches also tend to look at good (or bad) conduct as the product of subconscious *intuitions* as opposed to conscious, deliberate decisions.<sup>110</sup>

Criminology literature, although relatively sparse on the topic of corporate crime, suggests that whatever the value of formal sanctions, moral norms are a better predictor of wrongdoing.<sup>111</sup> Thus, where corporate crime is concerned, governance approaches that seek to “activate” social norms

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<sup>104</sup> “[In a values-based compliance program] sanctions are likely to be regarded as a means of reinforcing a cooperative scheme by ensuring that individuals do not exploit the willingness of others to cooperate.” Regan, *supra* note \_\_ at 974. “Leaders should model ethical behavior. They should, for example, be truthful with the organization’s stakeholders.” Dallas, *supra* note \_\_ at 56.

<sup>105</sup> Regan, *supra* note \_\_ at 975, citing Tyler, *Promoting Employee Policy Adherence*, *supra* note \_ at 1291-92 (“procedural-justice judgments are central to shaping employee cooperative behavior”).

<sup>106</sup> “Perhaps surprisingly, the two literatures have coexisted up to this point with few attempts to combine their insights.” N. Craig Smith, Sally Simpson, Chun-Yao Huang, *Why Managers Fail to Do the Right Thing*, 17 BUS. ETHICS Q. 633, 638 (2007) (noting the coexistence of ethical decision-making literature and criminology).

<sup>107</sup> Gary Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968). “Deterrence theory assumes that human behavior is reasoned and governed by free will and that persons will choose to be lawful if the pain associated with offending is greater than the pleasure it may bring.” *Why Managers Fail to Do the Right Thing*, *supra* note \_\_ at 645, citing Cesare Beccaria, ON CRIMES AND PUNISHMENTS (1963).

<sup>108</sup> John T. Scholz, *Voluntary Compliance and Regulatory Enforcement*, 6 LAW & POL’Y 385, 395-96 (1984).

<sup>109</sup> Regan, *supra* note \_\_ at 970-71 (distinguishing between compliance programs “based solely on promulgation and enforcement of rules and those that include what has been described as a values-based component”).

<sup>110</sup> Regan, *supra* note \_\_ at 944 (“A growing body of research suggests that a large portion of this process involves automatic non-conscious cognitive and emotional reactions rather than conscious deliberation”).

<sup>111</sup> *Why Managers Fail to Do the Right Thing*, *supra* note \_\_ at 637 (“[t]he limited evidence from the corporate crime literature indicates that formal legal sanctions may deter offending, but not for everyone”).

are more likely to be successful than those that simply seek to enforce the letter of the law.<sup>112</sup>

Much of this literature draws its strength from psychology and sociology.<sup>113</sup> Some of it is offered as a refinement of law and economics, while some normative discussions appear to reject the utility of deterrence models. Accordingly Eric Posner has argued that a person who acts according to social norms is in fact signaling a low discount rate; that person favors long term happiness over immediate wealth and gratification.<sup>114</sup> Dan Kahan has explained normative constraints on wrongdoing under his theory of “reciprocity.”<sup>115</sup> Relying on various experiments demonstrating compliance with laws in the absence of any likelihood of enforcement, Kahan theorizes that individuals contribute to the collective good when they presume that everyone else is also contributing to the collective good.<sup>116</sup> On the other hand, when individuals perceive that they are being treated unfairly or that they have become suckers, they go back to their own self-interested behavior and ignore unenforced rules.<sup>117</sup> Kahan has applied his theory of reciprocity primarily to discussions of street crime and community policing, but one could imagine the theory of reciprocity existing as easily within the corporate sphere.<sup>118</sup>

As applied to corporations, the law and social norms movement predicts that corporate employees will comply with norms when they perceive “procedural justice” within their community. That is, they must believe that the organization that employs them treats them objectively and

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<sup>112</sup> Paine, *supra* note \_\_ at 110-11; Regan, *supra* note \_\_ at 972 (arguing that effective compliance programs will combine aspects of both “deterrence” and “values-based” approaches).

<sup>113</sup> See e.g. Robert Ellickson, *ORDER WITHOUT LAW* (2001); TOM TYLER, *WHY PEOPLE OBEY THE LAW* (1990).

<sup>114</sup> Eric Posner, *LAW AND SOCIAL NORMS* (2000).

<sup>115</sup> Dan M. Kahan, *Reciprocity, Collective Action, and Community Policing*, 90 CAL. L. REV. 1513 (2002) and *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 Mich. L. Rev. 71 (2003).

<sup>116</sup> *Id.* See also, Regan, *supra* note \_\_ at 972-73 (arguing that organization stressing values inspires greater sense of identification and cooperation from its employees).

<sup>117</sup> Kahan’s theory presumes, nevertheless, a rational cost-benefit calculus, albeit one over a period of time. The individual in Kahan’s world cooperates because he presumes others will cooperate and that he will be enriched by mutual cooperation. Kahan, *Logic of Reciprocity*, *supra* note 115 at 72. Kahan’s notion of reciprocity is therefore different from other normative theories, wherein individuals engage or forbear in specified conduct regardless of perceived collective or individual benefits.

<sup>118</sup> Indeed, Paternoster and Simpson’s 1996 experimental study of corporate crime suggests that norms matter in restraining corporate crime at least as much as pure deterrence strategies. See Paternoster & Simpson, *supra* note \_\_ at 571 (finding that informal sanctions were likely to deter misconduct in corporate settings).

with respect.<sup>119</sup> This in turn requires a certain level of transparency and a system of sanctions that are both incremental and devoid of personal or cultural bias.

By now, it should be quite clear that the structural and cultural approaches to corporate governance are quite different. They rely on different mechanisms to achieve both organizational compliance and individual compliance within the organization:

<b>Theory of Governance</b>	<b>Approach to Organizational Compliance</b>	<b>Approach to Individual Compliance</b>	<b>Enforcement Methods emphasized</b>
<u>Structural</u>	Deterrence-Based	Cost-benefit Analysis (rational actor)	Monitoring, Reporting and Discipline
<u>Cultural</u>	Values-Based	Normative	Education, Training and Mediation

The foregoing discussion admittedly simplifies a complex and evolving literature. Nevertheless, it illuminates the larger differences between the two movements, which in turn help us understand the tensions behind the government's attempt to improve corporate governance in the wake of Enron-era corporate accounting scandals.

### **3. Enron and the Convergence of Classical and Cultural Governance**

The accounting scandals that came to the fore in 2001 created a great crisis among corporate regulators and prosecutors. On one hand, the spectacular frauds that had been brewing at Worldcom and Enron, along with old-fashioned looting at Adelphia, demonstrated an embarrassing weakness in the structural tools on which classical governance adherents had previously relied.<sup>120</sup> Auditors and lawyers had failed to disclose

<sup>119</sup> See Milton Regan, *Moral Intuitions and Organizational Culture*, 51 ST. LOUIS U. L. REV. 941, 975 (2007), citing Tom Tyler, *Promoting Employee Policy Adherence and Rule Following in Work Settings: The Value of Self-Regulatory Approaches*, 70 BROOK. L. REV. 1287, 1304 (2005).

<sup>120</sup> "The checks and balances that we thought would be provided by independent directors, independent auditors, securities analysts, investment bankers, and ... lawyers, too often failed. The regulatory checks represented by the SEC and federal and state legal constraints also proved inadequate, in meaningful part... because of scarce resources and overly protective case law and legislation." Harvey Goldschmid, Commissioner, Sec. & Exch. Comm'n, The Third Annual A.A. Sommer, Jr., Corporate Securities & Financial Law Lecture (Dec. 2, 2002), available at <http://www.sec.gov/news/speech/spch120202hlg.htm>.

wrongdoing<sup>121</sup>, while SEC regulators and enforcement agents had lacked the proper resources to lean on companies and their monitors.<sup>122</sup> The proper response, then, was to fill up the holes and create more enforcement.

At the same time, a number of observers attributed the accounting fraud crises to unrestrained “greed” within the corporate sphere.<sup>123</sup> The antidote for such greed therefore was moral reflection and training. If we transformed corporate officers and directors into better people, fraud and similar wrongdoing would abate.

As a result of these two competing narratives, much of Sarbanes-Oxley as well as the government’s approach to corporate compliance overall, displayed a dichotomous approach. For example, in a speech announcing the creation of the Corporate Fraud Task Force, a collection of law enforcement personnel tasked with coordinating and publicizing the prosecutions of corporate executives and companies, President George W. Bush stated:

At this moment, America’s greatest economic need is higher ethical standards, standards enforced by strict laws and upheld by responsible business leaders. The lure of heady profits of the late 1990’s spawned abuses and excesses. With strict enforcement and higher ethical standards, we must usher in a new era of integrity in corporate America.<sup>124</sup>

The speech of course presumes that increased enforcement and “higher ethical standards” go hand in hand. Yet, as the HP episode suggests, there may be times when enforcement interferes with the inculcation of the higher ethical standards that President Bush and Congress sought.

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<sup>121</sup> See John Coffee, *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 302 (2004) (“during the late 1990s, [gatekeeping] protections seemingly failed, and a unique concentration of financial scandals followed, all involving the common denominator of accounting irregularities”) (citations omitted).

<sup>122</sup> Karmel, *supra* note \_ at 99 (describing Congress’ denial of the SEC’s budget request in the 1990’s); Elizabeth F. Brown, *E Pluribus Unum – Out of Many, One: Why the United States Needs a Single Financial Services Agency*, 14 U. MIAMI BUS. L. REV. 1, 51-52 (2005) (“Congress used its control over the SEC’s budget in the 1990s to hinder the agency’s efforts to enforce the existing securities regulations and to discourage the agency from proposing new, more stringent regulations to protect investors. In response to the public outcry over the Enron and WorldCom scandals, Congress reversed itself and increased the SEC’s budget almost 33 percent to \$716 million in 2003, from the \$540 million that it received in 2002.”) (citing Stephan Taub, *SEC Boosting Big-Company Caseload*, CFO.COM, Mar. 9, 2004, <http://www.cfo.com/article.cfm/3012481?f=advancesearch>).

<sup>123</sup> Richard W. Stevenson & Richard A. Opiel, Jr., *Fed Chief Blames Corporate Greed; House Revises Bill*, N.Y. TIMES, July 17, 2002, at A1.

<sup>124</sup> President George Bush, Speech on Corporate Crime, Fed. Sent. Rpt’r, April 2003 at 242.

Congress' approach to reform also embraced both approaches. On one hand, many of the governance reforms adopted by Congress in the wake of Enron are primarily structural in that they move power from one group to another.<sup>125</sup> At the same time, other aspects appear, at least facially, to fall within the cultural paradigm of governance in that they are designed to improve the corporation's cultural ethos.<sup>126</sup> For example, Sarbanes-Oxley directs the corporation to publicize whether it maintains a Code of Ethics for its officers and directors<sup>127</sup>; to create and publicize a mechanism to channel allegations of wrongdoing by employee whistleblowers<sup>128</sup>; and to provide internal and external attestations (by the company's outside auditor) of the corporation's "internal controls."<sup>129</sup>

Many of these corporate compliance requirements are not new<sup>130</sup>; previous government policies and regulations, such as the United States Organizational Sentencing Guidelines (promulgated in 1991) and the Department of Justice's charging guidelines for prosecutors (first circulated in 1999), also encouraged or required corporations to create and maintain compliance programs.<sup>131</sup>

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<sup>125</sup> See Stephen Bainbridge and Christina Johnson, *Managerialism, Legal Ethics and Sarbanes-Oxley Section 307*, 2004 MICH. ST. L. REV. 299, 304-06 (describing provisions in the Act designed to shift power from management to independent directors).

<sup>126</sup> Bucy, *supra* note \_ at 1291 (Sarbanes-Oxley "affected corporate culture by requiring public companies to review their internal controls and disclose all material weaknesses in their reporting systems");

<sup>127</sup> Sarbanes-Oxley Section 406. Given the fact that Enron, Tyco and Worldcom all maintained codes of conduct prior to the disclosure of their respective scandals, one might reasonably wonder as to Section 406's value in reducing fraud.

<sup>128</sup> Sarbanes-Oxley Section 302 (requiring establishment of "procedures for the confidential, anonymous submission by employees ... of concerns regarding questionable accounting or auditing matters"). Section 806 protects from adverse action any employee who assists in an internal or external investigation. Sarbanes-Oxley Section 806; 18 U.S.C. 1514A (providing civil liability for employers who retaliate against whistleblower employees); 18 U.S.C. 1513(e) (criminalizing retaliation against whistleblowers, explicitly including termination of employment).

<sup>129</sup> Sarbanes-Oxley Section 404.

<sup>130</sup> One might argue that the 1977 Foreign Corrupt Practices Act, which required public corporations to maintain a set of internal accounting controls, gave birth to the modern corporate compliance industry. See [15 U.S.C. § 78m\(b\)\(2\)\(A\)-\(B\)](#) (2000)(requiring companies registered with SEC to keep records and system of internal accounting controls). *Corporate Compliance Survey*, *supra* note \_\_ at 1760 (citing insider trading and defense contractor scandals along with FCPA).

<sup>131</sup> Although the Delaware Supreme Court initially resisted a requirement that directors "install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists," *Graham v. Allis-Chalmers*, 188 A.2d 125, 130 (Del. 1963), the compliance language contained in the Organizational Sentencing Guidelines and the increasing risk of entity-level prosecutions eventually brought about a change of heart. See *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996) (directors acting "in good faith" ought to at least ensure that a system of internal controls "exists"); *Stone ex rel. AmSouth Bancorp. v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

In the wake of Sarbox, however, both the Sentencing Guidelines and the DOJ's prosecutorial charging criteria were altered to increase the emphasis on corporate compliance.<sup>132</sup> The Organizational Sentencing Guidelines, which already promised reduced sanctions for organizations that boasted "effective" compliance programs, explicitly required the participation of high-level personnel and periodic self-assessment. The Department of Justice, meanwhile, issued a memo in 2003 written by Deputy Attorney General Larry Thompson (the "Thompson Memo"), in which Thompson directed prosecutors to consider if the company's compliance program was "well designed."<sup>133</sup>

Cultural governance adherents enthusiastically embraced a number of the reforms in the Thompson Memo and the Organizational Sentencing Guidelines.<sup>134</sup> Presumably, they believed that these mechanisms would encourage management's commitment to creating and maintaining an ethical corporate culture across the firm. At the same time, these reforms were consistent with classical corporate governance goals insofar as they relied on sanctions to improve information flow and increase putative investors' trust in the capital markets.<sup>135</sup> Indeed, an interesting alliance was forged during this time between corporate culture theorists, and those who believed that strong government sanctions were necessary to alter the cost benefit analyses of both the wrongdoers and monitors who had fallen down on the job.<sup>136</sup>

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(confirming that boards retain a "duty of oversight" with regard to the company's compliance with the law).

<sup>132</sup> "Sarbanes-Oxley attempts to improve organizational ethics by defining a code of ethics as including the promotion of 'honest and ethical conduct,' requiring disclosure on the codes that apply to senior financial officers, and including provisions to encourage whistleblowing." David Hess, *A Business Ethics Perspective on Sarbanes-Oxley and the Organizational Sentencing Guidelines*, 105 MICH. L. REV. 1781, 1782 (2007) (citations omitted).

<sup>133</sup> See Thompson Memo, *supra* note \_\_ at \_\_. The DOJ has since superseded the Thompson Memo with the McNulty Memo, see McNulty Memo (December 2006).

<sup>134</sup> See, e.g. Callahan, et al, *supra* note \_\_ at 191 (praising Sentencing Guidelines' "carrot and stick" approach toward corporate compliance); Hess, *supra* note \_- at 1816 (arguing that as a result of Sarbox and the Sentencing Guidelines, "we are moving in the direction of improving corporate compliance programs and encouraging the managerial commitment necessary for firms to develop ethical corporate cultures"); Hess, McWhorter and Fort, *supra* note \_\_ at 764 ("We believe that the Guidelines can serve an additional, broader purpose--that is, supporting the components of trust we identified as Hard Conviction, Real Confidence, and Good Faith.").

<sup>135</sup> Langevoort, *supra* note \_- at 1831.

<sup>136</sup> Board members, typified by Enron's lackadaisical board, were key among those whom lawmakers presumed needed stronger incentives to prevent wrongdoing. See Troy Paredes, *Enron: The Board, Corporate Governance and Some Thoughts on the Role of Congress in ENRON: Corporate Fiascos and Their Implications*, (Nancy Rappaport and Bala Dharan, eds. 2004) at 504 ("Whether or not any Enron director violated his or her fiduciary duties or engaged in fraud, the board's conduct fell far short of what is expected and what is required for good corporate governance.").

Given the persistence of fraud and ethical misconduct after the enactment of Sarbox,<sup>137</sup> one might reasonably wonder just how long this alliance will hold up. Whatever the impetus for reform, the government's implementation of Sarbox and subsequent criminal investigations of corporate entities suggests that the government is most concerned with increasing its own power and information, as opposed to improving corporate culture.<sup>138</sup> Indeed, in 2004, Professor Larry Cata Backer cast Sarbox and its ilk as part of panoptic<sup>139</sup> increase in government power through the delegation of monitoring and corporate surveillance:

[T]he state has increased the breadth of power to discipline those persons it has deputized with surveillance duties. Indirectly, this is accomplished by the construction of a system in which the state sits at the top of a pyramid of monitoring by others.<sup>140</sup>

From this perspective, compliance officers and whistleblowers, however enthusiastically embraced by ethics scholars as the vanguard of a different and more democratic workplace, are in fact quasi-public monitors who

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<sup>137</sup> See ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY 25 (2007), available at

<http://www.corporatecompliance.org/Content/NavigationMenu/Resources/Surveys/2007NationalBusinessEthicsSurvey.pdf> (“Despite remedies available, business in the U.S. face an ethics risk at pre-Enron levels.”); PRICEWATERHOUSECOOPERS, GLOBAL ECONOMIC CRIME SURVEY 15 (2007), available at

[http://www.pwc.com/extweb/pwcpubs/nsf/docid/1E0890149345149E8525737000705AF1/\\$file/PwC\\_2007GECS.pdf](http://www.pwc.com/extweb/pwcpubs/nsf/docid/1E0890149345149E8525737000705AF1/$file/PwC_2007GECS.pdf) (“Fraud remains an intractable problem...The results of this research have shown that the controls that have been implemented will not be sufficient to mitigate the risk of economic crime on their own.”). Despite the survey evidence that fraud persist, the Corporate Fraud Task Force's prosecutions have decreased in recent years. See Daphne Eviatar, *Case Closed?*, AMERICAN LAWYER, Nov. 1, 2007, available at

<http://www.law.com/jsp/tal/PubArticleTAL.jsp?hubtype=Inside&id=1193735022055#>.

The DOJ's explanation for the decrease is that “fraud is being detected by corporations themselves.” *Id.* This seems quite unlikely; if corporations were “themselves” detecting fraud, they presumably would be reporting such fraud to government regulators and prosecutors. The more likely explanation is that the government has, after a period of intense media interest, turned its resources elsewhere.

<sup>138</sup> See Larry Cata Backer, *Surveillance and Control: Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley*, 2004 MICH. ST. L. REV. 327 (2004). One might argue that this increase was merely one aspect of the Bush administration's general approach to increasing executive power. See John S. Baker, *Reforming Corporations through Threats of Federal Prosecution*, 89 CORNELL L. REV. 310, 348 (2004) (noting that the DOJ's response to corporate crime emerged at the same time as the Bush administration's response to terrorism).

<sup>139</sup> The panopticon was Jeremy Bentham's idea of a circular prison whose prisoners know they are surveilled at all times. Bentham, *The Panopticon Writings*. Ed. Miran Bozovic (London: Verso, 1995). p. 29-95, available at <http://cartome.org/panopticon2.htm>

<sup>140</sup> *Id.* at 345.

serve more as a conduit between the company and the *State*, rather than as one between the corporation's various "stakeholders."<sup>141</sup>

Backer's claim has been supported both by the charging criteria contained in the Department's memo to prosecutors and by the implementation of that criteria over the last five years. Neither the Thompson nor the McNulty Memos even mention the word "ethics." The word "culture" appears only on the first page of the latter, wherein the DOJ opines that, "Indicting corporations for wrongdoing enables the government to address and be a force for positive change of corporate culture."<sup>142</sup>

One must wonder if the cultural governance adherents meant something more than the crude threat of indictment when they championed Sarbanes-Oxley and the revised Organizational Sentencing Guidelines as a means of improving corporate culture. Simply threatening an entity with criminal liability for all of its employees' criminal acts has long been recognized as an unsound approach for achieving deterrence. As Jennifer Arlen and Renier Kraakman pointed out nearly a decade ago, pure strict liability regimes do not work when the corporation's compliance program increased likelihood of uncovering harm outweigh its ability to prevent such harm.<sup>143</sup>

Arlen and Kraakman concluded that the way to get around this problem was to enforce a "mixed" or composite liability system, whereby the company would suffer some baseline penalty for its employees' wrongdoing, and then receive a worse (or better) penalty depending on its efforts to comply with the law.<sup>144</sup> The Organizational Sentencing Guidelines and Department's charging criteria arguably implemented this type of liability by providing probation and/or lesser sanctions for companies that demonstrated adequate "cooperation" and effective "compliance."

Unfortunately, the application of composite liability has generated problems in its application. Because the collateral costs of indictment are so high, the Organizational Sentencing Guidelines are rarely used and most corporations resolve their problems beforehand in negotiations with

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<sup>141</sup> See *Id.* at 345: "With SOX, the SEC can more effectively control and process information through its web of deputies, especially whistle-blowing employees, officers faced with certification requirements, outside directors with fiduciary duties, auditor and outside counsel with detect and report obligations."

<sup>142</sup> McNulty Memo at \_\_\_.

<sup>143</sup> See Jennifer Arlen & Renier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 708 (1997). See also Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 823 (1994).

<sup>144</sup> Arlen and Kraakman, *supra* note \_\_\_ at 694.

prosecutors.<sup>145</sup> Second, prosecutors maintain a tremendous amount of power over corporations, in part because the corporation lacks a viable alternative (the collateral costs rule out the possibility of trial) and because there exists little oversight over prosecutorial plea-bargaining.<sup>146</sup> Third, due to lack of expertise or political desire, the government has largely declined to define the term “compliance” with specificity. Instead, the government has focused primarily on the issue of fakery, ie, the corporation’s pretense of cooperation after the fact or cosmetic compliance before the fact:

Too often business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effective exposure of the complete scope of wrongdoing under investigation. The revisions make clear that such conduct should weigh in favor of a corporate prosecution.<sup>147</sup>

As a result of its emphasis on sham compliance programs, the DOJ has more or less failed to aid organizations in formulating or otherwise testing their ethical climate prior to the disclosure of a corporate scandal.<sup>148</sup> By declining to define or review the details of corporate compliance programs in advance, the Department has effectively divorced itself from subsequent compliance failure.<sup>149</sup> Instead, once a scandal occurs, the DOJ can use its power as leverage to demand greater cooperation with the government’s investigation in order to compensate for the perceived prior “ineffectiveness” of the company’s compliance program.<sup>150</sup>

Post-scandal cooperation requires the company to engage in practices that are in direct tension with the building blocks of the practices that organizational theorists advocate. For the government prosecutor, the compliance program is primarily an extenuated arm of the state and only

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<sup>145</sup> See Chris Wray and Robert Hur, *The Power of the Corporate Charging Decision Over Corporate Conduct*, 116 YALE L.J. POCKET PART 306 (March 20, 2007) (“the initial threat of corporate criminal charges has far broader and deeper effects on American businesses’ behavior than does the prospect of sentencing itself”).

<sup>146</sup> See Miriam Baer, *Insuring Corporate Crime*, *supra* note \_\_ at \_\_.

<sup>147</sup> Thompson Memo at 1, *supra* note \_\_.

<sup>148</sup> “The Department has no formal guidelines for corporate compliance programs.” McNulty Memo at \_\_ Chapter VIII (B).

<sup>149</sup> “Superiors do not like to give detailed instructions to subordinates. The official reason for this is to maximize subordinates’ autonomy. The underlying reason is, first, to get rid of tedious details. ... Perhaps more important, pushing details down protects the privilege of authority to declare that a mistake has been made.” Robert Jackall, *MORAL MAZES* 20 (1988).

<sup>150</sup> Michael Simons, *Enron and Its Aftermath: Vicarious Snitching: Crime, Cooperation and ‘Good Corporate Citizenship*, 76 ST. JOHN’S L. REV. 979, 980 (observing that prosecutors define “good corporate citizenship” as “cooperating fully in any investigation”); Backer, *supra* note \_\_ at 345 (“the state maintains a great capacity for surveillance through the use of its power to extract ‘cooperation’ from the ‘observed’ corporation”).

secondarily an entity devoted to forging more trust and transparency across the firm.<sup>151</sup> To avoid indictment, corporate entities have been expected to waive the entity's attorney-client privilege and hand over the results of any internal investigation;<sup>152</sup> refrain from paying attorneys fees for indicted employees,<sup>153</sup> threaten uncooperative employees with termination unless they speak freely with government agents,<sup>154</sup> accept the government's placement of an outside monitor who reports primarily to prosecutors and not to the corporation's board or shareholders;<sup>155</sup> and sanction employees who voice disagreement with factual assertions contained in public deferred prosecution agreements between the government and the corporate entity.<sup>156</sup> Although several of these government demands ultimately were rebuffed, they fell apart not because voluntary government forbearance (much less "negotiated governance" between the government and regulated firms), but rather because the individual employee-targets of the government's investigation successfully challenged the government's actions in court.<sup>157</sup>

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<sup>151</sup> During the investigation of KPMG's employees, prosecutors urged KPMG's lawyers to tell their employees to be completely "open" during interviews with government agents because these statements would provide "good material for cross-examination," *United States v. Stein*, 440 F.Supp.2d 315, 321 (S.D.N.Y. 2006), and to de-emphasize, in company communications, the employees' right to counsel "to increase the chances that KPMG employees would agree to interviews without consulting or being represented by counsel." *Stein*, 435 F.Supp.2d 330, 347 (S.D.N.Y. 2006).

<sup>152</sup> The McNulty Memo now places controls over the manner by which prosecutors may request waivers by corporations. See McNulty Memo, *supra* note \_\_ at \_\_. The waiver of the corporation's attorney-client privilege in corporate investigations and its chilling effect on employee communication has been discussed at length. See e.g. Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. Rev. 311, 347 (2007)(arguing that corporate waiver of privilege has placed corporate counsel in "an untenable position" with employees); David M. Zornow & Keith D. Krakaur, *On the Brink of a Brave New World: The Death of Privilege in Corporate Criminal Investigations*, 37 AM. CRIM. L. REV. 147, 153-55 (2000).

<sup>153</sup> *United States v. Stein*, 435 F.Supp.2d 330, 344 (S.D.N.Y. 2006) (*Stein I*).

<sup>154</sup> *United States v. Stein*, 440 F.Supp.2d 315, 318 (S.D.N.Y. 2006) (*Stein II*).

<sup>155</sup> Bristol Myer Squibb's agreement, for example, explicitly discusses the role of its monitor as a conduit to the United States Attorneys' Office. See Richard S. Gruner, *Three Painful Lessons: Corporate Experience with Deferred Prosecution Agreements*, 1623 PLI/Corp 51, 66 (2007).

<sup>156</sup> For example, AOL's deferred prosecution agreement promises that none AOL's agents or employees will make, "any public statement ... contradicting any statement of fact set forth in the Statement of Facts [in this agreement]. Any such willful, knowing and material contradictory public statement ... shall constitute a breach of this Agreement, and AOL thereafter would be subject to prosecution as set forth in paragraph 17 of this Agreement. The decision of whether any public statement by any such person ...has breached this Agreement shall be at the sole reasonable discretion of the Department of Justice." Richard S. Gruner, *Three Painful Lessons: Corporate Experience with Deferred Prosecution Agreements*, 1623 PLI/Corp 51, 66 (2007)

<sup>157</sup> See *Stein I*, 435 F.Supp.2d at 362-65 (criticizing the Thompson Memo); *Stein II*, 440 F.Supp.2d at 319 (suppressing statements by KPMG employees because they believed they would be fired by KPMG unless they spoke with government agents); *United States v.*

Thus, the corporate “tone at the top” that most preoccupies the government is not the tone that management establishes with the company’s employees (much less its shareholders or any other stakeholder) but rather, the “tone” the company’s general counsel adopts when she speaks with federal agents and prosecutors during the government’s investigation.<sup>158</sup>

It is striking how much the reality of corporate policing conflicts with the theory of cultural governance. Under cultural governance theory, executives refrain from wrongdoing because of the trust and loyalty they feel toward organizations that have treated them with fairness and respect.<sup>159</sup> Fairness and respect, however, require the individuals running such organizations to be honest with their subordinates and operate in a transparent manner. Internal policing has very little to do with these concepts. The McNulty Memo’s most prominent terms are detection, detection, reporting and discipline, not trust, procedural justice and respect.<sup>160</sup>

This is not to say that all compliance programs and reporting initiatives are devoid of value. Depending on how they are implemented, they may increase the perceived likelihood of detection and deter managers who are considering engaging in wrongdoing. They also may improve corporate culture by signaling employees that corporate management takes its legal obligations seriously.<sup>161</sup> Nevertheless, to the extent the government has transformed the corporate compliance program into a corporate *policeman*, it threatens to undercut the creation of an ethical corporate culture.<sup>162</sup>

The ethical reforms contained in the Sarbanes-Oxley Act are therefore classical enforcement mechanisms dressed up in cultural norms’ clothing. The idea of using compliance and whistleblowing to create a more democratic, less hierarchical, and more transparent corporate institution is just that: an idea. In reality, the federal government freely utilizes the corporation’s compliance program (including its whistleblowing

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*Stein*, 488 F.Supp.2d 350 (S.D.N.Y. 2007) (*Stein III*) (finding that the government’s conduct as a whole violated the KMPG defendants’ 5<sup>th</sup> and 6<sup>th</sup> Amendment rights).

<sup>158</sup> As one of the former prosecutors of Bernie Ebbers explained, “whether the company really intends it or not, in the government’s view, the ultimate purpose of its role is to help the government convict its former employees.” David Anders, Speech, *Criminalization of Corporate Law*, 2 J. BUS. & TECH. L. 71, 71 (2006).

<sup>159</sup> Hess *et al*, *supra* note \_\_ at 750.

<sup>160</sup> See McNulty Memo at Chapter VII and discussion *infra* at n. 206.

<sup>161</sup> See Regan, *supra* note \_\_ at 974 (contending that a combination of value-based and deterrence-based programs best achieve overall compliance goals, although deterrence should not predominate).

<sup>162</sup> “Too much control through monitoring and punishment can lead to distrust ... as well as to a reduction in intrinsic motivations (and the notion of Good Faith).” Hess, *supra* note \_\_ at 757.

channel, internal investigations and in-house counsel) as a means of identifying and sanctioning wrongdoers.

Sarbanes-Oxley will continue to stir debate as either a needed response to unrestrained greed, or as a pastiche of politically motivated requirements that were either unnecessary or downright harmful to shareholders and corporations.<sup>163</sup> Whatever the merits of these individual arguments, it is clear that there has been little consideration of the resulting tension between corporate governance and corporate policing. More important for this discussion, there has been even less consideration of how specific corporate policing techniques such as deception might undermine the very governance values that the statute and the government's renewed enforcement efforts were intended to bring about.<sup>164</sup>

## **B. Corporate Law Enforcement and Deception**

The prior section explored the theoretical underpinnings of post-Enron corporate compliance policies and suggested that the government's implementation of its policies deeply conflict with at least some of the theories that support the notion of the "self-regulating" corporation.

The current section explores why the typical corporate compliance program might rely on deception in accomplishing its task of monitoring and reporting wrongdoing. As the foregoing analysis demonstrates, the government's delegation of the police function to the corporate compliance program raises questions about entity goes about collecting information necessary to prevent and remediate wrongdoing. Despite best efforts taken in "good faith," the corporate policeman may find it awfully difficult to obtain information necessary to deter harm. As a result, corporate compliance programs may resort to using deceptive techniques to identify corporate crime, particularly the types of crimes that characterized many of the scandals earlier in the decade.

Although the prevalence of specific variety of wrongdoing varies across industries and firms, fraud is the violation that most threatens the public corporate entity (particularly when it infects the company's

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<sup>163</sup> See, e.g. Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005). See also Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work)*, 35 CONN. L. REV. 915 (2003) (agreeing that Sarbox is an unruly combo of multiple policies and requirements).

<sup>164</sup> See e.g. Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125 (2003); John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid"*, 57 BUS. LAW. 1403 (2002); William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023 (2003).

accounting and reporting functions) and therefore preoccupies the public corporation's compliance program.<sup>165</sup>

Fraud is a broadly generic type of wrongdoing "that encompasses the multifarious and often ingenious means by which one individual can gain an advantage over another through deliberate false suggestion, concealment, or misrepresentation of the truth."<sup>166</sup> Although the Board-level leak at HP did not constitute fraud, it nevertheless was deceptive in that it was carried out in secret and sowed uncertainty and distrust in the rest of the Board. Given the failure of HP's prior attempt to identify its leaker through overt means, it was not surprising that Patricia Dunn and HP's investigators concluded that a certain level of deception was necessary to identify the person who was leaking information to the press.

Because fraud and related types of wrongdoing rarely take place in public and are often not easy to grasp or understand, the corporation will have to do more than simply demand information in order to identify its creators. Therefore, it is crucial to consider the extent to which (1) corporate law enforcement actually relies on deception; and (2) how such reliance affects the corporation's culture and ultimately its compliance with law. Because we know so much more about public law enforcement (and because corporations are often urged to achieve the same results through "self-policing"), I first focus on how public law enforcement collects information.

## 1. How the Government Obtains Information

The government utilizes a combination of the following four strategies to obtain information necessary to achieve its enforcement goals:

First, it receives information from individuals who *voluntarily* provide it. Some of those persons are victims of crime and seek the government's help in redressing their injuries. Others, however, are merely good Samaritans who have come forward simply out of desire to contribute to their community's collective well being.

Second, and perhaps most important, the government may *demand* information. Through yearly filing requirements, grand jury subpoenas, and search warrants, the government maintains an impressive array of tools designed to pry information from unwilling sources. The government's power to demand information is fairly broad, although restrained by judicial and legislative oversight. For most records (including records of phone

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<sup>165</sup> See David Hess, *A Business Ethics Perspective on Sarbanes-Oxley and the Organizational Sentencing Guidelines*, 105 MICH. L. REV. 1781, 1782 (2007).

<sup>166</sup> Daniel Otsas, *When Fraud Pays. Executive Self-Dealing and the Failure of Self-Restraint*, 44 AM. BUS L.J. 571 (2007).

calls, bank and credit card records and employment documents maintained by employers), the government's burden is fairly low. Assuming it is acting in good faith, the government can obtain most, if not all, of these documents through grand jury subpoenas.<sup>167</sup>

The strategy of demanding information has its limits. Criminals may attempt to subvert the government's demands by hiding or altering information. Companies might submit false or misleading reports. Criminals might keep money in the form of cash in order to evade the well-known reporting requirements that apply to financial institutions.

Happily, the government may utilize a third strategy: it can *pay* for information. Local police, as well as federal agencies such as the Federal Bureau of Inspection and Drug Enforcement Agency, quite famously employ confidential informants or "CI's."<sup>168</sup> A CI may be paid in one of two ways. Either his handlers will pay him in cash for information, or the government will pay him in the form of a reduced criminal sentence.<sup>169</sup> The latter transaction is often referred to as "cooperation" in criminal law circles.<sup>170</sup> In exchange for the defendant's cooperation in convicting his coconspirators and other criminals, the defendant receives a lesser sentence in prison. Defendants who are most likely to follow through on this exchange are those who have been apprehended, against whom the government has built a strong case, and who are facing a substantial amount of prison time if they refuse to cooperate.

The government's ability to pay for information, in turn, relies on two related principles: broad criminal liability and harsh penalties. The breadth of the criminal law and the certainty of harsh sanctions create "value" on the government's end of the cooperator transaction: in exchange for the defendant's information, the government can offer significant "breaks" on legal penalties.<sup>171</sup>

However, the payment strategy has its limits. Some defendants will value silence more than the government's offer for a reduced sentence. This is particularly the case where the government's evidence is weak and

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<sup>167</sup> Prosecutors routinely issue subpoenas on behalf of the grand juries and direct the course of the "grand jury's" investigation. "As a practical matter, grand jury subpoenas are almost universally issued by and through federal prosecutors." *Stern v. U.S. Dist. Court.*, 214 F.3d 4, 16 (1st Cir. 2000)(citation omitted).

<sup>168</sup> Alan Feuer & Al Baker, *Officers' Arrests Put Spotlight on Police Use of Informants*, N.Y. TIMES, Jan. 27, 2008, at A25. (FBI maintains 15,000 informants and DEA maintains approximately 4,000).

<sup>169</sup> *Id.*

<sup>170</sup> Stephanos Bibas, *Transparency and Participation in Criminal Procedure*, 81 N.Y.U. L. REV. 911, 932 (2006).

<sup>171</sup> Professor Katyal has explained in detail how the broad doctrine of conspiracy aids law enforcement in extracting information from defendants seeking to reduce potential prison sentences. See Neal Kumar Katyal, *Conspiracy Theory*, 112 YALE L. J. 1321, 1328 (1997).

conviction without assistance is not likely. Moreover, in some ill-defined subset of cases, defendants will purport to accept the government's offer of a lesser sentence, but deliver tainted goods in the form of false or incomplete information.

Accordingly, when demanding and paying for information max out the government's returns, the government will turn to a fourth strategy: it will *trick* the defendant into giving it up. It may do this in one of two ways. First, it may permit (or indeed, encourage), its agents to lie to targets during the course of an investigation, such as when the police falsely inform a suspect that his fingerprints have been found on a weapon when in fact no such fingerprints exist.<sup>172</sup> Interestingly enough, the purpose of the lie is to convince the defendant to sell his "information" (invariably, his confession) to the government. By lying, the government agent convinces the defendant to devalue his silence and simultaneously implies that the government's "payment" for such information is in fact much better than it really is. The common refrain is the police's claim (often false) that if the defendant "just" confesses, the interrogation will end and courts will deal with him leniently. It is important to note here that unlike the payment scenario, the bargain struck by the defendant is based on entirely false premises: the government in these situations often has no intention of treating the defendant leniently regardless of whether he confesses.

A second way to cheat information out of targets and defendants is to pose as a fellow coconspirator. One might see this as yet another way to convince the defendant to "sell" his information in exchange for a benefit (money, new suppliers or customers, assistance in committing a crime, or sheer camaraderie) that is in fact bogus.

Obviously, most investigations feature combinations of all of these strategies. Out of a sense of civic duty, a neighbor *voluntarily* advises the police that the apartment next to hers is inhabited by drug dealers. Through a search warrant, the government *demand*s entry into the apartment and finds drugs there, as well as a tenant who previously intended to sell those drugs. The government then offers to *pay* that tenant a lower sentence provided he agrees to wear an undisclosed microphone to his next meeting his supplier, at which point, he might introduce the supplier to an undercover officer posing as an interested buyer, thereby *tricking* the supplier into making incriminating statements to the undercover officer.

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<sup>172</sup>The Sixth Circuit reinstated a conviction of a defendant whose confession was obtained during a police interrogation in which the police falsely informed a defendant accused of kidnapping and robbery that the defendant's fingerprints had been found on the victim's van, that she had identified him from a photographic array, and that she was waiting outside the interrogation room, "prepared to identify the assailant." *Ledbetter v. Edwards*, 35 F.3d 1062, 1066 (6<sup>th</sup> Cir. 1994) (" [the defendant's] confession was obtained by means of legitimate law-enforcement methods that withstand constitutional scrutiny").

The law grants public law enforcement agents wide latitude in using and combining these strategies, many of which involve some level of secrecy, surprise and deception. Law enforcement agencies and other observers defend the use of these tools as necessary implements of successful enforcement and deterrence.<sup>173</sup> Indeed, deceptive techniques have become so ingrained in the law enforcement psyche that they are often promoted as first-resort techniques among agents, prosecutors<sup>174</sup> and the general public.

Federal law does not govern the details of undercover policing. Undercover agents and informants routinely solicit, attend and record meetings with criminal targets.<sup>175</sup> So long as at least one of those undercover agents or informants is present while recording conversations with the targets of the investigation, the federal wiretapping laws do not apply.<sup>176</sup> Nor are undercover investigations governed, for the most part, by

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<sup>173</sup>“The use of undercover techniques ... is essential to the detection, prevention and prosecution of white collar crimes, public corruption, terrorism, organized crime, offenses involving controlled substances, and other priority areas of investigation.” The Attorney General’s Guidelines on Federal Bureau of Investigation Undercover Operations (May 30, 2002), available at <http://www.justice.gov/olp/fbiundercover.pdf>. “In most democracies, political elites, legal actors, and critics agree that undercover investigations are in some sense a necessary evil.” Jacqueline Ross, *The Place of Covert Surveillance in Democratic Societies: A Comparison of the United States and Germany*, 55 AM. J. COMP. L. 493 (2007). “This technique is a critically effective means of investigating organized, clandestine, sophisticated criminal activity which is not readily susceptible to detection by traditional investigative techniques.” Jay B. Stephens, *Setting the Sting, Minimizing the Risk. The Government’s Case for an Effective Undercover Investigative Technique*, 1 CRIM. JUST. 14 (1986-87). See also Ileana Saros, *The Undercover Operation: Indispensable Tool of Law Enforcement*, 9 CRIM. JUST. Q 27, 28 (1985) (“no comprehensive law enforcement program could succeed without the use of undercover investigations”).

<sup>174</sup> Ross, *supra* note \_\_ at 494 (observing that training for federal prosecutors in Illinois includes the following instruction: “Before you subpoena documents; before you call witnesses to the grand jury; before you consider conventional sources of evidence; make sure to exhaust all undercover options first. This should become your mantra.”); “The use of undercover techniques is ubiquitous.” Bernard Bell, *Theatrical Investigation: White Collar Crime, Undercover Operations, and Privacy*, 11 WM. & MARY BILL RTS. J. 151, 152 (2002); Bennett Gershman, *The New Prosecutors*, 53 U. PITT. L. REV. 393, 396 (1992) (“over the last twenty years, the scope of undercover activity has surged”).

<sup>175</sup> For a discussion of the historical use of undercover agents and informants by police departments and public law enforcement agencies, see John Ortiz Smykla and Henry Hamilton, *Guidelines for Police Undercover Work: New Questions about Accreditation and the Emphasis on Procedure over Authorization*, 11 JUST. Q. 135, 136-38 (1994).

<sup>176</sup> *United States v. White*, 401 U.S. 745 (1971). Federal courts consider “consensual” the telephone or video surveillance conducted in the presence of an undercover agent or informant. Some state laws, however, restrict the ability of law enforcement agents to engage in such recordings. See generally, Melanie Black Dubis, *The Consensual Electronic Surveillance Experiment: State Courts React to United States v. White*, 47 VAND. L. REV. 857 (1994).

any omnibus federal statute.<sup>177</sup> Despite some interest following the Abscam investigation that embroiled Congress in 1980, Congress has shown fairly little interest in regulating or limiting the scope of undercover criminal investigations.<sup>178</sup> To the contrary, federal laws that prohibit deceptive conduct routinely exempt law enforcement agencies.<sup>179</sup>

The judiciary also exercises fairly little control over undercover investigations.<sup>180</sup> The government cannot engage in behavior that “shocks the conscience”, and it cannot entrap the defendant; but these are very easy hurdles to clear, thanks to a number of court opinions.<sup>181</sup> Accordingly, the strongest restraints on government undercover activities are those contained in internal agency guidelines<sup>182</sup> and to a lesser extent, state law.<sup>183</sup>

The government’s flexibility in implementing multiple strategies of collecting information reduces the criminal’s access to “detection avoidance” measures -- the costly actions that criminals take in order to reduce the likelihood of being caught and/or punished.<sup>184</sup> Perpetrators are likely to have a more difficult time dissuading judges and juries from evidence obtained through wiretaps and recorded conversations with informants.<sup>185</sup>

In instances of overt contact, the government still may employ a fair amount of deception to extract information from witnesses and suspects.

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<sup>177</sup> Ross, *supra* note \_\_ at 511.

<sup>178</sup> *Id.* at 511. See also Katherine Goldwasser, *After ABSCAM: An Examination of Congressional Proposals to Limit Targeting Discretion in Federal Undercover Investigations*, 36 EMORY L.J. 75 (1987).

<sup>179</sup> See, e.g., 15 U.S.C. 6821(c) (law enforcement agencies excluded from prohibiting deceptive measures used to obtain information from financial institutions)

<sup>180</sup> Bennett Gershman, *The New Prosecutors*, 53 U. PITT. L. REV. 393, 395-96 (1992).

<sup>181</sup> *United States v. Russell*; 411 U.S. 423 (1973); *Jacobson v United States*, 503 U.S. 540 (1992).

<sup>182</sup> The Attorney General’s Guidelines on Federal Bureau of Investigation Undercover Operations (2002), available at <http://www.usdoj.gov/olp/fbiundercover.pdf>. See also John Ortiz Smykla and Henry Hamilton, *Guidelines for Police Undercover Work: New Questions about Accreditation and the Emphasis on Procedure over Authorization*, 11 JUST. Q. 135, 136-38 (1994) (observing within local police departments, deficient and in some cases, nonexistent, guidelines for undercover investigations).

<sup>183</sup> Although the DOJ previously took the position that federal prosecutors were not subject to state professional rules of responsibility, Congress overturned such judgment with its passage of the McDade Amendment, which prohibits prosecutors and agents from contacting represented defendants, with certain exceptions. See generally Recent Development, *Revisiting the McDade Amendment: Finding the Appropriate Solution for the Federal Government Lawyer*, 44 HARV. J. ON LEGIS. 232 (2007). For a more general discussion of state law constraints, see Melanie Black Dubis, *The Consensual Electronic Surveillance Experiment: State Courts React to United States v. White*, 47 VAND. L. REV. 857 (1994).

<sup>184</sup> See Chris William Sanchirico, *Detection Avoidance*, 82 NYU L. Rev. 1331, 1333 (2006).

<sup>185</sup> See Ross, *supra* note \_\_ at 510 (citing Heymann’s testimony in 1981).

The police may lie to suspects about the purpose of an interview; the strength of the government's case; and the magnitude of punishment the defendant may receive if he cooperates or does not cooperate with the government.<sup>186</sup> Because it produces mixed results, the use of deception in one-on-one interrogations has become more controversial.<sup>187</sup> Deceptive interrogation techniques invoke concern because they interfere with the defendant's autonomy and produce false confessions.<sup>188</sup> Interestingly enough, as critics focus energy on deceptive interrogations, law enforcement agents may come to embrace undercover investigations even further.<sup>189</sup>

Although deception is a useful strategy, it eventually loses some of its power over time. If it is well known that police lie to suspects about the strength of a case, then eventually, the savvy suspects (recidivists in particular) will call the government's bluff during police interrogations. Similarly, perpetrators who become aware of undercover investigation techniques will eventually find a way to evade those techniques. Some drug dealers will limit the number of buyers with whom they deal. Others will routinely switch or "drop" cell phones.<sup>190</sup> As a result, over time, deception-fueled police techniques may catch the laziest and least sophisticated criminals, while their smarter, more creative and more sophisticated counterparts go further underground.

Nevertheless, even as it leads to fewer prosecutions, deception-fueled detection avoidance is beneficial insofar as it imposes a cost on criminals. A drug dealer who fears infiltration of his business by undercover agents may sell cocaine to a very select group of clients that he knows very well. His risk management strategy, however, may reduce the profitability of his business.<sup>191</sup>

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<sup>186</sup> See generally, Deborah Young, *Unnecessary Evil: Police Lying in Interrogations*, 28 CONN. L. REV. 425 (1996).

<sup>187</sup> Texas Tech Law Review's 2007 Symposium issue contains a number of thoughtful articles addressing the topic of police deception during interrogations. See Citizen Ignorance, Police Deception, and the Constitution: A Symposium, 39 TEX. TECH L. REV. 1077 (2007).

<sup>188</sup> George C. Thomas III, *Regulating Police Deception During Interrogation*, in Citizen Ignorance, Police Deception and the Constitution, 39 TEX. TECH. L. REV. 1293, 1307 ("Police deception that would leave a suspect feeling hopeless about his chance of avoiding a conviction creates an atmosphere in which a sufficiently attractive offer of leniency can induce an innocent suspect to confess.")

<sup>189</sup> "Undercover investigations substitute stealth for highly contested and/or regulated tactics, like police interrogation. If regular policing strategies disproportionately catch the poorest and least sophisticated criminals, infiltration provides access to the misdeeds of well-insulated elites." Ross, *supra* note \_\_\_ at 510.

<sup>190</sup> See, e.g. Bruce D. Johnson and Mangai Natarajan, *Strategies to Avoid Arrest: Crack Sellers' Response to Intensified Policing*, 14 AM. J. POLICE 49 (1995).

<sup>191</sup> Alternately, he may simply pass those costs onto his customers.

Accordingly, apart from community-based pressures to disclose its operations, the government itself will harbor independent, deterrence-based reasons to partially disclose its deceptive practices. When the government announces that it has employed certain deceptive techniques, it will increase the criminals' perceived likelihood of detection.<sup>192</sup> Deception by police increases distrust by and among criminals and thereby reduces group conduct. If the government can engineer a world where every coconspirator is conceivably an undercover agent or informant, group conduct will become disfavored. Conspiracies will become smaller, less-stable and less viable.<sup>193</sup>

In sum, public law enforcement agencies use multiple strategies to accumulate the information necessary to apprehend, incapacitate and deter wrongdoers. Although the government is subject to oversight over its execution of some of these strategies (courts must approve search warrants and wiretaps, for example), it nevertheless possesses a remarkable amount of access to the information it wants and needs.

## **2. Information Flow within the Corporation**

If the government uses a combination of voluntarily provided information, demands, payments and trickery to amass information, how does the corporation accomplish the same goal?

Like the government, the corporation facially is designed to efficiently obtain and filter relevant information to its officers, directors and shareholders. Executive officers make decisions regarding the short and long-term course of the company on the basis of information supplied by mid and lower-level employees. Directors vote on important company matters on the basis of information supplied to them by executive officers and external auditors. Shareholders rely on directors to punish or reward officers on the basis of the information that directors have received. Information is the life-blood of the American corporation.

The right information, however, does not always make its way to the right place. Officers and employees may fail to provide adequate or reliable information; directors may decline to act on or disclose such information to shareholders.<sup>194</sup> Efficient markets are supposed to correct this problem

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<sup>192</sup> See generally, Daniel S. Nagin, *Criminal Deterrence Research at the Outset of the Twenty-First Century*, 23 CRIME & JUST. 1, 5 (1998) (“deterrence is ultimately a perceptual phenomenon”).

<sup>193</sup> Bruce Hay, *Sting Operations, Undercover Agents, and Entrapment*, 70 MO. L. REV. 387, 395 (2005) (arguing that government uses undercover sting operations “to sow distrust among crooks so that (ideally) every crook is afraid that his confederates or victims are [government] agents”); Katyal, *Conspiracy Theory*, *supra* note \_\_ at \_\_.

<sup>194</sup> See Lawrence E. Mitchell, *Structural Holes, CEOs, and Informational Monopolies: The Missing Link in Corporate Governance*, 70 BROOK. L. REV. 1313 (2005).

over time. To the extent markets lack efficiency, securities laws correct the problem by requiring disclosure (backed up by strong sanctions for lying) and internal and external monitoring. Together, markets and regulation improve the quality of information that flows up and out through the corporation.

Nevertheless, some people will continue to lie or misrepresent information. As the lies become more complex and cheaters work in concert to hide their lies, detection becomes exponentially more difficult. Accordingly, it is interesting to consider how the four methods of information-gathering play out in the corporate enforcement context.

First, the corporate investigator may receive information voluntarily through the company's whistleblowing channel. The supporters of Sarbanes-Oxley would say that this is exactly what Congress intended when it required public companies to establish hotlines for confidential and anonymous reporting, and also put in place stringent laws protecting employees against retaliation. Yet, a recent survey by the Ethics Resource Center, a national non-profit ethics resource group, found that many employees fail to report misconduct because of a combination of both fear of retaliation and sense of futility.<sup>195</sup> The employees' explanation for not coming forward is interesting because the Ethics Resource Center also found that the actual rate of retaliation is quite low.<sup>196</sup> Either employees perceive a higher likelihood of retaliation than actually exists or retaliation itself remains under-reported and undetectable.

Whatever the explanation for the Ethics Resource Center's data, it is safe to assume that corporate compliance programs will find voluntary reporting channels insufficient to root out wrongdoing. How then, might the corporation use the remaining three tools of acquiring information?

Like the government, the corporation might also demand information from its employees. On the surface, corporate law enforcement may appear more agile in its ability to acquire information by force. Public law enforcement is bound by the Constitution, federal and state laws, and internal agency guidelines. In contrast, unless state action is present, corporate law enforcement is not bound by the Fourth, Fifth or Sixth Amendments of the Constitution.<sup>197</sup>

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<sup>195</sup> See ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY 6 (2007), available at

<http://www.corporatecompliance.org/Content/NavigationMenu/Resources/Surveys/2007NationalBusinessEthicsSurvey.pdf> (citing the "disconnect" between fear and actual incidence of employer retaliation).

<sup>196</sup> *Id.*

<sup>197</sup> I am excluding for now those instances in which private law enforcement acts under the control, or at the direct request, of the government.

Nevertheless, corporate investigators must contend with a patchwork quilt of workplace privacy statutes<sup>198</sup>, labor laws<sup>199</sup>, and common law tort claims such as defamation, wrongful termination and infliction of emotional distress.<sup>200</sup> Individually and a whole, these laws (emanating from different states, courts and regulators) create greater uncertainty for the corporate investigator than the Supreme Court's singular directives to the police.<sup>201</sup>

Corporate law enforcement also is hampered by limitations on its jurisdiction. There are certain categories of information that corporate investigators simply cannot obtain. They cannot subpoena the personal phone or bank records of suspected targets; compel cooperation from ex-employees or other persons unrelated to the company; search the homes of suspected executives; tap their employees' personal cell phones or landlines; or review emails sent from personal email accounts.<sup>202</sup>

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<sup>198</sup> See generally Reginald C. Govan, *Workplace Privacy*, 729 PLI/Lit 273 (2005) (describing federal and state limitations on workplace surveillance and searches of employee computers, email and telephone calls). The common way in which employers avoid the reach of state privacy statutes and common law claims is by expressly warning employees in advance that their computers and email are subject to monitoring. See e.g. *Campbell v. Woodward*, 433 F.Supp.2d 857, 861 n.4 (N.D.Ohio.2006) (collecting cases).

<sup>199</sup> For example, from 1999 through 2003, if a corporation conducted an investigation of an employee with the assistance of an outside firm or investigator, the FTC treated the resulting investigative material as "consumer reports" under the Federal Credit Reporting Act ("FCRA"), thereby entitling the companies' employees to advance warning of the investigation and the opportunity to thwart it by "destroy[ing] incriminating evidence and conspir[ing] with coworkers who might also be involved in the fraud or theft to collaborate on their cover stories.." Bruce H. Hulme, *The FCRA and Corporate Investigations*, in *CORPORATE INVESTIGATIONS* (Reginald J. Montgomery and William J. Majeski eds. 2005) 11.

<sup>200</sup> See e.g. *Gibson v. Philip Morris, Inc.*, 292 Ill.App.3d 267 (Ill.App.Ct. 1997) (statements in corporate investigative memo sufficiently "published" for purposes of defamation claim). See also Devin Ehrlich, Aurora Cassirer and Scott Feldman, *Truth and Consequences: How to Avoid Employee Claims of Defamation*, 24 No. 8 ACC Doc. 36 (2006) (describing conflicting approaches to employee defamation claims over statements made in intracorporate documents created during investigations).

<sup>201</sup> Companies who do business outside the United States face even greater certainty, for even when their compliance programs follow domestic laws, they still may violate privacy and labor laws in foreign jurisdictions. See generally Marisa Anne Pagnattaro and Ellen R. Pierce, *Between a Rock and a Hard Place: The Conflict Between U.S. Corporate Codes of Conduct and European Privacy and Work Laws*, 28 Berkeley J. Emp. & Lab. L. 375 (2007) (detailing instances in which the EU, France and Germany rejected corporate whistleblower provisions on privacy or labor law grounds).

<sup>202</sup> Similar observations have been made about corporate accountants: "An accountant does not have subpoena power, nor does an accountant understand how to conduct an investigation. ... Unlike the SEC or the Justice Department, accountants cannot compel testimony or offer plea bargains to uncover wrongdoing. Rather, accountants are limited to a few cursory tests for verifying data." Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 N.C. J. INT'L L. & COM. REG. 725, 798 (2003).

HP aptly demonstrates these limitations. After the first leak, Carly Fiorina ordered an investigation that included interviews of HP board members. The interviews yielded no results.<sup>203</sup> The source of the leak chose not to come forward with information. Although HP could have taken the more intrusive step of asking each HP board member to produce personal telephone records, it would have had little ability to “demand” this information. Board members either could have refused or handed over selective telephone record information.

If the corporation’s ability to receive and demand information is limited, can it make up lost ground by paying for information? Probably not: because the law casts the corporation simultaneously in the role of the “person” to be deterred, and as the “person” who deters others, its ability to pay for information is deeply compromised.

Consider the typical corporate entity. To obtain the government’s “carrot” which is prosecutorial leniency, the corporation not only must *report* all incidents of wrongdoing, but it also must *identify* by name the employees who have committed such wrongdoing; provide documents and witness statements that prove the employees’ guilt; and separately *discipline* the employee(s) responsible for the wrongdoing.<sup>204</sup> To be sure it receives the government’s blessing, the corporation may extend its discipline not only to the employees who directly engaged in wrongdoing, but also to those employees who initially failed to detect, question or prevent such conduct. Moreover, because the government treats more harshly those corporations that had prior warning of wrongdoing, discipline also may extend to employees who have engaged solely in “questionable” but not fully illegal conduct.<sup>205</sup> Finally, because the government declines to

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<sup>203</sup> See discussion *infra* at \_\_\_.

<sup>204</sup> “[A] corporation’s cooperation may be critical in identifying culprits and locating relevant evidence.” McNulty Memo at \_\_\_, Chapter VII (B). In a separate section, the Memo directs prosecutors to consider if corporations have “shielded” employees by “retaining the employees without sanction for their misconduct.” McNulty Memo at \_\_\_, Chapter VII (B)(3).

<sup>205</sup> The McNulty Memo very clearly directs corporations to err on the side of employee discipline:

A corporation’s response to misconduct says much about its willingness to ensure that such misconduct does not recur. Thus, corporations that fully recognize the seriousness of their misconduct and accept responsibility for it should be taking steps to implement the personnel, operational, and organizational changes necessary to establish an awareness among employees that criminal conduct will not be tolerated. Among the factors prosecutors should consider and weigh are whether the corporation appropriately disciplined the wrongdoers and disclosed information concerning their illegal conduct to the government.

After conceding that employee discipline may be “difficult” due to the involvement of “the human element,” the Memo concludes:

provide specific guidelines on how much discipline the corporation must mete out, the rational corporate actor will err on the side of too much discipline because the risks of applying too little discipline (an indictment) appear far worse than the risks of too much discipline (loss of employee morale and employee talent).<sup>206</sup>

In sum, the rational corporate entity may apply discipline harshly and broadly because the government's "carrot" is premised on the corporation's demonstration of robust discipline. The safest form of discipline a corporation can mete out when it detects wrongdoing is to terminate the employee. To do anything less is to risk a later conclusion that the corporation's compliance program was ineffective.<sup>207</sup> In this manner, the government's so-called lenient treatment of corporate entities effectively ratchets up internal corporate discipline; the more the corporation seeks forbearance from prosecutors, the less forbearing it will be with its own employees when it detects wrongdoing.<sup>208</sup>

The above dynamic, whereby the corporation serves as both the subject of a prosecution and a deputy attorney general, has serious implications for the company's information gathering abilities. At the very least, the current system places the corporate compliance officer in an inherently adversarial relationship with the company's employees. Such a relationship is not likely to encourage voluntary reporting.

More important, the dynamic leaves the compliance program little flexibility to purchase its information from unwilling employees. Unlike his public law enforcement counterpart, the corporate investigator has few

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While corporations need to be fair to their employees, they must also be unequivocally committed, at all levels of the corporation, to the highest standards of legal and ethical behavior. Effective internal discipline can be a powerful deterrent against improper behavior by a corporation's employees. In evaluating a corporation's response to wrongdoing, prosecutors may evaluate the willingness of the corporation to discipline culpable employees of all ranks and the adequacy of the discipline imposed. The prosecutor should be satisfied that the corporation's focus is on the integrity and credibility of its remedial and disciplinary measures rather than on the protection of the wrongdoers.

<sup>206</sup>See John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965 (1984).

<sup>207</sup>See McNulty memo at \_\_\_\_\_. Although it is possible that in some limited circumstances, after the corporation has disclosed wrongdoing to the government, the government might prefer the corporation to retain the employee while the government conducts its own investigation,

<sup>208</sup>Ironically, draconian sanctions may spur more serious crimes because employees have little reason to cease wrongdoing once their conduct is sufficient to trigger their termination. The lack of gradation in sanctions therefore eliminates marginal deterrence. Steven Shavell, *Criminal Law and the Use of Nonmonetary Sanctions as a Deterrent*, 85 COLUM. L. REV. 1232, 1245 (1985) (discussing benefits of marginal deterrence).

carrots to offer employees in exchange for information.<sup>209</sup> Public law enforcement agents may offer a violent member of the mob a life free of prison if he testifies against his colleagues. Corporate law enforcement retains no such discretion. The corporation cannot credibly promise its employee *anything* if she tells the truth; even the marginally savvy employee is well aware of this fact.<sup>210</sup> If cooperating and noncooperating employees are treated more or less the same, few employees who are themselves mired in wrongdoing will voluntarily report someone else's wrongdoing (much less their own) to corporate investigators.<sup>211</sup>

As the foregoing demonstrates, corporate-entity level sanctions do not necessarily reduce society's enforcement costs.<sup>212</sup> Entity liability is often favored because it can overcome problems caused by: (i) judgment proof individuals; and (ii) organizations that effectively eliminate individual liability either by splitting responsibility among multiple actors, or by withholding information from the state.<sup>213</sup> Accordingly, scholars have often concluded that the "firm" is in a better position than the state to identify and sanction misconduct:

The firm is much closer to the action, better educated about the activities under scrutiny, and a more efficient user of enforcement resources. While the organization does not have access to some means of sanctioning that the state enjoys (e.g., imprisonment), the organization can impose sanctions that the state cannot (e.g., reduced compensation and firing). The state's sanctions may be more severe, but they are probably more remote in how they affect the calculus of most agents contemplating violations of law.<sup>214</sup>

In small companies, or, where the conduct in question is impossible to hide (both within and outside the company), Buell's observations are correct. If

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<sup>209</sup> Many have discussed this issue with regard to the corporate attorney-client privilege. See, e.g. Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. Rev. 311, 347 (2007) ("How does counsel conduct an honest investigation knowing that all uncovered material will likely be ceded to the government"). Similar information flow problems exist, however, if the corporation is permitted to keep its privilege but required to discipline all wrongdoers.

<sup>210</sup> Moreover, the corporation has even fewer carrots or sticks to offer former employees.

<sup>211</sup> Of course, innocent "bystander" employees also may come forward and report wrongdoing, particularly with the benefit of an anonymous reporting system. To the extent these employees are "innocent" as defined by law or by the corporation's internal code of ethics, they may lack understanding or knowledge of the material components of an illegal scheme. The corporate investigator therefore may find himself the repository of bits of information that hints at illicit conduct, but without the benefit of an insider's overview.

<sup>212</sup> John T. Scholz, *Voluntary Compliance and Regulatory Enforcement*, 6 Law & Pol'y 385, 388 (1984).

<sup>213</sup> Sam Buell, *Criminal Procedure Within the Firm*, 59 Stan. L. Rev. 1613, 1625-26 (2007), citing Arlen & Kraakman, *supra* note \_\_ at \_\_.

<sup>214</sup> Buell, *supra* note \_\_ at 1626.

the company always knows when its employee has caused harm (and if everyone else always knows when the company's employee has caused harm), then company-level sanctions should be sufficient to promote deterrence.<sup>215</sup>

The calculation will change, however, in extremely large firms where harms remain hidden for a period of time from *both* the outside world *and* from the company's internal monitors. In these "hidden" situations, monitors may encounter far more difficulty detecting and understanding wrongdoing. As Buell himself observes, "Private organizations are relatively opaque, the more so the larger and more sophisticated they are. Layers of hierarchy must be penetrated to reach principal actors."<sup>216</sup> In such circumstances, state actors are not the only investigators who will find difficulty getting to the root of the matter. Corporate compliance officers also will require multiple sources of information and substantial assistance from those who can help decode and explain such information. In situations such as these, compliance efforts focused solely on sanctions and discipline may well *increase* the costs of enforcement by driving information further underground.<sup>217</sup> As information goes further underground, deception may offer the corporate investigator the most plausible manner of uncovering wrongdoing.<sup>218</sup>

### 3. Deception and Corporate Policing

*Workplace undercover investigations are not new. Used for decades by employers in the United States and elsewhere, these complex and sometimes lengthy operations often produce results impossible to achieve by other means.*<sup>219</sup>

Like its public law enforcement counterpart, the corporate policeman uses differing levels of deception to obtain information about its internal corporate community.<sup>220</sup> The corporation's access to deception, however, is not without cost. Indeed, as HP itself demonstrates, the private

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<sup>215</sup> This indeed is the argument for entity level liability for unintentional wrongs.

<sup>216</sup> *Id.* at 1625.

<sup>217</sup> Sanchirico, *supra* note \_\_ at 1337 ("Sanctioning a given species of violation not only discourages that violation, it also encourages those who still commit the violation to expend additional resources avoiding detection.").

<sup>218</sup> Undercover operations and surveillance are widely accepted techniques for investigating clandestine terrorism conspiracies. See Dru Stevenson, *Entrapment and Terrorism*, 49 B.C. L. Rev. 125 (2008).

<sup>219</sup> Eugene Ferraro, UNDERCOVER INVESTIGATIONS IN THE WORKPLACE, xiii (2000) (describing justifications and methods for numerous types of undercover investigations).

<sup>220</sup> *Id.* at 27-80 (explaining how to place undercover operative within the corporate organization).

firm's ability to use deception in investigations is far more unclear and therefore creates the potential for civil and criminal liability.<sup>221</sup>

Despite the risk of subsequent liability, corporations increasingly employ surveillance, undercover investigations and deceptive techniques in one-one-one interrogations. Surveillance within corporations is hardly a new phenomenon.<sup>222</sup> With the advent of new technologies, private employers have steadily policed their workforce by reviewing workers' emails<sup>223</sup>; tracking employees' internet use<sup>224</sup>; videotaping and monitoring employees visually and aurally<sup>225</sup>; tracking workers' whereabouts with GPS satellites or other types of technology<sup>226</sup>; and requiring employees to submit to drug tests and medical screening.<sup>227</sup>

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<sup>221</sup> See text and footnotes, *supra* at \_\_\_\_ (discussing state and workplace laws that limit incursions on employee privacy).

<sup>222</sup> See e.g. Kevin Brass, *Agencies Booming. Firms Hire Detectives to Stem Drug Abuse*, L.A. Times, Sept. 8, 1987 at 8 (describing rise of undercover workplace investigations to combat suspected drug use among employees).

<sup>223</sup> "Companies . . . keep an eye on e-mail, with 55% retaining and reviewing messages." AM. MGMT. ASS'N & ePOLICY INST., ELECTRONIC MONITORING & SURVEILLANCE SURVEY 3 (2005), available at [http://www.amanet.org/research/pdfs/EMS\\_summary05.pdf](http://www.amanet.org/research/pdfs/EMS_summary05.pdf) [hereinafter 2005 ELECTRONIC MONITORING SURVEY]. Employers may review and intercept emails maintained on the company's server. See Govan, *supra* note \_\_- at 37, citing *Fraser v. Nationwide Mut. Ins. Co.*, 352 F.3d 107 (3<sup>rd</sup> Cir. 2003). See also *Smyth v. Pillsbury Co.*, 914 F.Supp. 97, 101 (E.D. Pa. 1996) ("[T]he company's interest in preventing inappropriate and unprofessional comments or even illegal activity over its e-mail system outweighs any privacy interest the employee may have in those comments."). See also Ray Lewis, *Employee E-Mail Privacy Still Unemployed: What the United States Can Learn from the United Kingdom*, 67 La. L. Rev. 959, 965-967 (2007)

<sup>224</sup> "When it comes to workplace computer use, employers are primarily concerned about inappropriate Web surfing, with 76% monitoring workers' Website connections." 2005 ELECTRONIC MONITORING SURVEY 1, *supra* note \_\_. See, e.g., *United States v. Simons*, 206 F.3d 392, 398 (4th Cir.2000) (holding that employee had no reasonable expectation of privacy in files transferred from Internet on work computer).

<sup>225</sup> Martha Neil, *New Big Brother Software Will Monitor Workers' Facial Expressions*, ABA Journal Law News Now Blog, Jan 16, 2008, available at [www.abajournal.com/news/new\\_big\\_brother\\_software\\_will\\_monitor\\_workers\\_facial\\_expressions](http://www.abajournal.com/news/new_big_brother_software_will_monitor_workers_facial_expressions)

<sup>226</sup> "Employers who use Assisted Global Positioning or Global Positioning Systems satellite technology are in the minority, with only 5% using GPS to monitor cell phones; 8% using GPS to track company vehicles; and 8% using GSP to monitor employee ID/Smartcards." 2005 ELECTRONIC MONITORING SURVEY 2, *supra* note 120. See also Richard Mullins, *Tracking Employees*, KNIGHT RIDDER TRIB. BUS. NEWS, Jan. 17, 2007, at 1.

<sup>227</sup> See AM. MGMT. ASS'N, WORKPLACE TESTING SURVEY: MEDICAL TESTING 1 (2004) ("Nearly 63% of U.S. companies surveyed require medical testing of current employees or new hires."). See, e.g., *Slaughter v. John Elway Dodge Southwest/AutoNation*, 107 P.3d 1165, 1169 (Colo. Ct. App. 2005) (Dismissing suit by individual who was fired for refusing a drug test: "[Plaintiff] has cited, and we are aware of, no federal or Colorado case that has held that the Fourth Amendment gives rise to a public policy regarding the [drug testing] of private individuals and entities.").

Apart from daily surveillance of rank-and-file employees, corporations have also learned to adopt more sophisticated investigative measures. A Google search of the terms, “undercover corporate investigations” and “undercover workplace investigations”, generates links to numerous private investigation companies, all of whom claim to conduct corporate undercover investigations for both well-known and smaller corporations.<sup>228</sup> Corporate security organizations, created for and by private investigators, sponsor workshops that provide instruction on some of the better techniques for undertaking such investigations.<sup>229</sup> Corporate law enforcement – including undercover investigations -- has become big business.

As corporate compliance occupies a more central role in corporate governance, we should expect corporate law enforcement to rely on deceptive techniques for many of the same reasons that public law enforcement relies on these methods. First, investigators widely believe them to be effective. Many of the crimes that pervade corporate life – fraud, bribery, embezzlement and other forms of theft or misappropriation – are the types that will be carried on in secret and difficult to detect through overt monitoring.<sup>230</sup> The fear of that employees will expend energy avoiding detection will spur corporate investigators to adopt of deceptive techniques to counteract perceived detection avoidance.

Second, many of the individuals who populate corporate security organizations have also worked in public law enforcement agencies as prosecutors and investigators.<sup>231</sup> Accordingly, private law enforcers with experience in the public law enforcement field may be particularly likely to

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<sup>228</sup> See e.g. <http://www.google.com/search?sourceid=navclient&ie=UTF-8&rls=GGLG,GGLG:2005-46.GGLG:en&q=%22undercover+corporate+investigations%22> (last visited April 10, 2008) and <http://www.google.com/search?hl=en&rls=GGLG%2CGGLG%3A2005-46%2CGGLG%3Aen&q=%22undercover+workplace+investigations%22> (last visited April 10, 2008).

<sup>229</sup> See, e.g., Parrent Smith Investigators, <http://www.psinvestigates.com/index.htm> (last visited Jan. 22, 2008) (Offering a workshop on “How to Legally and Effectively Use Private Investigators - In the wake of the HP and Pellicano scandals, how to determine if an investigator is using legal and ethical means to handle your case.”); American Corporate Security Investigations, Inc., <http://acsii.net/> (last visited Jan. 22, 2008) (Offering Corporate Investigation and Presentation services); Fraud Resource Group, <http://www.fraudresourcegroup.com/business.html> (last visited Jan. 22, 2008) (Offering “Fraud Prevention Education Seminars” and “Undercover Workplace Investigations.”). See also Michael Orey, *Corporate Snoops*, BUSINESS WEEK, Oct. 9, 2006, at 46.

<sup>230</sup> The same arguments are often raised in the context of terrorism investigations. See Dru Stevenson, *Entrapment and Terrorism*, 49 B.C.L.REV. 125, 126 (2008).

<sup>231</sup> Emma Schwartz, *From Public to Private Employment: Companies Seek Exiting Government Lawyers for Hire*, Legal Times, August 25, 2005 (corporations attempting to demonstrate commitment to compliance by hiring former regulators and government attorneys).

draw on their prior knowledge of deceptive techniques to detect wrongdoing.

This second point is particularly ironic. To demonstrate their *bona fides* to the government, corporations are likely to hire former prosecutors and investigators to staff their compliance and security departments. The importation of public law enforcement techniques into the corporate setting, however, may exacerbate the very problems that the government expects corporate compliance departments to solve.

### **C. The Costs of Deception-fueled Enforcement**

As criminologists have long noted, deception imposes costs on both the deceivers and the deceived.<sup>232</sup> Communities that have long been accustomed to government-fueled deception may learn to distrust both the government and each other.<sup>233</sup> As a result, citizens who witness wrongdoing may feel less impetus to interfere with wrongdoers or provide information to the government. As mutual trust decreases, so too may social cohesion.<sup>234</sup> Social norms that previously restrained misconduct may fall apart.

In the public enforcement realm, many of these issues have been discussed with regard to criminal law enforcement in poor urban areas.<sup>235</sup> Observers have yet to consider, however, the ramifications of legally encouraged deception in the corporate arena. A few of the most obvious concerns include abuse of power, the erosion of informal norm-based mechanisms of control, and reduced risk-taking and entrepreneurialism.

#### **1. Abuse of Power**

As observers of the public realm have long known, undercover investigations bear great potential for abuse and lawbreaking by the very

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<sup>232</sup> See Gary Marx, *POLICE SURVEILLANCE* (1988); George I. Miller, *Observations on Police Undercover Work*, 25 *Criminology* 27 (1987).

<sup>233</sup> Alexandra Natapoff, *Snitching: The Institutional and Communal Consequences*, 73 *U. CIN. L. REV.* 645, 652 (2004)

<sup>234</sup> "The mutual distrust between African Americans and law enforcement officers makes it less likely that African Americans will report crimes to the police, assist the police in criminal investigations, and participate in community policing programs that lead to greater social control of neighborhoods.... Neighborly distrust leads to greater atomization of African Americans in poor communities, which leads, in turn, to a breakdown in social cohesion in the places where the need for social cohesion is the greatest. Individuals who keep to themselves reduce opportunities for enforcement of law-abiding norms in the community." Tracy Meares, *It's a Question of Connections*, 31 *Val. U. L. Rev.* 579, 590 (1997) (citation omitted)(criticizing police departments' approach to teenage violence and drug use).

<sup>235</sup> See generally Natapoff, *supra* note 233.

people who are charged with protecting the community.<sup>236</sup> Enforcers may become so used to lying to criminal targets that they also deceive innocents.<sup>237</sup> Alternately, enforcers may spend so much time with their targets that they come to identify with them.<sup>238</sup> Close supervision of informants and undercover agents is therefore necessary to prevent externalities such as the fabrication or destruction of evidence. Internal agency oversight<sup>239</sup> and judicial doctrines such as entrapment<sup>240</sup> curb, but do not eliminate, the specter of public law-enforcement abuse.

As the HP episode itself demonstrates, the possibility of abuse is just as prevalent in the corporate context, wherein enforcers must navigate the line between permissible deception and outright illegal conduct. This is particularly risky in the corporate world because there currently are *no* universally enforceable standards for corporate internal investigations and few mechanisms in place to monitor corporate investigations other than *ad hoc* arrangements between corporations and their outside and internal counsels. Indeed, many of the state professional responsibility codes discourage in-house counsel's supervision of covert investigations because lawyers are barred from engaging in deceptive conduct, either directly or indirectly through agents.<sup>241</sup>

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<sup>236</sup> Jacqueline E. Ross, *Tradeoffs in Undercover Investigations: A Comparative Perspective*, 69 U. CHI. L. REV. 1501, 1527-28 (2002)(undercover investigations create risks of "misuse and political targeting"), reviewing Cyrille Fijnaut and Gary T. Marx, UNDERCOVER: POLICE SURVEILLANCE IN COMPARATIVE PERSPECTIVE, (1995). "State sponsored deception ... raises all of the ethical issues generally associated with deception." Gary T. Marx, *Under-the-Covers Undercover Investigations: Some Reflections on the State's Use of Sex and Deception in Law Enforcement*, 11 CRIM. JUST. ETHICS 13 (1992).

<sup>237</sup> "When police are permitted to lie in the interrogation context, why should they refrain from lying to judges when applying for warrants, from violating internal police organization rules against lying, or from lying in the courtroom?" Jerome Skolnick and Richard Leo, *The Ethics of Deceptive Interrogation*, 11 CRIM JUST. ETHICS 3, 9 (1992).

<sup>238</sup> Bruce Hay, *Sting Operations, Undercover Agents, and Entrapment*, 70 MO. L. REV. 387, 397 (2005)(relationship between undercover agents and targets "in which the police befriend and employ people who belong behind bars, invites corruption and blackmail, depletes the symbolic value of the law, and sullies the courts who are asked to put their stamp of approval on it").

<sup>239</sup>For a discussion of internal guidelines, see Henry Hamilton and John Ortiz Smykla, *Guidelines for Police Undercover Work: New Questions About Accreditation and the Emphasis of Procedure Over Authorization*, 11 Just. Q 135 (1994) (following survey of 100 largest police departments, authors conclude that departmental guidelines tend to stress "procedures" for conducting investigations at the expense of discussing "when" such investigations are appropriate).

<sup>240</sup> "[T]he law ... gives insufficient incentive to government agents to limit undercover encouragement of crime; the entrapment defense improves matters by removing the law enforcement gain from overzealous or wasteful sting operations." Richard McAdams, 96 J. CRIM. L. AND CRIMINOLOGY 107, 165 (2005).

<sup>241</sup> See, e.g. Model Rule of Professional Conduct 8.4(c)(professional misconduct for an attorney to engage in "dishonesty, fraud, deceit or misrepresentation") and 8.4(a) (attorney may not violate Professional Rules through another person); Model Code of Professional Responsibility DR 1-102(A)(4)(a lawyer "shall not" engage in conduct involving "dishonesty, fraud, deceit or misrepresentation") and DR 1-102(A)(2)(lawyer may not

In sum, to the extent lawmakers and scholars intend corporations to increase their policing functions, the same lawmakers and scholars must consider, at the very least: the abuses of power that traditionally inhere with the police power, the extent to which those abuses may apply in the corporate context, and the institutional safeguards necessary to curb and eliminate such abuses.

## 2. Signaling, Reciprocity and “Informal Social Control”<sup>242</sup>

*Typically, once the investigator is placed and has begun his cover position, some period of time is required for him to build relationships of trust and acceptance with supervisors. During this relationship-building phase, the investigator ... establishes himself as a hardworking, dedicated employee who listens to instructions and completes his assignments. This element is critical, for after the relationship-building phase the investigator wants the opportunity to freely wander and associate without attracting unnecessary attention from supervisors.*<sup>243</sup>

*The successful undercover investigation will also recruit a sponsor. A sponsor is a carefully selected coworker that the investigator can use to create the appearance of having coworker friends that seem to trust her and without hesitation will vouch for her. Without attracting undue attention then, the skilled investigator transitions from relationship building to proactive investigation.*<sup>244</sup>

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violate rules through “actions of another”). For a discussion of how different jurisdictions have inconsistently applied these rules to private attorneys who supervise covert investigations, see Douglas R. Richmond, *Deceptive Lawyering*, 74 U. CIN. L. REV. 577, 583-98 (“lines cannot be confidently drawn in this area; at best, lawyers must evaluate associated risks on a continuum”). By contrast, the law has provided prosecutors more leeway to supervise government-initiated covert investigations, although they must avoid contacts with represented parties and may not misrepresent their identities “when acting in representational roles. *Id.* at 592-93. See also Bruce Green and Fred Zacharias, *The Uniqueness of Federal Prosecutors*, 88 GEO. L.J. 207, 230-232 (2000) (“countless reported decisions acknowledge the occurrence of surreptitious recording in criminal investigations without questioning its propriety.... No disciplinary body has ever sanctioned prosecutors for authorizing undercover officers and informants to gather evidence in this manner.”).

<sup>242</sup> See Neil Gunningham, *Private Ordering, Self-Regulation and Futures Markets: A Comparative Study of Informal Social Control*, 13 LAW & POL’Y 297, 298 (1991) (describing “potentially crucial role that informal mechanisms of social control ... can play in constraining deviance” among futures traders).

<sup>243</sup> Ferraro, *supra* note \_- at 28.

<sup>244</sup> *Id.* at 30.

Many readers will find themselves disturbed by the preceding description of a typical private undercover investigation. There is something quite odd about the sincerity with which the author advises the investigator to obtain the “trust” of his fellow employees when of course, he harbors no such trust in his colleagues and certainly does not merit such trust.<sup>245</sup> Corporate investigators defend such acts as necessary for the overall social welfare of the company and its shareholders. “American corporations have the moral responsibility to keep a clean house. . . . Consistent with that responsibility, employers of all sizes have the obligation to investigate all matters involving employee malfeasance and criminal activity in their workplace. To do otherwise is negligent and *immoral*.”<sup>246</sup> Nevertheless, to borrow Eric Posner’s language about law and social norms, an employee who became aware of a corporate mole within her midst would have to maintain an awfully low “discount rate” to conclude that such deception truly was in her overall best interests.<sup>247</sup>

Whatever one’s take on the value of social norms in corporate law, it is not much of a stretch to conclude that aggressive corporate policing that includes deception may reduce employee morale and thereby interfere with the company’s good faith attempts at improving and maintaining a cohesive and ethical corporate culture. If trust, loyalty and procedural justice are building blocks of a compliant culture, deceptive enforcement techniques appear antithetical to the entity’s compliance efforts. Deceptive enforcement techniques may undermine the entity’s legitimacy by causing employees to feel they have been treated unfairly.<sup>248</sup> As such, they run the risk of altering or impairing “existing public and private networks and structures and formal and informal mechanisms of social control.”<sup>249</sup>

Deceptive enforcement techniques also entrench corporate hierarchy by investing power and information in those who are authorized to deceive, and stripping privacy, dignity and information from those who are the subject of deception.<sup>250</sup> Deceptive policing techniques create, at best, a specious form of transparency. Employees are monitored and even know

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<sup>245</sup> Law enforcers have expressed similar notions in the context of criminal investigations. See *Ledbetter v. Edwards*, 35 F.3d at 1066 (“What you try to do is establish a bond of trust between you and the offender.”).

<sup>246</sup> Ferraro, *supra* note \_\_\_ at 23 (emphasis added).

<sup>247</sup> Posner has argued that social norms are reflections of an individual’s discount rate. See discussion, *supra* at \_\_\_.

<sup>248</sup> “[I]f an individual perceives a rule to be unnecessarily restrictive or perceives that she has been treated unfairly in an enforcement proceeding, the norms of autonomy or fair process may counteract the effects of the norm of law compliance.” Michael P. Vandenbergh, *Beyond Elegance: A Testable Typology of Social Norms in Corporate Environmental Compliance*, 22 STAN. ENVTL. L. J. 55, 82 (2003).

<sup>249</sup> Gunningham, *supra* note \_\_\_ at 300.

<sup>250</sup> See discussion *infra* at \_\_\_. See also Gary T. Marx, *Seeing Hazily (But Not Darkly) Through the Lens: Some Recent Empirical Studies*, 30 LAW AND SOCIAL INQUIRY 339, 368-70 (describing surveillance structures of varying power differentials).

this generally; but they have no idea who is watching them, or how and when.

Having stripped its employees of trust, the company's policing program may cause employees to conclude that they have been played as "suckers." To the extent one believes in "reciprocity theory" as articulated by Professor Dan Kahan, deception is one of the least effective law enforcement techniques the corporation could employ.<sup>251</sup>

Reciprocity theory (which Kahan and others have supported by reference to experimental psychology) rejects the notion that criminal wrongdoing is influenced by individuals' cost-benefit analysis. Instead, Kahan theorizes, most members of the community are primed to contribute to the collective good (even at personal expense), provided they believe that others are also contributing to the collective good: "Moral and emotional reciprocators take pride in contributing their fair share to public good, but deeply resent being taken advantage of."<sup>252</sup> As HP itself demonstrates, corporate policing has the potential to trigger employees' sense that someone is "taking advantage" of them.

This is not to say that all enforcement efforts are doomed from the start. Some levels of surveillance may be accepted as necessary or legitimate. Audits, drug screening and even monitoring for inappropriate computer use might be accepted among a company's employees as a normal and necessary component of everyday work life. As HP demonstrates, however, the more deceptive and uncommon the practice, the more likely it is to trigger negative feelings.

If deception encourages otherwise compliant employees to conclude that the corporation is treating them as suckers, it may also signal a different group of employees -- the so-called Holmesian bad men who have no interest in the collective good in the first place -- that the company's overt monitoring abilities are relatively weak. Surveillance and undercover investigations are fairly expensive and create numerous risks. Presumably, the company would not resort to them if overt monitoring mechanisms (periodic reports and certifications, regularly scheduled audits) were adequate. A company that must resort to deceptive practices must lack either the informal controls or the direct monitoring capacity to ensure that its employees and officers are following the law.

Here again, HP is instructive. On one hand, once the company's pretexting investigation was disclosed, the perceived immorality of its

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<sup>251</sup> See generally Dan Kahan, *Reciprocity, Collective Action, and Community Policing*, 90 CAL. L. REV. 1513 (2002).

<sup>252</sup> Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner's "Law and Social Norms,"* 36 U. RICH. L. REV. 367, 379 (2002).

investigation all but eclipsed the questionable conduct of leaking information to the press without authorization. On the other, the investigation demonstrated to current and future leakers the inherent limitations of a private company's corporate security program. For the cynic, HP's lesson is that prospective leakers, if they speak to journalists over the telephone, should use cell phones registered in someone else's name.

To the extent this discussion appears overly pessimistic, it is worthwhile to consider the atmosphere of heavily policed crime areas where undercover investigations and police deception are the norm. In cities such as these, cultural norms have arisen that *discourage* cooperation with the police.<sup>253</sup> Although many explanations abound for citizens' refusal to cooperate with the police, at least some of the fault might be laid with the deceptive techniques that police have been known to use when they interact with witnesses and targets of investigations. People do not like to assist institutions they dislike and distrust.<sup>254</sup>

### 3. Collective Action and Risk-Taking

One of the benefits of publicized deception (ie, an atmosphere in which employees know that informants and other forms of surveillance are possible, if not likely) is that it destabilizes conspiracies, which are more dangerous than individual criminal conduct.<sup>255</sup> People are less likely to work with one another if they distrust each other. Thus, it is not surprising that Professor Neal Kumar Katyal expressly argued for law enforcers to adopt destabilizing tactics in his seminal discussion on conspiracy:

[C]onspiracy law should encourage the use of excessive monitoring, chill discussion within the [criminal] firm, lead it to

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<sup>253</sup> David Kocieniewski, *Scared Silent: So Many Crimes, and Reasons not to Cooperate*, N.Y. TIMES, Dec. 30, 1997, at 121; Christopher Heredia, *T-Shirts Illustrate Divide: 'Stop Snitchin' Stymies Police Trying to Cut Crime*, SAN. FRAN. CHRON., Jan. 28, 2006, at B8; Tracey L. Meares, *It's a Question of Connections*, 31 VAL. U. L. REV. 579, 590 (2004) ("The mutual distrust between African Americans and law enforcement officers makes it less likely that African Americans will report crimes to the police.").

<sup>254</sup> "Citizens are more disposed to cooperate with police when institutions enjoy a high level of legitimacy. The perceived legitimacy of an institution, it has been shown, depends largely on whether citizens perceive that they are receiving fair and respectful treatment by police and other decision makers." Kahan, *Reciprocity, Collective Action, and Community Policing*, *supra* note \_\_ at 1525.

<sup>255</sup> "When the labor in criminality is divided, criminality is likely to be more effective and to cause greater harm. A crime in an organization therefore may present a greater threat to society than a similar crime committed by an individual outside the organizational setting." Buell, *supra* note \_- at 1624. Neal Kumar Katyal, *Conspiracy Theory*, 112 YALE L. J. 1311 (2001) (conspiracy provides both economic and psychological benefits to member of group, thereby increasing risks of harm to community).

compartmentalize information, strive to create team-production problems, impose vicarious liability to make illegal firms more inefficient, make it difficult for the parties to use default rules and off-the-rack principles to reduce transaction costs, refuse to extend legal enforcement to intra-firm disputes, and water down their intellectual property.<sup>256</sup>

When a world is populated primarily by criminal groups, who engage solely in deviant behavior and live apart from innocents, the resulting inefficiencies wrought by Katyal's prescriptions are positive outcomes. Society benefits when criminal groups weaken and crack under pressure. Accordingly, the specter of undercover surveillance and investigations isolates and atomizes criminals by making them more distrustful of each other.<sup>257</sup> Criminals who devote more time to looking over their shoulder therefore are necessarily forced to reduce the quantity and quality of their wrongdoing.<sup>258</sup>

The same result does not hold, however, if the criminals co-exist with non-criminals *and* if the criminals and non-criminals engage in socially beneficial conduct *alongside* deviant conduct. This, unfortunately, is exactly the case for most corporations.

With the exception of purely illegal operations (which are not the subject of this article), corporations are not fronts for purely illegal activity, but rather mostly law-abiding organizations that include some potential and actual wrongdoers who simultaneously perform socially beneficial tasks. Law enforcement techniques grounded in deception atomize not only the criminals in the organization, but everyone else as well. Accordingly, completely legal corporate projects based on group trust may be undermined by the feelings of distrust and resentment that well-publicized (or even semi-well publicized) deception creates.<sup>259</sup>

In a related vein, deception might also undermine legitimate risk-taking behavior within firms. Risk-taking is often considered beneficial in

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<sup>256</sup> Katyal, *Conspiracy Theory*, *supra* note\_\_ at 1397.

<sup>257</sup> Cf. Dru Stevenson, *Entrapment and the Problem of Deterring Police Misconduct*, 37 CONN L. REV. 67, 84-85 (explaining rise of group-oriented crime and consequent need for undercover police operations to counteract power of criminal groups).

<sup>258</sup> "Would-be culprits are less likely to break the law when they know that an apparently genuine criminal opportunity may be a police trap. Potential confederates become less trustworthy." Bruce Hay, *Sting Operations, Undercover Agents and Entrapment*, 70 MO. L. REV. 387, 394 (2005).

<sup>259</sup> This is not to say that all group conduct is wonderful. Overly cohesive groups may suffer from "groupthink" and other pathologies. See James Fanto, *Whistleblowing and the Public Director: Countering Corporate Inner Circles*, 83 OR. L. REV. 435, 446 (2004) (observing that "cohesive group" can convince itself that its actions are "disinterested even if in reality they are designed to perpetuate the group and enrich its members"); Katyal, *Conspiracy Theory*, *supra* note \_- at 1315-25 (cataloging dangers of group identity).

corporations. Indeed, it is the *raison d'être* for Delaware's business judgment rule.<sup>260</sup> Deception-fueled enforcement, however, reintroduces risk back into the workplace by raising the likelihood that mistakes will be repackaged and questioned as incidents of wrongdoing.<sup>261</sup> Perhaps this is no accident. Donald Langevoort has suggested that one of the goals of Sarbanes-Oxley may have been to reduce risk-taking among corporate executives.<sup>262</sup> Self-policing certainly is one way of doing so.

#### **4. Concluding Thoughts on Deception's Costs in the Corporate Workplace**

Some may argue that many of the costs of corporate policing, and corporate-sponsored deception in particular have been well known for quite some time. But an interesting characteristic of lower-level workplace surveillance was that it was limited largely to specific workplace vices (drug use; Internet pornography; and in some instances, lack of productivity) and had little to do with the board of directors. For "crimes" such as these, the undercover workplace monitoring operations were limited mostly to mail rooms, lunch rooms and areas of the company that lower – level employees frequented.<sup>263</sup>

The monitoring of financial reporting and other high-level business functions, on the other hand, was historically left to lawyers, auditors, and other professional gatekeepers who were not likely to employ the deceptive techniques that public and private law enforcement officials regularly employ. The legislative response to Enron and similar scandals dramatically altered the scope and importance of the company's compliance apparatus.<sup>264</sup> Policing is no longer the concern of some mid-level

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<sup>260</sup> "The law protects shareholder investment interests against the uneconomic consequences that the presence of such second-guessing risk would have on director action and shareholder wealth in a number of ways. It authorizes corporations to pay for director and officer liability insurance and authorizes corporate indemnification in a broad range of cases, for example. But the first protection against a threat of sub-optimal risk acceptance is the so-called business judgment rule." *Gagliardi v. TriFoods Int'l*, 683 A.2d 1049, 1052 (Del. Ch. 1996).

<sup>261</sup> Donald Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 309 (2006) ("Accountability has its downside: the familiar problems of risk aversion and frustration from fear that one will be incorrectly second-guessed."). See also Renier Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 98 YALE L.J. 857, 884 n. 78 (1984) (citing overdeterrence costs when managers forego legally risky but beneficial activity due to fear of increased penalties).

<sup>262</sup> Langevoort, *Social Construction of Sarbanes-Oxley*, *supra* note \_\_- at 1832.

<sup>263</sup> See Eugene Ferraro, UNDERCOVER INVESTIGATIONS IN THE WORKPLACE 1-16 (describing use of undercover investigations to eliminate drug and alcohol use in workplace settings)

<sup>264</sup> See Christopher A. Wray and Robert K. Hur, *The Power of the Corporate Charging Decision Over Corporate Conduct*, 116 YALE L.J. POCKET PART 306 (2007). Prior to the

“corporate security” executive, but rather the responsibility of the board. Moreover, whereas monitoring was previously driven either by regulatory or economic considerations (eliminating employee waste, for example), board-level monitoring and surveillance are now driven by the positive obligations put in place by Sarbanes Oxley and by the extremely high-stakes risks associated with entity-level corporate prosecution. As a result, the company must “catch” its own employee-crooks before prosecutors or shareholders get to them first.

Accordingly, monitoring and surveillance has not merely migrated upward within the corporate food chain, but by necessity, it has become more complex and, as HP itself demonstrates, more deceptive. With complexity and deception, ironically, comes the very result that the post-Enron response sought to prevent: the breaking of laws. It is hardly news that law enforcers sometimes break laws in the course of their jobs. The prevalence of “internal affairs” units in large police departments across the country aptly demonstrates the maxim that those who enforce laws are not immune from the urge to break them. However common sensical this problem may appear, it is one that has been largely ignored by the proponents of corporate compliance.

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federal government’s response to Enron and related scandals, the Delaware Chancery Court had already signaled the importance of corporate compliance in *In Re Caremark Int’l Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996). See discussion at notes \_\_ *supra* and H. Lowell Brown, *The Corporate Director’s Compliance Oversight Responsibility in the Post-Caremark Era*, 26 DEL. J. CORP. L. 1 (2001).

### **III. Corporate Policing, Corporate Governance and the Board**

Our current legal regime has created a climate in which two disparate and competing value systems are likely to conflict. On one hand, we have encouraged corporations, who are also private employers, to adopt a police ethic that inevitably includes deception and secrecy. Deceptive policing, in turn, can create distrust, disloyalty and unpredictability within the firm. At the same time, we have advised these same companies that they must adopt internal governance techniques that emphasize transparency and promote a sense of trust and well-being among the corporation's various stakeholders, particularly its employees. We have assumed that these goals are consistent and mutually supportive. An example of this presumed consistency appears in the ABA Compliance Committee *Corporate Compliance Survey* in 2005, in which it opined:

No compliance program, no matter how well designed and funded, can operate successfully in a corporate culture poisoned by cynicism and distrust. Employees will discount all statements regarding ethics and values as mere words, more evidence of corporate hypocrisy.<sup>265</sup>

The ABA Compliance Committee continues, “[T]he company should sincerely articulate core values that employees believe define the organization’s culture. Then, legal compliance and ethics will be woven into the corporate fabric, and not awkwardly affixed in case the government comes knocking.”<sup>266</sup> The ABA’s statement reflects the common presumption that corporate culture improves corporate compliance. But the ABA seems to have missed the opposite question: does corporate compliance improve corporate culture?

The repository of this conflict is the corporation’s board of director. Although the board will likely delegate both the governance and policing functions to lawyers and outside consultants, its members nevertheless retain the ultimate responsibility for overseeing the corporation’s internal policing apparatus. For lower level employee investigations, the tension between policing and cultural governance remains safely out of sight and mind. When, however, the allegation of misconduct reaches upward into the board itself (as was the case with HP), the conflict between policing and governance becomes a recipe for dysfunction.

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<sup>265</sup> *Corporate Compliance Survey*, *supra* note \_\_ at 1787.

<sup>266</sup> *Id.*

Board members lack the expertise to directly monitor the private law enforcers who are conducting investigations (particularly investigations that reach up into the highest levels of the company). The company's internal counsel therefore will be relied on to both monitor and design the corporation's police function. Corporate counsel, however, may either be too aligned with the company's investigators (as was the case with Kevin Hunsaker) or too out of the loop (as appeared to be the situation with Ann Baskins) to provide adequate guidance or oversight. Even when the company turns to external counsel (as HP did with Wilson Sonsini) for help, it either may do so too late in the process to resolve the conflict of enforcement and governance norms. Moreover, all of these consultants will generate costs to the company over time, with questionable results.<sup>267</sup>

The primary aim of this Article has been to expose a conflict that has not been discussed in either the corporate or criminal law literature. In the rest of this section, I make additional suggestions for better understanding and perhaps reducing this budding conflict.

## **1. Researching the Effect of Corporate Policing on Corporate Governance and Culture**

The above analysis demonstrates the need for research on the narrow topic of how corporate policing affects efforts at implementing and maintaining a healthy corporate culture. As part of this effort, in addition to researchers should attempt to better understand corporate policing and to quantify factors that relate to both corporate policing and corporate culture, such as:

- the extent of “in-house” policing within large and smaller companies (including publicly held and private firms);
- the investigatory tactics (including surveillance and undercover investigations) used to obtain information;
- the quantity and quality of sanctions meted out by the corporation in response to in-house corporate investigations of wrongdoing;
- the manner in which sanctions are communicated to the company's employees;
- the board's understanding of the company's policing apparatus, including the nature and quantity of investigations and the manner by which employees are sanctioned; and

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<sup>267</sup> Part of HP's settlement with the California AG required it to obtain the assistance of Bart Schwartz, a well-known former prosecutor, in redesigning its compliance and ethics program. See HP Press Release, *HP Reaches Resolution with California Attorney General of Claims Arising from Board Leak Investigation* (December 6, 2007), available at <http://www.hp.com/hpinfo/newsroom/press/2006/061207a.html>.

- the employees' knowledge of the company's policing apparatus, including its tactics, and the quality and quantity of its discipline.

In addition, employees should be surveyed regarding their feelings of loyalty toward the organization; their perception of management's commitment to building an ethical culture; their willingness to engage in and/or report misconduct; and their willingness to seek advice for resolving difficult ethical issues.

The attempt to measure compliance and ethical behavior in corporations is not a new phenomenon. Several organizations have published widely-reported surveys that have concluded that ethical misconduct remains an intractable problem for American businesses.<sup>268</sup> Although some of the persistence in misconduct may be the fault of "cosmetic" or sham programs,<sup>269</sup> the intractability of the problem suggests something more. Researchers should therefore consider the interplay between corporate policing and the corporate compliance industry's improvement (or lack thereof) corporate culture.

## 2. Recognizing the Gap in Corporate Law Enforcement

The foregoing discussion also suggests that both scholars and policymakers should re-evaluate the presumption that corporate entities are always better situated than government enforcers to identify and deter employees from wrongdoing. As HP itself demonstrates, numerous physical and jurisdictional limits constrain corporate policing. Many of us would conclude that this is a good thing. Police power is not something we countenance easily in any setting, and we should think hard before we extend it to potentially thousands of private investigators within corporate firms.

Moreover, the incentives for corporate investigators are different from their public law enforcement counterparts. Government prosecutors and agents are presumed to be devoid of bias in part because they make the same salary regardless of whom they convict.<sup>270</sup> Government agents are, at the very least, subject to judicial oversight and a set of internal rules and

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<sup>268</sup> See, e.g. ETHICS RESOURCE CENTER, NATIONAL BUSINESS ETHICS SURVEY 1 (2007) ("More than five years after Enron and other corporate ethics debacles, businesses of all size, type and ownership show little – if any – meaningful reduction in their enterprise-wide risk of unethical behavior.").

<sup>269</sup> Kimberly Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L. Q. 487 (2003) (criticizing compliance programs that are cosmetic and erected as a means of evading legal requirements).

<sup>270</sup> This of course is a simplification; apart from money, prosecutors and agents receive different forms of compensation for their zeal, such as promotions and increased political power.

regulations that have arisen over the years to combat abuse and incompetence. No similar set of uniform standards or oversight has been put in place for corporate law enforcement.

Accordingly, our law of corporate policing is at a crossroads. Either we will enact laws and regulations that increase the corporate investigator's power, or we will accept the gap between the corporate and public policeman's powers. Accepting the policing gap between corporate and public law enforcement as a given necessarily means that we must also accept limitations on the corporate compliance function, at least so far as deterrence is concerned. Where corporate officers and employees are intent on hiding wrongdoing from internal monitors and gatekeepers, the tools available to corporate law enforcement simply may not be enough to apprehend or prevent the criminal act. In some instances, the corporation may not always be the entity best situated to police its employees.

## **IV. Conclusion**

The HP pretexting crisis did not last very long and its perpetrators are no longer connected to the company. One might say that the company has learned its lesson. Yet the underlying tension between corporate compliance and cultural corporate governance remains firmly intact. It may well be that this tension is unavoidable. Regardless of how many individuals demonstrate ethical values consistent with reciprocity theory, a significant minority may be better moved by cost-benefit analysis and, accordingly, those policies that best heighten the costs of misconduct. For that reason, we should expect effective corporate compliance programs to incorporate aspects of both the "values-based" and "deterrence-based" approaches to compliance.<sup>271</sup>

As corporate entities continue their search for the goldilocks of compliance regimes, we do them a great disservice if we ignore the underlying tension between those values that are touted as the bedrock of a sound corporate culture (trust, fairness, honesty), and those tools that are deemed essential for the discovery and discipline of wrongdoing (deception). So long as we continue to ignore this tension, we should not be surprised by scandals such as HP's pretexting episode. However extreme an example it might have been, it is neither the only, nor final, instance of conflict between corporate policing and corporate governance.

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<sup>271</sup> Regan, *supra* note \_\_- at 971.