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Business Crime: What to Do When the Law Pursues You

(with updates by John L. Akula)

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Business Crime: What to Do When the Law Pursues You

U.S. prosecutors are imposing giant fines and imprisoning managers when regulatory compliance problems arise. Know how to protect your company and yourself when a legal crisis hits.

BY JOHN L. AKULA

Editor's Note: MIT Sloan Management Review *first published "Business Crime: What to Do When the Law Pursues You" in our spring 2000 edition. In the article, author John L. Akula examined the state of how white-collar crime was being prosecuted in the United States. Given recent changes in both regulatory and legal standards affecting managers, we asked the author to explain how the landscape has changed for managers. His additions are published here alongside the 2000 article, annotating the original text.*

IN 1997, U.S. federal agents launched a series of no-warning searches at the offices of Columbia/HCA, the largest for-profit health care provider in the United States, looking for evidence of improper charges billed to the federal government's Medicare program. The chairman's public comment that "government in-

WHY UPDATE THIS ARTICLE NOW?

The most significant change in the 10 years since this article was first published is that the enforcement approach to white-collar crime that was then taking shape — and that the article described — has become much more firmly institutionalized. The prosecutorial machinery has been successful in demanding more agressive self-policing by companies, and in imposing stricter accountability on individual managers.

But there have been some shifts managers need to know about. These are flagged in the inserts that follow. Revisiting white-collar crime is timely. When the economy is stumbling and skepticism about leading institutions is widespread, companies and managers are scrutinized more closely than in more prosperous and trusting times.

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vestigations are matter-of-fact in health care" sat poorly with the company's directors, and the chairman was soon gone. Years later, the investigation continues. Most of senior management has been replaced. Several executives have been indicted; two are appealing jail sentences. Other investigations and suits have been launched against the company. Institutional investors are suing the board. The company's stock has been as low as 40% of its previous high.

In 1996, food-processing giant Archer Daniels Midland Co. (ADM) pled guilty to price-fixing charges. Key evidence had been gathered through an ADM manager who secretly recorded business meetings for the government. ADM was fined $100 million and promised to cooperate in the prosecution of its executives. Subsequent convictions included the vice chairman, who is now appealing a two-year jail sentence.

After several waves of bank failures in the U.S. savings and loan industry during the 1980s, Congress funded the Office of the Special Counsel for Financial Institution Fraud, which coordinated a massive prosecutorial effort. Criminal convictions were obtained against 5,506 defendants; jail sentences were meted out in 3,793 cases. Among those convicted were 1,588 bankers, including 411 bank CEOs, chairmen of the board or presidents.

In the United States, cases such as those mentioned above are becoming more common. Every senior manager should expect to confront, at some time, a serious allegation that his or her company and some of its managers have committed a crime — not a crime like stealing, which could arise in a nonbusiness setting, but a violation of the criminal provisions by which the complex regulations governing U.S. business are sometimes enforced. Few companies can avoid these regulations, which deal with securities, antitrust, the environment, government procurement, international trade, financial services, health care and other aspects of business. The criminal provisions are invoked more often than the public record suggests, because many disputes with government that are officially noncriminal involve threatened criminal proceedings.

A serious allegation of criminality is a crisis for the corporation and often also for the managers who direct the corporation's response. It is hard to look good in the shadow of the criminal law, and a manager who appears to be muddling through is likely to suffer the eroded confidence of his or her superiors. However, even otherwise skilled managers are often ill prepared. Such crises are too infrequent for the development of needed judgment. Sometimes a manager's response puts the company in deeper trouble than the initial illegality. The criminal law raises difficult emotional issues; few responsibilities are as unsettling as passing judgment on once-trusted colleagues. And the criminal overlay to business regulation is a mine field. Unlike the general criminal law — which builds upon simple, well-understood, enduring prohibitions, and is violated only by con- duct that strays far from the acceptable — business regulation is dauntingly complex and shifting, and the

OUTSOURCING COMPLIANCE

The extent to which the government demands cooperation from companies has advanced to the point where government has in effect "outsourced" parts of its policing function. Many companies now have robust internal monitoring and reporting systems for certain compliance problems, resulting routinely in rigorous internal investigations and self-reporting of violations to the government.

In this process, the company's lawyers — especially outside law firms — often play a major role. Law firms have become more directive with clients around compliance issues. That reflects both stricter legal standards regarding client conduct and the law firms' own reluctance to take on liability risks or to be tainted in the eyes of regulatory agencies.

There is an on going debate over the proper role of a company's lawyer when illegal conduct comes to his or her attention. The traditional view, which has a constitutional underpinning and is deeply embedded in our legal system, is that the lawyer must have an overriding loyalty to the client, which would be unacceptably compromised if the lawyer was generally required to report a client's illegal conduct to the government. Cynics argue that lawyers can close their eyes to illegality and even be enlisted to make noncompliance more artful and difficult to detect. But advocates for the current system point out that companies and managers are far more likely to obey the law when they consult their lawyers often. And nothing is more likely to chill a close relationship with counsel than forcing the lawyer to snitch to the government.

In the aftermath of the wave of scandals involving Enron Corp. and other major companies, one concern expressed by Congress was "Where were the lawyers?" The Sarbanes-Oxley legislation (discussed below) required the SEC to establish standards of conduct for lawyers practicing before it — standards that would apply primarily in the representation of publicly traded companies. The SEC's proposed rules would have required a lawyer who became aware of a significant current violation to report it "up the ladder" within the company until the lawyer received an appropriate response; if necessary, the lawyer was required to go all the way up to the board's audit committee or independent directors. If the company failed to provide an appropriate response, the lawyer would have been required to withdraw from representing the company and notify the SEC of the withdrawal. This "noisy withdrawal" proposal met with strong opposition, especially from the legal profession, and the final rules required only that a lawyer report "up the ladder" within the company.

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distinction between routine business practices and criminal activity can be blurry.

The demands on managers and directors are rising. The law now requires that compliance be *well managed*, in regard to preventing violations and responding to them. Individuals whose judgment is challenged by the government cannot count on support from their companies. The law pressures a company to distance itself from individuals who may have committed crimes and also those who have mismanaged compliance.

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Punishment is becoming more severe. For corporations, the ceiling on fines is rising fast. Many statutes once fixed fines at levels unlikely to daunt large companies. New elastic standards are tied to harm, benefit and culpability. ADM's $100 million was a sevenfold increase over the previous antitrust record; the current record is now $500 million. Enforcement agencies have become entrepreneurial. All criminal fines once went to the U.S. Treasury, but under "forfeiture" provisions first appearing in drug statutes, agencies were allowed to keep some enforcement proceeds. This practice is filtering into corporate regulation.

Managers are also facing tougher sanctions. Although U.S. antitrust laws date back to 1890, no businessman was jailed — except in violent crimes and labor disputes — until 1959. Only since the mid-1970s have jail sentences become routine. In the last 10 years, the length of a typical antitrust sentence has tripled to 18 months. Environmental enforcement ramped up more quickly. During 1984, all jail sentences for environmental offenses added up to six months; by 1997, that figure had risen to 2,400 months. The widespread S&L jail sentences were unprecedented. And for every manager who goes to jail, there are many who suffer lesser sanctions.

This article is not a substitute for legal advice, but it will help managers and directors meet their expanding challenges. It first explains the key arenas of legal accountability, and then offers guidance for managing a legal crisis, and for staying out of trouble in the first place.

Corporate Accountability — The Three Key Legal Arenas

In years past, a company faced with an allegation of criminal activity often had a one-dimensional strategy — avoid any finding of guilt. A typical response involved "circling the wagons" around the company and its managers, and opposing the government at every turn. Today, that strategy is rarely used, because companies are responding to more complex considerations. These cluster around three key arenas, and the manager's task starts with understanding each.

The Corporation: Criminal, Good Citizen or Both?

The first arena is that of corporate criminal liability. When does a company commit a crime, and how is the seriousness of the offense gauged?

In an earlier era, the criminal law did not apply to corporations, which had "no body to kick and no soul to damn." Many nations still limit the application of the criminal law to corporations, but in the United States today, a corporation commits a crime whenever one of its employees commits that crime, if the employee acts within the scope of employment and, in part, for the corporation's benefit. It is irrelevant that the employee acts contrary to instructions or corporate policy, is motivated by personal benefit, has little authority or that any benefit to the corporation from the crime is tenuous. A corporation can also commit a crime if the activities and knowledge of various employees, when added together, comprise that crime, even though no individual employee has committed it. Defenders of these expansive modern rules on corporate criminal liability argue that narrower rules could be too easily evaded. However, under the modern rules, even a company that is managed in the spirit of respect for the law will often find that it cannot police all employees carefully enough to avoid any criminal activity. If such a company is in a regulation-sensitive line of business, it may commit crimes quite often.

U.S. law has special rules for evaluating the seriousness of a corporation's crime. For an individual's

SALOMON BROTHERS: THE HIGH COST OF A HESITANT RESPONSE

According to the U.S. Securities and Exchange Commission, in early 1991 the head of Salomon's government trading desk purchased more of a U.S. Treasury bond offer than the law allows by submitting false bids in the name of Salomon customers. When one customer learned about it, the trader confessed to a Salomon vice chairman. This led to consultations among four senior executives: the vice chairman, president, chairman and chief legal officer, who counseled that the bids appeared criminal and should be reported to the government.

Again according to the SEC, these four agreed to report the incident, but they made no specific plan, and they did not tell the government for three and a half months. In the interim, regulators expressed concerns about abuses in a later Treasury auction. The chairman met with officials, assured them that Salomon had acted properly and would cooperate in an investigation, but did not mention the earlier transgression. As to the later matter, Salomon retained outside counsel to conduct an internal investigation. When these lawyers drew close to uncovering the earlier transgression, Salomon issued a press release about the earlier misconduct and announced that it had suspended the trader and some lower employees. Salomon did not mention that top management had long known about the matter, but this news soon became public, and the four senior executives resigned.*

News reports suggested that officials were incensed at having been kept in the dark and arguably misled. The SEC brought civil charges against the former chairman, president and vice chairman, citing a securities industry statute requiring effective supervision to prevent violations. The SEC fined them and barred the chairman from the top position in any industry firm. The SEC emphasized that upon learning of misconduct, the top managers had failed to investigate or place limits on the trader's activity, and that the trader subsequently broke the rules again.

Civil charges were filed in federal court against the firm and were settled for $290 million. Some estimates put the firm's total losses at closer to a billion dollars.

The U.S. Attorney was reported to favor criminal charges against the firm. Most observers thought the impact of such charges would be devastating. In 1988, Drexel Burnham Lambert, another major investment house, had pled guilty to felony charges relating to securities law violations and was soon in bankruptcy. Salomon was perhaps more vulnerable, since it faced disqualification from much of its global role. The firm's new management was cooperative and contrite. It waived the attorney-client privilege, shared the results of its internal investigation, made employees and documents available to the government and put in place a vigorous compliance program. These factors were cited by the U.S. Attorney when he announced he would not seek criminal charges. An extensive investigation had uncovered other instances of similar misfeasance, but no deeper illegalities.†

The settlement with the firm did not protect individual employees under investigation. The head trader went to jail.

* The official chronology of the misconduct — and the government usually writes the record — is set out in SEC Release No. 34-31554 (December 3, 1992), reproduced in Federal Securities Law Reports (CCH) at para. 85,067. The three Salomon executives who were fined consented to the order against them, but not to the SEC's findings of fact.

† For a discussion of the decision not to bring criminal charges in this and several other high-profile cases, see: F. J. Wain and J. C. Schwartz, "Deferred Prosecution: The Need for Specialized Guidelines for Corporate Defendants," in Journal of Corporation Law, 23 fall 1997 pp. 121-134. Reprinted in Caremark and the Globalization of Good Corporate Conduct (New York: Practicing Law Institute, 1998), pp. 183-195.

crime, the law gives great weight to his state of mind. Did the perpetrator mean to break the law? Did he purposely harm another? But how culpable is a corporation, and how severely should it be punished? The current federal approach is reflected in the 1991 Organizational Sentencing Guidelines (OSG), under which a corporation's fine for a crime largely reflects two calculations. The first is a "base fine" tied to the seriousness of the discrete offense. The second is a "culpability score" that gauges whether, as to the particular offense and more generally, the company is a "good citizen corporation." A checklist measures whether the company has an effective compliance program, responds early to problems, disciplines employees, notifies regulators of problems and cooperates in investigations. The culpability score can make an enormous difference in the final fine, in the most extreme cases varying the base fine by a factor of as much as 80. The OSG applies only to sentencing, but the same approach is taken at other stages in the criminal process, including the decision to prosecute.[2]

Crimes are punished. The general criminal law uses prison and stigma, but, for corporations, jail is impossible and stigma ambiguous. Corporations can be subject to monetary fines, and fines are going up. Corporations have become more vulnerable to large fines as the distinction between civil and criminal enforcement has blurred. Many modern regulations permit multiple civil damages, or "civil money penalties," enabling government to impose punitive financial sanctions without meeting the burdens of a criminal conviction.

When prosecutors confront serious corporate misfeasance, they almost always target individual managers for harsh treatment.

Nevertheless, those who enforce the law question the effectiveness of corporate fines as deterrence, especially when noncompliance is profitable and the likelihood of being caught small. How much did

THE MANAGER AND THE COMPANY — WHOSE LAWYER, AND WHO PAYS?

The company's lawyers spend most of their time working with the company's managers, and often they form strong personal relationships. But the client is the company, and not any individual manager. For routine business matters, this distinction has little practical significance, but it greatly complicates the manager-lawyer relationship when allegations of criminal conduct are made.

Typically, both the company and certain of its individual managers face the possibility of criminal charges. But the company can qualify for leniency and sometimes escape a criminal conviction entirely by gaining "cooperation credit" from the prosecutors. The pressure to cooperate plays out in the attorney-client context in two especially significant ways.

The first relates to the "attorney-client privilege." When a client seeks out a lawyer for legal advice, those conversations are privileged; the lawyer will not disclose those conversations to any third party without the client's permission, even in a legal proceeding. But a client can "waive the privilege" and permit disclosure. A manager typically consults with the company's lawyer on legal matters. The company's lawyer is bound by the attorney-client privilege, but given that the client is the company, the company can waive the privilege even though an individual manager wants to keep the consultations confidential. After this article was first published, federal prosecutors began to demand with increasing frequency that target companies desiring to be seen as cooperative waive the attorney-client privilege, and such waivers became much more common.

The second relates to "indemnification," the legal term for the obligation assumed by most companies to pay for the costs incurred by managers defending themselves against litigation or threatened litigation. There are some long-recognized limitations to indemnification when a manager becomes entangled with the criminal law, most notably that a company generally cannot indemnify a manager for the costs of willful criminal conduct. But that limitation generally comes into play only after a conviction. A company generally advances funds to a manager facing criminal charges to pay for the manager's legal defense team, subject to a "claw back" provision allowing the company to seek repayment if there is a criminal conviction. (Until recent years, companies rarely attempted to exercise that right, but claw backs are no longer rare.) As with the attorney-client privilege, the federal government, after this article was first published, pushed a new line of attack, sometimes taking the position that a company could be deemed uncooperative because it advanced such funds. Given that the cost of effectively defending a criminal charge in a complicated white-collar case is beyond the means of all but the wealthiest individuals, as a practical matter, the government could prevent a manager from mounting an effective defense.

This issue played out most dramatically in a case brought against major accounting firm KPMG International and several individuals within the firm, alleging criminal activity relating to the marketing of tax shelters. For a financial service provider such as KPMG, a criminal conviction, or even an indictment, can be a corporate death sentence. The federal prosecutors used that leverage to force the company to curtail defense funds advanced to individual managers, despite the company's indemnification policy. The federal judge hearing the case found the prosecutors' use of pressure troubling and eventually threw out many of the charges against the individual defendants on the grounds that the government denied them effective counsel.

In the face of an increasingly widespread sense that prosecutors were going too far, the government has in the last few years retreated a bit. Under revised guidelines for federal prosecutors, company waivers of the attorney-client privilege are no longer sought except under limited circumstances, and pressure to cut back on defense funds is no longer considered a generally acceptable practice.

The heightened sensitivity to conflicts in the attorney-client relationship has had one benefit for managers. Many companies, especially large ones, now consider it routine to pay for separate counsel for any manager caught up even peripherally in a criminal investigation, such as individuals who are not targets but whom the government wants to question. Managers should not be bashful about asking the company to pay for a personal lawyer.

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ADM's fine hurt, given its $1.3 billion in liquid assets and profits the previous year of $700 million? Yet making fines even bigger raises other problems. Fines fall first on shareholders (although they may have profited from misfeasance), and impairing a company hurts employees, creditors and those seeking compensation for the same harm.

The Manager: Where the Blame Rests Most Heavily

The second key legal arena is the liability of individual managers for their personal criminal conduct.

The growing use of severe sanctions against individual managers is driven by several considerations. Prosecutors concerned about the effectiveness of punishing corporations take comfort in the undisputed effectiveness of punishing managers — no manager views jail time as a cost of doing business, and even lesser sanctions — or just the threat of lesser sanctions — can be devastating to a manager's career and family. Accepting corporate fines as satisfaction in full is often viewed as allowing managers to purchase leniency with corporate assets. The federal Sentencing Guidelines for Individuals toughened punishment, especially for white-collar crime, and usually require jail time upon conviction for most major offenses. Thus, when today's prosecutors confront serious corporate misfeasance, they almost always target individual managers for harsh treatment, even if the company is treated leniently — often because it cooperates in the prosecution of its managers.

Are managers being held to higher standards than other people? In some respects, probably yes. Even though ignorance of the law is generally not an excuse for breaking the law, prosecutors are usually reluctant to pursue those who unknowingly do wrong. Yet managers are often required to cultivate whatever expertise is needed under today's complex regulatory regimes. Some modern statutes assign compliance responsibilities to specific managers, and these persons are at high risk — environmental compliance officers are referred to only half-jokingly as "designated jailbirds." Other statutes have broad requirements of adequate supervision within an organization generally. Managers far from a problem can be legally entangled by these provisions — as knowledge of a specific compliance problem passes up the management ladder, so does supervisory responsibility for that problem.

There are good reasons for making it easy to convict managers, whose inattentiveness or lapses of judgment can cause grave harm. Sophisticated managers can meet standards that are higher than those routinely imposed by the law. And prosecutors say they rarely seek convictions on the basis of the loosest legal standards unless culpability in a stricter sense is present. But threatening managers with criminal liability is widely used to gain leverage.

The Board: A Sharper Eye on Compliance

The third key arena is corporate governance. Directors can commit regulatory crimes like any other corporate agent, but the central concern for boards is not criminal liability, but a still-emerging body of doctrine that is increasing the threat of civil liability for directors who are not sufficiently attentive to compliance concerns.

One key development was the Private Securities Litigation Reform Act of 1995 (PSLRA), which requires auditors to examine a company's compliance procedures and to report apparent illegalities to the board. This brings compliance within the established orbit of audits and securities law disclosures. The PSLRA's impact is being reinforced by a 1997 Statement on Auditing Standards, which strengthens auditors' obligations to probe for and report fraud.[3]

Another landmark was the 1996 Delaware court ruling in *Caremark*. In this civil lawsuit evaluating director responsibility for one company's losses due to criminal infractions under the Medicare program, the court underscored a board's responsibility to adopt systems that keep it adequately informed of compliance problems.[4] This contrasted to an earlier Delaware court opinion that had written approvingly of directors who assumed that managers were honest until given reason to think otherwise.

How worried should directors be? The ramifications of the PSLRA and *Caremark* are still unfolding. Director liability is still almost exclusively a civil, not criminal, matter. Outside directors are much less likely to have the close involvement that would expose them to more severe sanctions. A broad body of state law protects directors — the "business judgment rule" limits second-guessing of boards, and indemnification and liability insurance for directors is encouraged. When merger litigation in the 1980s threatened to increase director liability, many states strengthened legal protection for board members.

However, the newer demands for accountability may prove stronger. They are grounded in federal law, which can override state laws that protect directors. For example, the U.S. Securities and Exchange Commission (SEC), a federal agency, has imposed limits on corporate indemnification of directors who vio-

THE BOARD, SENIOR MANAGEMENT AND SARBANES-OXLEY

Post-Enron, Congress enacted the federal statute known as Sarbanes-Oxley, or "SOX," which applies primarily to publicly traded companies. SOX, along with the regulations and stock exchange rules that followed, represented the first major effort by the federal government to set standards for corporate governance. One of the concerns motivating Congress was the perceived ineffectiveness of the boards at Enron and other companies. SOX strengthened the role of independent directors. Extensive requirements were imposed relating to monitoring, auditing and reporting of financial condition and risks. The personal legal exposure of individual senior officers was expanded.

In the post-Enron era, it appears that boards of directors — especially the newly empowered independent directors — are taking a more aggressive role in compliance. For example, when the SEC indicated that it would be investigating the back-dating of stock options, many companies launched internal investigations and turned the results over to the government. Often, the independent directors drove that process and were very risk-averse.

However, one striking feature of the recent financial crisis is the number of situations in which the boards of directors of major publicly- traded companies appear to have had little grasp of the true financial risks being assumed by their companies. Did SOX do much good? And if not, what is still missing?

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late federal securities laws, even when such indemnification would be permitted under state law.

Perhaps more importantly, state laws protecting directors emerged in the context of private disputes over corporate assets. Today's demands for increased director accountability will often arise in the context of compromised public interests relating to bank or insurance company failures, pollution, price fixing and health care overcharges. Often, the company involved will have admitted to criminal conduct. In these circumstances, directors may enjoy less deference to their judgment.

Moreover, directors seeking to avoid civil liability will be pressed to become more informed about concrete compliance problems. After they have such knowledge and act — or fail to — they are vulnerable to the more serious allegations that can be made against those with specific knowledge and a supervisory role. As a director's conduct becomes more culpable, the protection of indemnification and insurance recedes. The U.S. Department of Justice (DOJ) suggests harsher treatment for corporations that are too generous in advancing defense funds to individuals who need legal representation.[5]

The Corporation in Trouble

Crises are unpredictable. The company may be put off balance repeatedly as matters unfold. There are no rules adequate for every contingency. But certain issues must almost always be addressed when criminal prosecution becomes a possibility.[6]

Targeted!

A company's first reaction is often blunted by uncertainty and defensiveness, but managers should quickly come to grips with some new and harsh realities.

No matter how the crisis comes to light — through other managers, auditors, counsel, a private lawsuit or a public event — a government investigation is a likely outcome. The regulators with whom a company routinely deals are often lax, and complex corporate practices are often opaque to their oversight. The investigative and enforcement personnel within regulatory agencies are more focused and persistent. The prosecutorial agencies to which serious matters are referred — for federal offenses, the DOJ and U.S. Attorney's Offices, supported by the FBI — are an even harsher breed. Prosecutors have exclusive power to initiate criminal proceedings and extraordinary discretion. Sentencing guidelines have increased their clout — judicial discretion over sentencing gives judges a final say, but with guidelines a prosecutor's framing of charges takes on additional importance. Unlike regulators, who are uncomfortable with disparate treatment of similarly situated companies, prosecutors see their role as serving up examples, treating them harshly to deter others who might not be caught.

> The Department of Justice suggests harsher treatment for corporations that are too generous in advancing defense funds to individuals.

Expect to see confidential information made public. Government investigative tools are powerful, and corporations have little privacy under the law. Barriers that assure confidentiality in other circumstances are easily pierced. A company's internal records can be reached. Managers questioned by government and warned about the penalties for evasion often disclose all they know. A company should assume its internal deliberations — except for certain discussions with counsel — will come to light. Government investigations of business crime are increasingly using tools like wiretaps and no-warning searches that until recently were reserved for criminal enterprises.

> The criminal process is a drama in vilification. Do not expect a sympathetic public ear.

The public often displays great interest in accusations against companies. Prosecutors are publicity minded and regularly ride high-profile cases to elective office. You may think this is unbusinesslike, or that a complex problem is being viewed simplistically. However, the criminal process is a drama in vilification. Do not expect a sympathetic public ear.

Avoiding a Second Wave of Legal Problems

Management must act promptly to avoid the secondary legal problems that can arise from investigations.

Lying and tampering with evidence are serious offenses — often more serious than the offenses that triggered an investigation. Prosecutors are good at spotting cover-ups and they respond harshly — both to buttress their powers and the integrity of the process, and because it is fair to punish obstruction severely when underlying offenses may have been obscured.

Who Takes Charge?

Responsibility for guiding the company through the crisis should be vested above the highest level of management whose judgment will be scrutinized for direct misfeasance or lapses of supervision. If that includes senior management, responsibility should be placed with outside directors.

Such crises require special skills, and may indicate a management failure. Is there need for technical expertise, better communication with regulators, assistance with the media or fresh leadership?

The lawyers will have a central role. They will assess the case against the company, and coordinate a defense to what may involve criminal, administrative and civil threats from a variety of parties. The lawyers will act to protect the confidentiality of deliberations on legal strategy, and position the company with respect to managers whose conduct will be questioned. The use of outside rather than in-house counsel will add cost and portentousness which may or may not be appropriate. Outside counsel often brings more expertise, and also independence, which can constrain the company but comfort the board and outside constituencies. Outside counsel offers better protection of confidentiality because in-house counsel often blurs its legal and managerial roles. Managers sometimes complain that the lawyers assume control over management decisions as well as legal ones, but there is no clear line between the two, and often only the lawyers have experience with such crises.

Figuring Out the Problem

The company will probably want a formal internal investigation. The investigation needs to be done right, since the results may get a hard look from within and outside the company. The principle of placing responsibility above the highest level of management that may be scrutinized applies here too. Managers offended by this should consider that the alternative to a credible internal investigation may be a hostile external one.

The company needs to determine what went wrong, not just legally, but operationally. Was the problem in the central office or the field? Was it a failure to adapt to shifting public policy? Did management not follow legal advice or get poor advice? Was the weakness due to temporary circumstances such as personnel turnovers, or more structural factors?

The most important question the company must ask is whether it "owns" the challenged conduct, or attributes it to rogue employees for whom it is not morally responsible, though it may be legally so. That is, does the company consider itself an appropriate target or a victim?

Once the company has made its assessment of what went wrong, it will try to convince the regulators. This can have a substantial impact even if not completely successful. The company may share its good-faith evaluation of individual managers. This can range from fully backing some managers to encouraging the prosecution of others, or a broad range of middle positions, such as disciplining some managers but helping them defend against criminal liability.

An assessment takes time, but time can be costly. Regulators are more open-minded early in their involvement, before their views have solidified. The good citizen corporation accepts responsibility, but doing so without knowing what went wrong creates new problems. Shortly after the Exxon *Valdez* oil spill in 1989, Exxon's CEO acknowledged the possible role of the captain's drinking. Later, he and many others concluded that the causes of the accident lay elsewhere. In the civil trial that resulted in a $5 billion verdict, mostly for punitive damages, the CEO's change of view was used to discredit him.

In the Exxon *Valdez* $5 billion civil trial, the CEO's change of view was used to discredit him.

Shielding the Public From Harm

Management should ask whether steps are needed to protect the public from continuing risk, since preventable harm inflicted after a company is alerted to a problem will be viewed harshly. A tendency to delay is common. If an internal investigation is under way, interim measures such as revised procedures may seem unfair to employees and a premature acknowledgment of guilt. The company may fear that failure to notify regulators will appear more derelict if internal action is taken. However, interim measures to protect the public are often the only responsible reaction to a problem not yet fully understood. In its action against the Salomon executives, the SEC placed special emphasis on the fact that the errant trader continued to break the rules after top management knew about an earlier offense.

Disclosure to the Public

If a company is under investigation, should the company declare this publicly? Investigative agencies often proceed discreetly. This can benefit the targeted company — an agency can more easily relent if public scrutiny is absent. But secrecy may violate securities law requirements on disclosure and insider trading.

Disclosure to Regulators—A Better Idea Than You Think

If regulators are unaware of a legal problem, should the company tell? Serious crimes must be disclosed, although for some kinds of crimes the facts are rarely clear. Some laws specifically require disclosure, as for certain environmental spills.

Other legal requirements may have the same effect. Reports filed with the government by regulated industries and contractors must be accurate. Nondisclosure may actively mislead an agency, or render other disclosures misleading. Public protection may require agency involvement.

When notifying regulators of a legal problem is not legally required, this course may have little appeal at first glance. Perhaps the problem can be hidden, or dealt with responsibly within the company. There is not yet a clear moral consensus on confession or snitching. Nevertheless, disclosure often makes sense:

- Failure to disclose is a "slippery slope." The failure is likely to inhibit an effective internal response not just to the current infraction, but to future infractions. Dealing forthrightly with any future problem will also call attention to past offenses that have been buried, and employees implicated in later incidents will rightfully complain that they are being treated unfairly compared with those involved in earlier incidents that were covered up. Maintaining secrecy may require increasingly culpable conduct, such as pressuring others to lie.
- The attempt at secrecy may fail. Companies are scrutinized by regulators, media, lawsuits, and audits. An employee — past or current —may "blow the whistle." The company will have missed the chance to be forthcoming, and judgment will be harsher when facts become known by other means, especially for managers involved in the cover-up.
- Often voluntary disclosure is made after a period of equivocation. This can be the worst of both worlds. The delay, and those responsible for it, must be disclosed. The rewards for self-reporting diminish over time, and little credit is given if other events are in motion that would have brought the matter to light.
- The more serious the problem, the more tempting secrecy. But a company is on firmer ground arguing it can manage a minor problem. Covering up a major infraction is likely to become another major infraction.

Thus, while secrecy may be appealing initially, especially to managers closest to a problem, those taking a broader view may conclude otherwise. Disclosure should be given full and prompt consideration.

Avoiding a Repeat Performance

The most important reason to figure out what went wrong is to avoid repeating it. Most excuses — misunderstanding the law, an innocent's vulnerability to the machinations of others — ring false the second time. Agencies often decide after preliminary review to dispose of a matter leniently, but not when a company has been in trouble before. Expect harsher treatment the second time around.

Staying Out of Trouble

How Much Should a Company Worry?

More now than a few years ago, but otherwise the answer varies. The law is generally stricter for businesses with a direct impact on public health or safety. Big

THE MANAGER AS TARGET

A manager targeted in a government investigation faces starker choices than a company. Personal culpability is more pointed. You are less likely to be advised by counsel. You are likely to be confused when served with a subpoena or questioned. What should you do?

• *Consult a lawyer.* Early in the process, company counsel may in effect speak for the company and its employees. However, if there is risk of being a target, or you can't assess the risk, consult a lawyer who represents you. Unless your company believes you deliberately committed a crime, it may be willing to pay for your counsel. You will want an attorney who specializes in white-collar defense work and the regulations involved, can work with company counsel and will be respected by prosecutors. Many are ex-prosecutors. Friends who are lawyers can provide leads. So can corporate counsel. Most big firms have the skill, but are pricey. Good lawyers are in small firms too. You can shop; most lawyers will consult once for free. But be prepared for big bills — the government has ample resources and the company sometimes has even more, which along with the high stakes makes for intense lawyering. Also expect a big up-front retainer — managers in trouble are bad credit risks.

• *Assess the risk.* You may initially try to assess the risk yourself. This is hard. You won't understand the law or facts. Companies clamp down on internal discussions. It is hard to tell friends from adversaries. Is the government after you? The company? Listen carefully but cautiously to the other parties' lawyers — they must disclose adverse interests, but not as fully or as soon as you would like, and it can be hard to distinguish pro forma and serious warnings.

• *Don't get in deeper.* You may be tempted or pressured to destroy evidence and the like. Don't. It's wrong. The penalties are severe. You are likely to get caught.

• *Don't be a pushover.* If you have shown bad judgment, or acted illegally but without being purposefully criminal, you may be at risk for more severe treatment than you deserve. Unfortunately, fundamentally honest managers can become entangled with dishonest ones, and the more honest ones are sometimes especially hesitant about defending themselves. Some corporations embrace the "bad apple" theory too enthusiastically. Prosecutors may turn out to be a surprise ally. They are careful about sorting out degrees of culpability. While companies tend to push blame down the corporate hierarchy, prosecutors like to push up.

companies attract attention. Some companies are weak on compliance. Certain industries are "hot spots" — finance usually gets a hard look during economic contractions, and health care is drawing attention because of rising health care costs, public concerns about profiteering and the government's role as a purchaser.

Keeping Bad Company

The most important rule for avoiding trouble is being careful of the company you keep. Expansive rules on accomplice liability reach those on the periphery of offenses. Many harshly scrutinized companies and managers did not engage in wrongdoing serious enough to attract attention, but became entangled in an investigation of a primary target with whom they had dealings. Some schemers aggressively recruit others, validating an "everyone does it" ethic.

Even an arm's-length deal with a party that has lax standards can be a problem. If the deal spreads the profits of noncompliance, regulators may scrutinize all who benefit. A company claiming ignorance of wrongdoing can be surprised to learn how much some of its own employees know, and the law deems the company to have all such knowledge.

Board Leadership

The arguments for board leadership in keeping a company attentive to potential legal problems have become stronger. The *Caremark* decision and the PSLRA sent a strong message to directors. The management systems endorsed by the OSG require board support. The board must protect its members and its ability to attract candidates. Yet focus on compliance is difficult to cultivate. Serious compliance problems are infrequent. Most relevant decisions are made outside the boardroom, and many are technical. Recent legal changes have raised the risks of passivity but not eliminated its attractiveness. What should a busy board do?

It should, with counsel, assess the company's vulnerabilities. What lines of business are compliance sensitive? Is there a history of compliance problems? Are there organizational weak points, such as employees with autonomy and incentives to cut corners? Has the company outgrown oversight systems that worked when it was smaller?

While some concerns can be addressed ad hoc, a company with sensitive lines of business is likely to conclude that a formal compliance program is appropriate. With appropriate management systems in place, the board should have a limited hands-on role. Procedures for bringing problems before the board should screen out those not warranting board attention. The board and its auditors should have a common understanding of how compliance issues will be raised in that context. The board will want a record of responsible consideration of matters that do come before it, including in every case documented assurances of an appropriate management response. Board policies about indemnification and the advancement of legal expenses should be carefully balanced; for example, should a company support a manager who is not cooperating with a company's own investigation?

In compliance matters, the board will rely on counsel and auditors, but these advisers may be uncomfortable policing the managers who retain them for much of their services. The board is owed an overriding loyalty, which it can usually command by making its expectations clear and creating channels of communication running directly to it or, when appropriate, the outside directors.

Boards must remember that systems and experts can't completely supplant the board's independent judgment. Recently, the SEC issued a report critical of some W.R. Grace Co. directors for failing to press the company to disclose details about the CEO's retirement package. The directors argued that expert counsel had approved the sufficiency of the disclosures, and one SEC commissioner agreed.[7] The SEC may have been concerned with board independence in a public company with a strong family presence. Uncritical reliance on routine procedures may be insufficient if there is reason to fear they may be out-of-plumb.

Compliance Programs

The OSG make effective compliance programs a key factor in corporate culpability and contain guidance on written standards and procedures, the designation of high-level personnel with compliance responsibility, education and training, and active self-policing. Some agencies have added further guidance. The absence of a compliance program might be the "sustained or systematic" failure that, under *Caremark*, is the basis of director civil liability.[8]

Setting up compliance programs with the help of lawyers and consultants has become routine. Running an effective program is more difficult:

- A program's written standards can't be clearer than the often ambiguous regulations they mirror, or incorporate the balance and context necessary to the interpretation of prohibitions.
- Compliance programs face cynicism, even from those who run them. Is the company committed or pretending? Given the OSG, even elaborate systems may be nothing but posturing for government.
- Compliance is about punishment, and commitment is difficult to cultivate when punishment looms larger than rewards. Compliance records can be obtained by regulators and adverse private parties, providing them a map to the company's lapses.

Regulators have an answer to cynicism and weak commitment. Compliance is taken seriously, they say, if a company punishes noncompliance and conduct that undermines compliance programs. Programs without a track record of internal discipline are likely to be window dressing, especially since companies can impose sanctions without meeting the burdens of a criminal proceeding. The regulators are, I think, right. A company should sometimes emphasize guidance over punishment, but a compliance program must have teeth. This is especially difficult but important for lapses by higher management, as to which the board will have to make its own commitment clear.

THE SURPRISE VISIT FROM THE FBI

The original article focused on what it was like for a manager to be a "target" of an investigation — someone whom the prosecutors view as a strong candidate for criminal charges — but didn't deal much with what it is like to be on the periphery of an investigation. But for every target, there is typically a much larger group of managers in whom the government is interested, often because of the information they can provide.

The government's investigative techniques for white-collar offenses can be aggressive, and even those on the periphery can be pushed to make quick judgments that carry significant risk. For example, one tactic used by the FBI is the surprise visit to the home of a potential witness. You are sitting down for dinner with your family and two FBI agents knock on the door and ask if they can speak with you. You believe that you have done nothing wrong. You may feel you have no legitimate reason to not answer their questions, and that a refusal will raise suspicion about whether you have something to hide.

Yet there is danger here. You may be asked about events that took place months or years before. Did you attend a particular meeting, or receive a copy of a particular e-mail? You may quite innocently give an inaccurate answer, since you have not had a chance to consult your records and are probably very nervous. If you provide an inaccurate answer, the rest of your dealings with the government will take place under the cloud of a possible allegation that you deliberately misled investigators. And, even if you are confident that you personally did nothing wrong, the legal reality may be more complicated.

What should you do? Fact patterns vary so widely that it is not possible to provide a rule that is right for every situation. But keep in mind that if there is any legal risk to you at all — including the risk of just not getting the facts right without a chance to give a more deliberative response — almost all lawyers would recommend that you state that you want to consult an attorney before answering questions. The investigators are then required to back off. A lawyer can then help structure further inquiries so as to minimize any risks to you. Don't be quick to answer questions without advice of counsel.

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Corporate Culture

Commentators emphasize the importance of "corporate culture" in ethics and compliance.[9] This is platitudinous but correct. Integrity is elusive, but anyone who has sat through meetings of boards or senior management knows that sometimes it is clear that ethical expectations are high and sometimes this clarity is lacking or worse.

Leadership sets the tone. On the board, the chair and others who enjoy special influence should be individuals of integrity. Clear expectations from the board to top management can diffuse far down the company. No circumstance puts a company at greater hazard than direct involvement of a senior manager in a crime: Under the OSG, it sharply increases corporate culpability and precludes credit for an otherwise effective compliance program.

The Regulation-Savvy Company

A company needs to be savvy about its regulatory environment. Legal standards are often so unsettled as to leave no practical course completely safe. Given ambiguous regulations and agency discretion, de facto standards can shift without notice. Agencies sometimes use enforcement actions to develop new standards.

A savvy company anticipates shifting standards to the extent possible, because backpedaling from strategies and relationships can be costly. Agencies sometimes provide informal notice of enforcement shifts with public comments, redeployment of resources and civil actions as preludes to later prosecutions. When a company practice falls under a shadow, it must be reevaluated. Senior management may need to prod, since managers closest to the practice may be too defensive. Even when agencies provide no warning, initial targets are often companies that have pursued a questionable practice most aggressively and crossed lines the rest of the industry has respected — being a front-runner can be risky.

Government and business see the world differently, but a company must understand the regulatory perspective. For example, there is often no clear answer to the question of whether an innovation is legal. Is it likely to be viewed by regulators as an evasion of rules too narrowly drawn, to be hit hard as soon as a means can be found? Or will the innovation be seen as providing public benefit, and calling for a new regulatory response but not a hostile one? Good lawyers bring this understanding, but some are disinclined towards the conjecturing that long-term planning requires. They feel it undermines their credibility and risks endorsing conduct that later proves problematic. In an earlier day, companies could turn to attorneys on the board for strategic advice, but many law firms, concerned about liability, discourage board service. Some otherwise astute managers are boneheaded about government in general; no one with that impairment should be driving sensitive corporate decisions.

Reading the Risks: Some Common Miscues

Some patterns of enforcement regularly blind-side business:

■ *Deregulation*. In traditionally heavily regulated industries, innovation is stifled, but regulators are rarely nasty — they mainly say no. With deregulation, public concerns about abusive tendencies can become more pointed. The law often responds by redefining abuses broadly enough to apply to shifting business practices and by using criminal sanctions severe enough to inculcate restraint even while the law permits private initiative wide range. Antitrust law and securities law fit this pattern: innovation-friendly, but with sharp-edged prohibitions against collusion and dishonesty. Regulation of the financial services industry is moving in this direction. Business should not misinterpret deregulation as "anything goes."

■ *Doing business with government*. When government enters commercial relationships, it does so under some unique disabilities. It often can't walk away from untrustworthy business partners; for example, Medicare can bar a health care provider only upon proof of egregious misconduct. It often relinquishes initiative and judgment to private parties; for example, pricing is often determined through bidding, most-favored-nation clauses or cost-based reimbursement. And government bureaucracies, lacking the spur of proprietary interest, often don't watch their money carefully day-to-day. All this creates opportunities for those who would overreach. Nevertheless, government does care about its money, although in an episodic and politicized fashion. And government has one unique strength — the police power — which it uses in place of the managerial devices by which the private sector protects its interests. Its commercial dealings typically show a pattern of broad passivity, with narrow and shifting nasty spikes of policing generating a steady stream of criminal prosecutions of those with whom it does business.

■ *Crooks, betrayals of trust and deep pockets*. One priority for prosecutors is companies that flagrantly violate the law. These are often marginal businesses hoping to fly under the enforcement radar. Occasionally, prosecutors target larger companies for complex and novel business arrangements that exploit the fuzzy edges of regulatory principles. Such companies can be surprised and incensed — shouldn't prosecutors be chasing blatant criminals? Yes, but not all the time. The law must evolve in the face of business innovation, and big companies should be held to high standards. The criminal law protects society against hard-core crooks from whom little is expected, and betrayals of trust by those in positions of high responsibility from whom much is expected. Targeting large companies for ambiguous offenses may become more attractive. "Good citizen corporations" that forgo defensive tactics are easier targets. The standards for an eye-catching fine are rising. Entrepreneurial enforcement can create agency dependency upon recoveries, and large companies can provide substantial settlements, even in weak cases.

Criminalizing—and Professionalizing— Management Accountability

Recent legal trends represent a massive infusion of individual responsibility into business regulation. The law could have taken other paths — for example, in products liability, corporations face expansive accountability but individual managers or directors are rarely called to account no matter how egregious their lapses. However, the trend toward greater individual accountability has been dominant; even today's corporate self-policing is, in practice, largely a matter of disciplining individuals.

The expansion of individual legal accountability does not appear to have run its course. Recent high-water marks such as the S&L imprisonments are viewed by the public and regulators as appropriate models for the future. Increasingly harsh punishment is a broad trend in U.S. criminal justice, not limited to regulatory crimes. The general U.S. incarceration rate is 600 adults per hundred thousand compared with 85 for Germany, 100 for England and 37 for Japan. The U.S. incarceration rate has doubled in 10 years, and public support for punitiveness remains strong. In this climate, the question isn't "Why send managers to jail?" but "Why not?"

Business leaders are accustomed to responsibility, but the free wheeling style they bring to many tasks will not serve them well in meeting their expanding legal accountability. A different frame of mind is required. I believe that the new business accountability is best viewed as the professionalization of the role of managers and directors in assuring the public accountability of our business institutions. This view is not offered as an academic assessment of no practical value, but rather because I think business leaders will

U.S. REGULATORS: THE WORLD'S ROGUE POLICEMAN OR ROLE MODEL?

Nations can police some activities outside their borders; otherwise, there could be no remedy for the terrorist rocket fired from abroad. The United States is especially aggressive in asserting this principle in business regulation. This may reflect its aggressive system of domestic regulation; a nation with strict rules on price fixing or insider trading cannot turn a blind eye to the possibilities for evasion presented by weaker rules elsewhere.

The U.S. Department of Justice has made international collusion an antitrust enforcement priority. The ADM prosecutions were part of this effort, and in that case related plea agreements were obtained from Japanese and South Korean companies and executives. In 1997, the DOJ claimed that over 20 grand juries were investigating international collusion. As of June 1998, 12 of the DOJ's 15 biggest antitrust settlements had been paid by foreign companies. However, U.S. "long arm" efforts are problematic for businesses based in other countries. For example, the self-regulation of London-based insurance carriers has been challenged in a civil case as collusion under the U.S. antitrust laws.

Criminal charges and multinational corporations are a potent mix. After a deadly explosion in 1984 in the Bhopal plant run by a Union Carbide Corp. subsidiary, India tried to extradite the U.S. company's chairman to face manslaughter charges. The United States refused. Most nations are reluctant to see their citizens face charges abroad; this protects home-office but not expatriate managers. In 1995, the head of Daiwa Bank in New York learned that a trader had been hiding losses. Japanese bank regulators were notified, but U.S. regulators were not told for two months, during which time the bank's filings were inaccurate, and, prosecutors claim, bank management explored ways to mask the losses. Daiwa was fined and forced to shut down all U.S. operations. The trader and New York office head were sent to jail.

Nations claim some power to control the activities of their "nationals" abroad. Here again, the United States is an outlier. The 1977 Foreign Corrupt Practices Act (FCPA) polices bribery of foreign officials by U.S. companies. Grievances based on the activities of U.S. companies abroad are finding their way into plaintiff-friendly U.S. courts.

Many view the U.S. posture as arrogant and ineffectual. The FCPA has not been vigorously enforced. Some foreign issuers of securities avoid the U.S. market to the detriment of U.S. investors. England has "blocking" and "claw back" laws to frustrate U.S. antitrust litigation.

But imitation is flattery. The major trading nations of Europe and, to a lesser extent, East Asia, are increasingly adopting American-style business regulation for securities markets, competition and the environment, including criminal penalties. Even the FCPA has attained new respectability with a recent OECD treaty on corporate bribery.

This convergence opens alternatives to "long arm" enforcement. Nations that recognize similar offenses can each prosecute their own companies and executives in international cases — often with U.S. prodding. However, U.S. harshness is found nowhere else; a business manager jailed in Europe is still a rarity.

SOME FINAL POINTERS FOR STAYING OUT OF TROUBLE

To start focusing your company on the risks of prosecution:

- Circulate among directors and senior managers materials that will stimulate thinking, like the recent U.S. Department of Justice internal guidelines on prosecuting corporations,* the U.S. Securities and Exchange Commission order on the Salomon executives † or agency guidelines on specific industries or regulatory regimes.‡
- Consult an experienced lawyer.
- Have top executives, the board and their key advisers develop a "corporate crisis checklist" and designate a crisis management team. Review the actual responses of other companies.

To nurture the right corporate culture:

- Give weight to integrity in picking people for positions of responsibility. Be especially cautious in situations where those who lack integrity can in the short run outperform those who have it. Integrity is a deep personal trait; don't expect to cultivate it in anyone who does not bring it to the job.
- Encourage open discussion of problems. Don't be the boss who wants to hear only good news.
- Don't tolerate dismissiveness toward the public interest. This requires limiting dismissiveness toward government, which for all its shortcomings, often speaks for the public interest.

If you are a manager facing lax standards in the workplace and you lack the clout to raise them, keep in mind that:

- Whistleblowing can be thankless.
- Changing jobs is usually a better idea.

If you are a senior manager and learn about possible serious illegality:

- Take action quickly. Delay is a severely aggravating factor.
- Involve outside counsel. They are experienced, act fast and have the clout to overcome internal foot-dragging.

* For a current statement of prosecutorial policy, see "Federal Prosecution of Corporations," internal U.S. Department of Justice document circulated under a memorandum from Eric Holder dated June16, 1999 (www.bna.com/prodhome/leg/guidance.html).

† For the official chronology of the misconduct, see SEC Release No. 34-31554 (December 3, 1992), reproduced in Federal Securities Law Reports (CCH) at para. 85,067.

‡ See, for example, U.S. Department of Justice, Antitrust Division, "Corporate Leniency Policy" (August 10, 1993), reproduced at Trade Regulation Reporter (CCH), para. 13,113.

find it helpful to keep in mind parallels between their new responsibilities and the way the traditional professions — such as doctors, lawyers, and accountants — approach difficult judgments.

Like the standards that have long applied in the professions, the new business accountability has little tolerance for inattention to risks. It is quick to impose a responsibility to dig deeper at the hint of a problem, and demands an expert's grasp of complex technical issues.

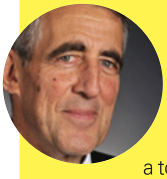
Accountability in the professions has always emphasized the individual, with an overlay of collegial responsibility, as among the partners of a professional services firm, who are typically jointly liable as individuals for any of the firm's lapses. They are not allowed to hide behind a corporate entity. The new business accountability shadows this pattern; directors and managers are held to high standards individually and as to the conduct of others on the team.

Professionals are "fiduciaries," holding positions of trust. Directors have long been considered fiduciaries for shareholders, and boards have become more professional under the prodding of federal securities laws. The new business accountability imposes on managers and directors similar duties to other constituencies: in health care, to patients and payers; in financial services, to those whose funds are held; for businesses with an environmental impact, to the communities affected. I believe that forceful sanctions for holding business to high standards are essential to public confidence in business institutions.

Even the business community harbors a grudging respect for hard-edged regulation: The tough antitrust and securities laws are broadly viewed by business as essential to the United States' robust system of competition and capital markets.

However, I doubt if business leaders will ever be as comfortable with their individual accountability as traditional professionals are with theirs. In the business world, standards are less stable or thoughtful, and new legal initiatives often involve years of groping before sound principles take clear shape. Education, training and the job environment provide little preparation or support for meeting these responsibilities. The penalties are more severe, with greater use of criminal sanctions. Moreover, compliance concerns are typically only a small part of a business leader's job. Managers and directors are not expected to act like cautious professionals most of the time — in fact, society encourages a more entrepreneurial, innovative and risk-tolerant mind-set. Yet from time to time they must "shift gears" and accept the priority of certain exacting public responsibilities, even when this conflicts with other demands of running a business. Shifting in and out of the appropriate orientation is not easy, but, in today's legal environment, a manager who fails to do so puts the company at risk and himself or herself at extreme peril.

WHISTLE-BLOWING



The law on whistle-blowing has greatly expanded since this article was first published, especially in terms of protecting whistle-blowers against retaliation. The strongest protections are in SOX, under which retaliation can be a crime. Laws applicable in many other legal contexts protect whistle-blowers by providing for damages and other relief if an employer retaliates. This is a complex body of doctrine, varying from one regulatory regime to another and from state to state. Generally, some form of public interest must be at issue for whistle-blowing to be protected. For example, a report that your company is illegally dumping toxic wastes would be protected, but a report that a top executive is a terrible manager who may drive the company out of business would not. In some circumstances protection is available only if the whistle-blower goes to the public authorities, but whistle-blowing internal to a company can be protected as well. A regulatory regime may require a company to set up an internal program to facilitate and protect whistle-blowers. Sometimes a whistle-blower can collect a "bounty," sharing in any financial recovery the government obtains based on the whistle-blower's information.

Whistle-blowing by a manager who has been directly involved in legally questionable activity can get tricky. In one recent high-profile case, a Switzerland-based employee of UBS the Swiss banking giant, provided U.S. authorities with information about UBS's role in assisting wealthy U.S. citizens hide assets in Swiss bank accounts to evade U.S. taxes. That information was crucial to a deferred prosecution agreement with UBS under which the bank paid a fine of $780 million and disclosed the identity of several thousand U.S. clients, some of whom are also being prosecuted. But, according to U.S. authorities, the whistle-blower, besides having been involved in the illegal activity, was not completely forthcoming about his own role or that of his clients. So criminal charges were brought against him. He has begun serving a 40-month prison sentence, an outcome which may discourage others from following in his footsteps. Perhaps the key lesson is that whistle-blowers need good legal advice before taking action — no well-advised client would be surprised to learn that the U.S. authorities become very nasty when they believe they have been misled.

Although the law involving whistle-blowing has changed substantially, it is difficult to assess changes in corporate culture. When an employee is in open dispute with a company, or already under scrutiny and perhaps facing termination, seeking protection as a whistle-blower may be attractive. But it is debatable whether whistle-blowing is otherwise a smart career move. The law may inhibit obviously retaliatory responses, but it provides no guarantee against longer-term adverse effects on a career.

Some corporations are making efforts to create an internal climate that encourages open discussion of touchy compliance issues. To the extent that these efforts succeed, whistle-blowing in its more dramatic and confrontational form may be supplanted by the kinds of internal corporate discussions that take place around other sensitive issues, and pose reduced career risks to the managers involved.

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