ARTICLES

THE 2004 AMENDMENTS TO THE FEDERAL SENTENCING GUIDELINES AND THEIR IMPLICIT CALL FOR A SYMBIOTIC INTEGRATION OF BUSINESS ETHICS*

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INTRODUCTION

The United States Sentencing Commission (the "Commission") recently made substantial revisions to the Federal Sentencing Guidelines for organizations (the "Guidelines"), with the changes going into effect on November 1, 2004.[1] In making these revisions, the Commission promised to create a "new era of corporate compliance" where organizations would focus "on ethical corporate behavior" and being a "good corporate citizen."[2] According to the Vice Chairman of the

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1. The Sentencing Guidelines are not limited to corporate or business entities, but also apply to "corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated associations, governments and political subdivisions thereof, and non-profit organizations." U.S. SENTENCING GUIDELINES MANUAL § 8A1.1, cmt. n.1 (2004).

2. News Release, U.S. Sentencing Comm'n, Commission Tightens Requirements for Corporate Compliance and Ethics Programs 1 (May 3, 2004), http://www.ussc.gov

Commission, the new Guidelines seek to build a "model company" and stress that "a good corporate citizen must first and foremost operate ethically."[3] To accomplish this, the new Guidelines toughen the criteria an organization must follow to create an effective compliance program. Perhaps most importantly, the Guidelines require that organizations establish an effective compliance and ethics program that promotes an organizational culture that "encourages ethical conduct and a commitment to compliance with the law."[4] Although organizations are not required to comply with the new Guidelines,[5] the Guidelines set the benchmark for proper corporate conduct. If an organization is subsequently convicted of a federal crime, its failure to maintain "an effective compliance and ethics program" may result in the assessment of harsher penalties against the organization by the court.[6]

This article reviews the changes to the Guidelines and assesses their ability to integrate notions of a "good corporate citizen" from law, management, and ethics. Linking these perspectives, we argue, is the concept of trust. We characterize trust as consisting of three distinct but interrelated types of trust that are drawn from the fields of law and economics, organizational sociology, and philosophy. We argue that seeking effective compliance and ethics programs would be further enhanced by an authentic, symbiotic corporate governance strategy that integrates these three types of trust. This article is a step in the direction of showing how such a symbiotic integration is now legally mandated, as well as being a potentially fruitful exercise of interdisciplinary

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(follow "Press Releases" hyperlink; then follow "May 3, 2004 News Release: Commission Tightens Requirements for Corporate Compliance and Ethics Programs" hyperlink).

3. Michael Bobelian, *New Sentencing Guidelines Cover Corporate Misdeeds*, N.Y. L.J., May 4, 2004, at 1 (quoting Judge Rubin Castillo, Vice Chairman, U.S. Sentencing Comm'n).

4. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a)(2).

5. *See id.* § 8, introductory cmt.

6. *Id.*; *see id.* § 8A1.2(a)(2)(D). In the recent decision of United States v. Booker, 543 U.S. 220 (2005), the United States Supreme Court found that if the Guidelines were "merely advisory provisions that recommended, rather than required, the selection of particular sentences in response to differing sets of facts, their use would not implicate the Sixth Amendment." *Id.* at 233. The Court found that "[t]he Guidelines as written, however, are not advisory; they are mandatory and binding on all judges." *Id.* Based on this language, the Guidelines are treated as advisory in nature and not binding upon the judges.

academic inquiry.

This article proceeds as follows. Part I reviews the Guidelines as originally formulated and the criticisms of the Guidelines in terms of achieving compliance with the law. Part II discusses the 2004 revisions of the Guidelines and assesses their potential impact. Part III analyzes the Guidelines in terms of establishing trust within organizations and between organizations and society, and considers the role of the law in fostering such trust. Part IV provides concluding comments.

I. THE "OLD" ORGANIZATIONAL SENTENCING GUIDELINES

A. Organizational Criminal Liability and the 1991 Sentencing Guidelines

An organization is vicariously liable for the criminal acts of its employees and agents done within the scope of their actual or apparent authority and with the intent to benefit the organization.[7] Thus, an organization is liable when it knowingly and intentionally authorizes an agent to act illegally on its behalf (*i.e.,* actual authority) or where a third party reasonably believes that the agent was expressly authorized to take

7. *See, e.g.*, United States v. Gibson, 409 F.3d 325 (6th Cir. 2005) (mining company convicted of violating federal mining health and safety laws); United States v. Therm-All, Inc., 373 F.3d 625 (5th Cir. 2003) (corporation convicted of conspiring to fix prices in the building insulation industry in violation of the Sherman Act); United States v. Jorgensen, 144 F.3d 550 (8th Cir. 1998) (upholding the conviction of a corporation and its officers for conspiracy, mail fraud, wire fraud and fraudulent sales); United States v. Aerolite Chrome Corp., 1993 U.S. App. LEXIS 6773 (9th Cir. 1993) (corporation convicted of knowingly discharging pollutants in violation of pretreatment standards); United States v. One Parcel of Land, 965 F.2d 311, 316 (7th Cir. 1992) (holding the corporation not liable for a stockholder's illegal activities because the corporation did not have knowledge of the activities); United States v. Automated Med. Labs., Inc., 770 F.2d 399, 406 (4th Cir. 1985) (appealing a corporation's conviction for falsifying logbooks and records); United States v. Bi-Co Pavers, Inc., 741 F.2d 730, 737 (5th Cir. 1984) (affirming a corporation's conviction based on illegal activities of its president); United States v. Phelps Dodge Industries, Inc., 589 F. Supp. 1340, 1358 (S.D.N.Y. 1984) (acknowledging that a corporation may be liable for criminal acts of managerial agents); *but see* United States v. Cargo Serv. Stations, Inc., 657 F.2d 676, 684-85 (5th Cir. 1981) (corporation found criminally liable of violating Sherman Act, even though corporate agents were acquitted).

the action resulting in the criminal violation (*i.e.,* apparent authority).[8] In federal court, criminal liability is imposed regardless of the agent's position within the organization.[9] Moreover, criminal liability may be imputed to an organization even where the organization received no actual benefit from the criminal conduct; the agent must only intend to bestow some benefit, however minimal, on the organization.[10] Even if an organization expressly prohibits the illegal conduct and uses its best efforts to prevent any wrongdoing, it may still be held criminally liable for its agents' illegal acts.[11] Although an organization may not be imprisoned, it can be fined, sentenced to probation, ordered to make restitution, required to issue public notices of conviction and apology, or to forfeit assets.[12]

During the 1980s, Congress perceived that judges were too lenient in sentencing dangerous criminals and that "glaring disparities" in sentencing could be "traced directly to the unfettered discretion the law confers on those judges and parole authorities [that implement] the sentence."[13] To have more predictable and determinate sentencing, Congress passed the Sentencing Reform Act of 1984 (the "Act"). Under the Act, Congress created an independent agency of the federal judiciary (the Commission) to develop sentencing guidelines and policy statements for judges to use when sentencing defendants convicted of

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8. Joel M. Androphy et al, *General Corporate Criminal Liability*, 60 TEX. B. J. 121, 122 ("[A] corporation would be criminally liable for conduct engaged in by the employee if a third party reasonably believes that the employee was expressly authorized to take the action resulting in the criminal violation").

9. Spencer R. Fisher, *Corporate Criminal Liability*, 41 AM. CRIM. L. REV. 367, 371 (Spring 2004).

10. *Id.* at 373.

11. Paul J. Desio, *Introduction to Organizational Sentencing and the U.S. Sentencing Commission*, 39 WAKE FOREST L. REV. 559, 560 (Fall 2004); *see also* United States v. Portac, Inc., 869 F.2d 1288, 1293 (9th Cir. 1989) (holding a corporation criminally liable even though agent was expressly advised that the company did not permit violations of the law); State v. Zeta Chi Fraternity, 142 N.H. 16, 21 (N.H. 1997) (ruling that a corporation can be convicted for actions of its agents even if it expressly instructed the agents not to engage in the criminal conduct); United States v. Beusch, 596 F.2d 871, 878 (9th Cir. 1979) ("[A] corporation may be liable for acts of its employees done contrary to express instructions and policies, but . . . the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation").

12. Desio, *supra* note 11, at 559.

13. S. REP. NO. 97-307 at 956 (1981).

federal crimes. The Act's primary purpose was to limit federal judges' discretion in handling indeterminate sentencing under the guise of ensuring that the "ends of justice" were properly and equally satisfied.[14]

In 1991, the Commission promulgated rules for the sentencing of organizations convicted of committing federal felonies and Class A misdemeanors, which are located in Chapter Eight of the Sentencing Guidelines.[15] With respect to organizational crime, the Commission adopted a "carrot and stick" approach. The Guidelines reward organizations that create an "effective compliance program"[16] to prevent and detect violations of the law through mitigation of prescribed fines or sentences and by severely punishing organizations that are involved in, condoned, or tolerated criminal activity.[17] As originally adopted, the Guidelines define an "effective program to prevent and detect violations of law" as a "program that has been reasonably designed, implemented, and enforced so as to prevent and detect the instant offense . . . ."[18] The 1991 Guidelines provide that the "hallmark" of an effective program is "that the organization exercise due diligence in seeking to prevent and detect criminal conduct by its employees and other agents."[19] "Due diligence" requires "at a minimum" that the organization adopt a compliance program meeting the following requirements:

1) Establishes standards and procedures which are "reasonably capable of reducing the prospect of criminal conduct"
2) Appoints "high-level personnel" to oversee the program
3) Ensures that authority in the program is not given to those that have "a propensity to engage in criminal conduct"

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14. 28 U.S.C. § 991 (2005); *see also* Anthony M. Kennedy, Assoc. Justice, Supreme Court of the United States, Speech at the American Bar Association Annual Meeting (Aug. 9, 2003), *available at* http://www.supremecourtus.gov (follow "Public Information" hyperlink; follow "Speeches" hyperlink; then follow "American Bar Association Annual Meeting, August 9, 2003" hyperlink) (revised Aug. 14, 2003).

15. U.S. SENTENCING GUIDELINES MANUAL § 8 (2004).

16. *Id.* § 8B2.1.

17. Elkan Abramowitz and Barry A. Bohrer, *A Decade with the Organizational Sentencing Guidelines*, N.Y. L.J., May 7, 2002, at 3; Paul Fiorelli, *Will U.S. Sentencing Commission Amendments Encourage a New Ethical Culture Within Organizations?*, 39 WAKE FOREST L. REV. 565, 567 (Fall 2004).

18. U.S. SENTENCING GUIDELINES MANUAL § 8A1.2 cmt. n.3(k) (1991) (amended 2004).

19. *Id.*

4) Communicates the program's requirements to all employees and agents
5) Ensures compliance through monitoring and auditing
6) Enforces the program through "appropriate disciplinary mechanisms"
7) Once a violation has occurred, updates the program to ensure effectiveness[20]

An organization's failure to satisfy these seven minimum requirements results in increased sanctions for criminal misconduct. As the Commission's chairperson explained: "[t]hese guidelines provide incentives for voluntary reporting and cooperation but punish an organization's failure to self-police."[21] An organization that incorporates all seven requirements, self reports, cooperates, and accepts responsibility for the illegal conduct of its employees may receive up to a 95% reduction in federal fines.[22] In contrast, organizations that fail to comply with these requirements may be subject to a 400% increase in their federal fines.[23] The fines imposed on an organization for violating federal law can be substantial. In 2001, the average fine for organizations was $2,154,929 (ten times greater than in 1995) and the median fine was $60,000 (twice the amount in 1995).[24]

Even more important than sentence reduction, the presence or absence of an effective compliance program can determine whether or not prosecutors will initiate criminal proceedings against an organization. An example of the presence or absence of a compliance program effecting proceedings can be observed from the fact that, approximately between 2000 to 2004, of the 377 organizations

20. *Id.* § 8A1.2 cmt. n.3(k)(1) – (7) (1991) (amended 2004).

21. News Release, U.S. Sentencing Comm'n, Sentencing Commission Convenes Organizational Guidelines Ad Hoc Advisory Group 1 (Feb. 21, 2002), http://www.ussc.gov (follow "Press Releases" hyperlink; then follow "February 21, 2002 News Release: Sentencing Commission Convenes Organizational Guidelines Ad Hoc Advisory Group" hyperlink).

22. Fiorelli, *supra* note 17, at 567.

23. *Id.*

24. U.S. SENTENCING COMM'N, REPORT OF THE AD HOC ADVISORY GROUP ON ORGANIZATIONAL SENTENCING GUIDELINES 26 (Oct. 7, 2003), http://www.ussc.gov/corp/advgrp.htm (follow "Report of the Ad Hoc Advisory Group on Organizational Sentencing Guidelines: October 7, 2003" hyperlink) [hereinafter ADVISORY REPORT].

sentenced under the guidelines, only sixteen had any type of compliance program.[25] This can be compared with the observation that, from 1993 to 2001, 812 organizations were sentenced under the guidelines, but only three of those organizations received a sentence reduction for having an effective compliance program.[26]

B. The Impact of the 1991 Guidelines

The Guidelines have led to significant changes by corporations. Compliance programs are now standard practice, with over 90% of large corporations having an ethics code.[27] The Ethics Officers Association, founded in 1992 with only a handful of members, now has over 1,000 members.[28]

Despite the widespread use of compliance programs, critics have challenged their effectiveness as a regulatory measure for several different reasons. The primary basis for many of these criticisms is the fear of cosmetic compliance; firms adopting only the appearance of a compliance program. According to one analysis, these codes are commonly viewed by employees "as public relations vehicles or 'just a piece of paper.'"[29] Other studies found that these "codes" were "unrealistic and failed to address practical management issues," and, thus, were largely ignored by employees.[30] According to Paul Fiorelli, a member of the Commission's Advisory Group, since the adoption of the Guidelines, organizations developed "token" or "paper" compliance programs by merely "checking the boxes" to comply with the seven

25. F. Joseph Warin and Michael D. Billok, *Navigating the Legal Requirements of Internal Compliance Programs*, THE CORPORATE GOVERNANCE ADVISOR, Nov./Dec. 2004, at 13-14.

26. ADVISORY REPORT, *supra* note 24, at 26; *see infra* notes 70-74 and accompanying text (discussing the Thompson Memorandum, *infra* note 35).

27. Janet S. Adams et al., *Codes of Ethics as Signals of Ethical Behavior*, 29 J. BUS. ETHICS 199, 199 (2001).

28. Ethics and Compliance Officers Association, About the EOA, http://www.theecoa.org/AboutEOA.asp (last visited Mar. 4, 2006).

29. JEFFREY M. KAPLAN ET AL, COMPLIANCE PROGRAMS AND THE CORPORATE SENTENCING GUIDELINES, PREVENTING CRIMINAL AND CIVIL LIABILITY § 7:14, at 7-30 (West Pub. 2003).

30. *Id.*

minimum requirements of the Guidelines.[31]

William Laufer identifies the "paradox of compliance," where a moral hazard problem results from firms using compliance programs simply as insurance against prosecution.[32] Due to this "insurance," firms take less care to prevent wrongdoing, which may result in more wrongful behavior.[33] Laufer also identifies a problem of "reverse whistle-blowing."[34] While conducting investigations under the Guidelines, prosecutors show leniency towards firms for working with the prosecutors and providing them with information.[35] However, this often results in senior managers providing prosecutors with information to implicate lower-level managers and protect the senior managers from liability (as well as preventing a more thorough investigation of the crime).[36] Although that may be fair when the lower-level manager is to blame, it creates problems when the firm has a culture of encouraging (and perhaps even rewarding) such wrongful behavior from its employees.[37]

The reverse whistle blowing phenomenon identified by Laufer shows how, in practice, the Guidelines can be used in a manner that goes directly against their intended purpose.[38] The Guidelines were, in part, a recognition that illegal corporate behavior typically cannot be fully explained by the "character flaws" of one individual committing the offense.[39] The Guidelines were enacted to recognize the culpability of

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31. Fiorelli, *supra* note 17, at 567.

32. William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 54 VAND. L. REV. 1343, 1405-07 (1999).

33. *Id.*

34. William S. Laufer, *Corporate Prosecution, Cooperation, and the Trading of Favors*, 87 IOWA L. REV. 643, 648-49, 657-63 (2002).

35. *See* Memorandum from Larry D. Thompson, Deputy Attorney General, to Heads of Department Components, United States Attorneys, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), www.usdoj.gov/dag/cftf/corporate_guidelines.htm [hereinafter Thompson Memo] (discussing the various issues prosecutors should take into account when "determining whether to bring charges, and negotiating plea agreements."); *see also* Laufer, *supra* note 34, at 654 (advising corporations of the benefits of embracing a prosecutor rather than "rejecting the prosecutorial overtures.").

36. Laufer, *supra* note 34, at 657-58.

37. *See* Laufer, *supra* note 34, at 659-62.

38. *See generally* Laufer, *supra* note 32.

39. Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar./Apr. 1994, at 106.

organizations in encouraging and influencing employee misconduct.[40]

There is also a general concern that the compliance programs adopted in response to the Guidelines are inefficient.[41] That is, they create costs for firms that are not justified by the benefits they provide to society.[42] For example, firms that genuinely seek to comply with the law must adopt the required compliance program — regardless of the other methods they use to ensure ethical behavior — to ensure they receive sentencing mitigation under the Guidelines if something does go wrong.[43] For other firms, simply forcing them to adopt a compliance program creates significant costs, but does little to prevent misconduct if implemented improperly.

Simply adopting a compliance program with the aforementioned seven factors does not assure a successful program; instead it depends on how the company approaches the program. Paine argued that firms could adopt either a compliance-based or an integrity-based approach.[44] Under a compliance-based program, firms typically over-emphasize threat of detection and punishment for misconduct, which can be counter-productive if employees view the program as simply a tool to achieve leniency from prosecutors and to protect top management from blame.[45] An integrity-based approach, on the other hand, seeks to develop legitimacy with the employees and focuses on internally developed organizational values.[46] Under this approach, obeying the

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40. ADVISORY REPORT, *supra* note 24, at 14-15; *see* Ilene H. Nagel & Winthrop M. Swenson, *The Federal Sentencing Guidelines for Corporations: Their Development, Theoretical Underpinnings, and Some Thoughts About Their Future*, 71 WASH. U. L.Q. 205, 210-11, 227 (1993).

41. Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 491-92, 511-14 (2003); *see also* Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with the Law*, 2002 COLUM. BUS. L. REV. 71, 117 (2002) ("Monitoring-based systems have unexpectedly serious (and probably immeasurable) costs, which society should not impose without strong reason.").

42. Krawiec, *supra* note 41, at 489.

43. *Id.* at 492-93.

44. Paine, *supra* note 39, at 111.

45. *Id.*; G.R. Weaver & Linda Klebe Trevino, *Compliance and Values Oriented Ethics Programs: Influences on Employees' Attitudes and Behavior*, 9 BUS. ETHICS Q. 315 (1999).

46. Paine, *supra* note 39, at 111.

law "is viewed as a positive aspect of organizational life, rather than an unwelcome constraint imposed by external authorities."[47]

The sum of these criticisms is the idea that it is not simply the adoption of a compliance program that matters, but the culture (using the term loosely)[48] of the organization that is the most important determinate for influencing employees' behavior (either positively or negatively). Although a good deal of ink has been spilt on the Enron case, a brief review and analysis is useful to demonstrate both the importance of corporate culture and the problems with the 1991 Guidelines.[49]

As is well known, Enron filed for bankruptcy in December 2001 with debts over $100 billion, amid allegations that it artificially boosted profits totaling over $1 billion.[50] Enron, however, had a model code of ethics[51] that likely satisfied the seven requirements of the Guidelines. The vision statement in Enron's Code of Ethics was "R.I.C.E.," which stood for "Respect, Integrity, Communication, and Excellence."[52] Enron's code "prohibited its employees from having financial or a management role in Enron's special purpose entities unless the chairman and the CEO determined that such participation would not adversely affect the best interests of the company."[53] However, Enron's directors waived the company's code of ethics in June 1999 to allegedly permit Enron's former CFO Andrew Fastow, and former Enron employee Michael Koppers, to run and financially benefit from Enron's special

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47. *Id.*

48. For a more complete discussion of ethical culture and ethical climate, see Linda Klebe Trevino et al., *The Ethical Context in Organizations: Influences on Employee Attitudes and Behaviors*, 8 BUS. ETHICS Q. 447 (1998).

49. For a complete, book-length description of Enron's culture from an insider, see MIMI SCHWARTZ & SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON (2003). For an insider story on the role of corporate culture in the ethical failures that brought down another highly-esteemed company, see BARBARA LEY TOFFLER WITH JENNIFER REINGOLD, FINAL ACCOUNTING: AMBITION, GREED, AND THE FALL OF ARTHUR ANDERSEN (2003).

50. *See* SCHWARTZ & WATKINS, *supra* note 49; *see also* BBC News, *Enron Files for Bankruptcy* (Dec. 3, 2001), http://news.bbc.co.uk/1/hi/business/1688550.stm.

51. *Corporate Ethics Training: Top-to-Bottom Training, Employee 'Ethics Help Line' are Key to Corporate Culture of Ethics*, CHARTWELL'S BEST PRACTICES FOR UTILITIES AND ENERGY COMPANIES (Chartwell Inc., Atlanta, GA, Sept. 2002), at 141.

52. Fiorelli, *supra* note 17, at 567.

53. Raphael S. Grunfeld, *Enforcing a Written Code of Ethics, Well-Ingrained Guidelines Given Higher Priority, Encourage Executives to Do the Right Thing*, N.Y. L.J., Nov. 18, 2002, at S3.

purpose entities.[54] In fact, three times in a twelve-month period, Enron's board of directors waived the code of ethics to permit transactions with its special purpose entities.[55] More importantly, the values of the vision statement appeared to be exactly opposite of the true culture that existed there.[56]

Enron had developed a culture of pushing the law to the limit and encouraging the discovery of loopholes to benefit the firm. As one commentator on Enron's culture noted, "law and rules were viewed as hindering innovation, creativity, and the entrepreneurial spirit rather than being a necessary foundation for them."[57] For example, Enron's special purpose entities pushed the limits of technical compliance with the General Accounting Principles (GAP), which permitted Enron to mislead investors and creditors by avoiding disclosure of certain assets and liabilities.[58] Likewise, at all levels of the organization, employees were apparently rewarded for the results they achieved, without concern for how those results were achieved. Furthermore, conflicts of interest were seemingly practiced at the upper levels of management, who did little to discourage such practices at lower levels. For example, in 1997, Enron acquired a company co-owned by the son of Chairman Kenneth Lay.[59] In addition, employees claim they were encouraged to use a travel agency operated by Lay's sister.[60]

The payouts for success — however it was achieved — were

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54. Greg Farrell, *Enron Law Firm Called Accounting Practices 'Creative'*, USA TODAY, Jan. 15, 2002, at D1.

55. Fiorelli, *supra* note 17, at 578.

56. *See* Press Release, Enron, Statement of Human Rights Principles, http://www.enron.com/corp/pressroom/responsibility/human_rights_statement.html (last visited Feb. 26 2006). *See generally* Fiorelli, *supra* note 17, at 578; Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and Their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L.J. 1, 45-46 (2003) (explaining the culture that existed at Enron).

57. Dallas, *supra* note 56, at 45.

58. Dallas, *supra* note 56, at 47; *Thoughts on Enron: What Happened, Why, and How It Can Be Avoided Again*: *Hearings Before the S. Comm. on Governmental Affairs*, 107th Cong. (2002) (statement of Frank Partnoy, Professor of Law, University of San Diego School of Law).

59. Anita Raghavan et al., *How Enron Bosses Created a Culture of Pushing Limits*, WALL ST. J., Aug. 26, 2002, at A1.

60. *Id.*

tremendous. For the most part, Enron removed seniority-based pay scales and replaced them with a twice-yearly performance-based bonus system where all employees were ranked against each other.[61] A single committee of 20 managers that required unanimous consent did the performance reviews. This caused employees to fear raising any concerns about company practices because upsetting just one committee member could mean a poor performance review.[62] Enron's reward system gave significantly higher payouts to the top individual performers, which worked against teamwork and encouraged individuals to refuse to share information, and, in some cases, resulted in employees stealing information from each other.[63] Likewise, it created tremendous pressures to continually improve earnings, as that was what was rewarded. This encouraged managers to push the boundaries of accounting practices farther and farther every year.[64]

A checks-and-balances system was either absent or seriously flawed. One commentator noted that Enron was missing "adult supervision."[65] New employees, some straight out of undergraduate business programs, could make multi-million dollar decisions without approval. In other cases, recent MBAs were appointed to the risk-management group and were expected to review proposals written by the same senior managers that wrote their performance evaluations.[66] In addition, the risk and control group reported to Enron Chief Operating Officer Jeffrey Skilling and not to the board of directors.[67]

Fiorelli facetiously asked, "[a]ssume that Enron successfully emerges from bankruptcy. Should it qualify for reductions from federal criminal fines because it had an 'ethics' program?"[68] The Enron example clearly shows the limits of the 1991 Guidelines approach. For example, even with a model code of ethics, how the organization rewards employees and controls risks can have a negative, and significantly stronger, impact on employee behavior. As Laufer argued,

61. Dallas, *supra* note 56, at 51.

62. John A. Byrne, *The Environment was Ripe for Abuse*, BUS. WK., Feb. 25, 2002, at 118.

63. *Id.*; Dallas, *supra* note 56, at 50.

64. Byrne, *supra* note 62, at 118; Dallas, *supra* note 57, at 49-50.

65. Byrne, *supra* note 62, at 118.

66. *Id.*

67. *Id.*

68. Fiorelli, *supra* note 17, at 565.

the presence of a compliance program may actually lead some firms to further encourage a culture that supports wrongful behavior.[69] The next section considers the reaction of the Sentencing Commission to such problems.

II. THE AMENDMENTS TO THE SENTENCING GUIDELINES

A. The Ad Hoc Advisory Group and the Call for an Increased Focus on Ethics

Enron and the various other ethics scandals at the start of the century led to a closer look at compliance programs. In January 2003, Deputy Attorney General Larry D. Thompson issued a Memorandum to all U.S. Attorneys requiring them to "determine whether a corporation's compliance program is merely a 'paper program' or whether it was designed and implemented in an effective manner."[70] If the compliance program was merely a "paper program," Mr. Thompson instructed U.S. Attorneys to strongly consider this factor in evaluating whether to initiate criminal prosecution against an organization.[71]

Prior to that, in 2002, in response to the ten-year anniversary of the Guidelines, the Commission formed an ad hoc advisory group (the "Advisory Group") to review the general effectiveness of the Guidelines for organizations.[72] The Sarbanes-Oxley Act also suggested such a review.[73] The Commission conducted a public hearing and solicitation of comments as part of this review.[74]

During the hearings, various commentators urged the Advisory Group to include "ethics" as a requirement under the Guidelines. Dov

69. *See supra* notes 34-35 and accompanying text.

70. Thompson Memo, *supra* note 35.

71. *Id.*

72. News Release, U.S. Sentencing Comm'n, Sentencing Commission Convenes Organizational Guidelines Ad Hoc Advisory Group (Feb. 21, 2002), http://www.ussc.gov (follow "Press Releases" hyperlink; then follow "February 21, 2002, News Release: Sentencing Commission Convenes Organizational Guidelines Ad Hoc Advisory Group" hyperlink).

73. Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 (2002).

74. *Public Hearings Before the U.S. Sentencing Comm'n* (Nov. 14, 2002), http://www.ussc.gov/corp/advgrp.htm; ADVISORY REPORT, *supra* note 24, at 1.

Seidman, Chief Executive Officer of Legal Research Network, stated, "by requiring only that an organization promote a culture that encourages a commitment to compliance with the law, I believe the advisory group stopped one step short. . . . [Y]ou can't have a culture of compliance unless you also have a culture of ethics."[75] Seidman went on to state his concern that, if ethics was not addressed, then the Guidelines would "foster the same type of corporate cultures that allowed individuals to seek out loopholes in the law."[76] Similarly, Bill Lytton, former counsel to Presidents Reagan and Bush, testified that the overarching goal in amending the Guidelines should be to "provid[e] and foster [an] atmosphere where people who want to do the right thing are encouraged to do it and people who don't want to do the right thing are found out and prevented from doing it."[77] Stuart Gillman, President of the Ethics Resource Center, testified that the Guidelines must "encourage organizations to foster ethical cultures, to ensure focus on the intent of legal and regulatory requirements as opposed to mere technical compliance that can potentially circumvent the intent or spirit of law or regulation."[78]

After these hearings, the Advisory Group concluded that the "effectiveness of compliance programs could be enhanced if, in addition to due diligence in maintaining compliance programs, organizations also took steps to build cultures that encouraged employee commitment to

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75. *Public Hearing Before the U.S. Sentencing Comm'n* 25 (Mar. 17, 2004) (testimony of Dov L. Seidman, Chief Executive Officer, Legal Research Network), http://www.ussc.gov (follow "Public Hearing Testimony" hyperlink; then follow "Transcript of Proceedings: United States Sentencing Commission Public Hearing (Washington, DC – March 17, 2004)" hyperlink).

76. News Release, Legal Research Network, Sentencing Corporate America: Ethical or Not? How Does the Low-Key Independent Government Agency Set Sentencing Guidelines for Individuals and Corporations? LRN CEO Testifies Criteria Should Include Ethics (Mar. 17, 2004), http://www.lrn.com/news/news/releases/sentencingcorporate.php.

77. *Public Hearing Before the U.S. Sentencing Comm'n Ad Hoc Advisory Group on Organizational Sentencing Guidelines* 40-41 (Nov. 14, 2002) (testimony of Bill Lytton, Executive Senior Vice President and General Counsel, Tyco International), http://www.ussc.gov/corp/ph11_02/plenary2.pdf.

78. *Public Hearing Before the U.S. Sentencing Comm'n Ad Hoc Advisory Group on Organizational Sentencing Guidelines* 10 (Nov. 14, 2002) (testimony of Dr. Stuart Gillman, President, Ethics Resource Center), http://www.ussc.gov/corp/ph11_02/plenary1.pdf.

compliance."[79] As a result, the Commission modified the Guidelines to require organizations to specifically establish a "compliance and ethics program."[80] To have an "effective compliance and ethics program," an organization must both "exercise due diligence to prevent and detect criminal conduct" and "otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[81]

In its commentary, the Advisory Report stated that:

> [O]rganizational culture, in this context, has come to be defined as the shared set of norms and beliefs that guide individual and organizational behavior. These norms and beliefs are shaped by leadership of the organization, are often expressed as shared values or guiding principles, and are reinforced by various systems and procedures throughout the organization.[82]

One such value is "law compliance."[83] However, the Advisory Report sends conflicting messages on what is required beyond compliance. In one place, the Advisory Report notes the "emphasis on ethics and values" and states that it is consistent with an emphasis on "honest and ethical conduct" found in the Sarbanes-Oxley Act of 2002. The Advisory Report mentions that the new emphasis is also consistent with recent changes to the listing requirements of the New York Stock Exchange and Securities and Exchange Commission regulations.[84]

On the other hand, the new Guidelines simply define a "compliance and ethics program" as a "program designed to prevent and detect criminal conduct."[85] The Advisory Report notes that "[a]t a minimum, such cultures will promote compliance with the law. To the extent that they encourage further ethical conduct, the organization and the community will benefit in additional ways."[86] The Advisory Report also states:

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79. ADVISORY REPORT, *supra* note 24, at 51.
80. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a) (2004).
81. *Id.*
82. ADVISORY REPORT, *supra* note 24, at 52.
83. *Id.* at 51.
84. *Id.* at 52.
85. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1, cmt. n.1.
86. ADVISORY REPORT, *supra* note 24, at 52-53.

> It is important to note, however, that this recommendation will not impose upon organizations anything more than the law requires, nor will it conflict with industry-specific regulatory requirements. It is also intended to avoid requiring prosecutors to litigate and judges to determine whether an organization has a good "set of values" or appropriate "ethical standards," subjects which are very difficult, if not impossible, to evaluate in an objective, consistent manner.[87]

Despite these seemingly conflicting statements, it does appear that the Guidelines encourage judges and prosecutors to look for evidence of an ethical corporate culture and not simply to look for an effective compliance program. The Guidelines and Advisory Report clearly specify that an effective compliance program requires a firm to both "exercise due diligence to prevent and detect criminal conduct" and develop an ethical culture.[88] While the goal is compliance with the law, these are two separate but complementary means of achieving that end. The Advisory Group recognizes that the new Guidelines have "the dual objectives of reasonable prevention and positive culture."[89] Although the Advisory Report indicates that the Commission is not imposing duties on the organization beyond what the law requires, its chosen means clearly requires firms to comply with the "spirit of the law" and not just the "letter of the law." For example, the Advisory Report states that ethical organizational cultures are "driven by values that go beyond aiming for the lowest possible standards of compliance."[90]

The minimum requirements for establishing an effective compliance program and ethical culture are based on the seven requirements of the 1991 Guidelines, but include some significant changes. The next section reviews those changes.

B. Amendments to the Requirements for an Effective Program.

First, the Guidelines created a new definition of compliance "[s]tandards and procedures" (Step 1), as "standards of conduct and internal controls that are reasonably capable of reducing the likelihood of criminal conduct."[91] This is consistent with changes to Step 7 that

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87. *Id.* at 53.
88. *Id.* at 53; U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a)(1).
89. ADVISORY REPORT, *supra* note 24, at 55.
90. *Id.* at 54.
91. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 cmt. n.1 (2004).

require corporations to continually assess the risk of criminal conduct occurring.[92] Previously, organizations were only required to update their programs after a violation had occurred. Under the new guidelines, firms are responsible for updating their programs on a continuing basis to protect against the risk of violations.[93] Together, these changes require more than merely adopting a manual that sets forth ethical guidelines for the organization. Instead, organizations must continually refine their programs to address changing circumstances and new risks. According to the Commission, "standards of conduct and internal controls are essential aspects of effective compliance programs and . . . these measures should be developed, implemented, and evaluated in terms of their impact on reducing the likelihood of violations of the law."[94]

Second, the Commission sought to clarify leadership responsibilities.[95] In the prior Guidelines, the role of leadership was only addressed by requiring that a high level official oversee the program (Step 2).[96] Based on its investigation, the Advisory Group found that a key lesson from the corporate scandals was the lack of "specification of the roles of organizational leadership in the organizational sentencing guidelines."[97] Accordingly, the new Guidelines sought to correct this problem in a few different ways. First, the new Guidelines require that the "governing authority" (*i.e.*, the board of directors) must be "knowledgeable" about the compliance and ethics program (which includes information on the compliance risks facing the firm and the programs installed to combat those risks) and be "proactive" in evaluating, monitoring, and managing this program.[98] Second, the Guidelines require that "high-level personnel" must "ensure"[99] that the organization has an effective compliance plan.[100]

92. *Id.* § 8B2.1(b)(7).

93. *Id.*

94. ADVISORY REPORT, *supra* note 24, at 56.

95. *Id.*

96. *See, e.g.*, U.S. SENTENCING GUIDELINES MANUAL § 8A1.2 cmt. n.3(k)(2)-(3) (2001) (amended 2004).

97. ADVISORY REPORT, *supra* note 24, at 57.

98. *Id.* at 60-61; U.S SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(A).

99. U.S SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(B).

100. ADVISORY REPORT, *supra* note 24, at 60-61.

"[H]igh-level personnel" is limited to such persons as "a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as law, sales, administration, or finance; and an individual with a substantial ownership interest.[101] Third, those individuals with "day-to-day operational responsibility" such as a Chief Ethics Officer must "be given adequate resources, appropriate authority, and direct access to the governing authority or appropriate subgroup of the governing authority."[102] Together, these provisions reflect the philosophy that a positive organizational culture is established by requiring all levels of the organization — the top, middle, and bottom — to be active in promoting the appropriate "organizational tone."[103]

Third, the Commission made it clear that ethics and compliance training (Step 4) was mandatory (that is, simply disseminating information on the program is not sufficient) and that all employees, including the board of directors and high-level employees, must receive training.[104] In addition, the Advisory Report indicates that educating employees about compliance requirements would not be enough, and that organizations must also motivate all employees to comply.[105] This is consistent with changes to Step 6, which provides that organizations should not only punish those that violate the ethics and compliance program, but they should also provide positive incentives for individuals to comply.[106] This is a continuation of the Commission's philosophy on using a "carrot and stick" to compel changes in an organization.[107]

Fourth, the Guidelines require the program to include a system that

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101. *Id.* at 62.

102. *Id.* at 60-61. An interesting issue that is not addressed or discussed in any of the materials relating to the adoption of the Amendments to the Sentencing Guidelines is the potential liability associated with serving as the Chief Ethics Officer. It is possible that a shareholder, member, or creditor of the organization could, in certain circumstances, bring an action against a Chief Ethics Officer for acting negligently in determining whether the organization is acting illegally. Of course, this potential exposure may provide an incentive to the Chief Ethics Officer to vigorously audit and enforce compliance with the Sentencing Guidelines.

103. Fiorelli, *supra* note 17, at 582.

104. *Id.* at 583.

105. ADVISORY REPORT, *supra* note 24, at 71.

106. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(6) (2004).

107. *See* Nagel & Swenson, *supra* note 40, at 227-28, 237-38; *supra* note 16 and accompanying text.

allows employees to report misconduct and seek guidance without fear of retaliation (Step 5).[108] The prior version was worded such that these systems were not mandatory.[109] Based on the testimony and evidence provided to the Advisory Group, there were two common problems plaguing companies who were ultimately convicted of a crime. The first problem was that employees or management knew or suspected that illegal conduct was occurring within the organization but did not report it because they feared "some sort of retribution" or that their jobs would be in jeopardy.[110] As a result, employees remained silent, thereby allowing the illegal conduct to continue.[111] The second problem was that most organizations lacked any mechanism to allow employees to report wrongful conduct confidentially.[112] The lack of confidentiality and fear of retaliation were the major road blocks to allowing employees to report an organization's criminal conduct. Based on the Advisory Group's investigation, it found that 44% of all non-management employees do not report the misconduct they observe.[113] Of those individuals, 57% failed to report because they felt that such a report would not be kept confidential, 41% feared retaliation from their manager, and 30% believed that co-workers would retaliate for any report of wrongdoing.[114] The purpose of this provision is to foster an organizational culture that promotes, not penalizes, employees who report violations of the law.

Overall, the new Guidelines require firms to be more proactive in designing and updating their programs. Organizations are also encouraged to consider not only the risk of illegal activities by employees, but also ethical lapses.[115]

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108. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(5).

109. ADVISORY REPORT, *supra* note 24, at 72.

110. *Public Hearing Before the U.S. Sentencing Comm'n Ad Hoc Advisory Group on Organizational Sentencing Guidelines* 14 (Nov. 14, 2002) (testimony of Deborah Yang, United States Attorney, Central District of California), http://www.ussc.gov/corp/ph11_02/plenary2.pdf.

111. *Id.*

112. *Id.*

113. ADVISORY REPORT, *supra* note 24, at 78 (citing Ethics Resource Center, 2003 National Business Ethics Survey (2003), *available at* http://www.ethics.org/nbes/nbes2003/index.html (last visited Mar. 8, 2006)).

114. *Id.*

115. Jeffrey M. Kaplan, *Compliance Programs 2.0: The Next Generation in*

C. An Assessment of the Amendments

The most important question, of course, is whether the Guidelines will make a difference in improving the behavior of organizations. Will the Guidelines continue as simply being "insurance" against prosecution, or will they actually prevent misconduct? From the prosecutor's perspective, the Guidelines may not have changed much, as the prosecutors likely already considered many of the same factors for an effective program now formalized into law when deciding whether or not to prosecute a firm.[116] From the organization's side, however, there will likely be a significant impact, as firms will be encouraged by in-house counsel and consultants to update their programs. Furthermore, due to the shift to a more punitive approach to corporate crime in other areas, the Guidelines will be even more important.[117] The impact of these changes also will be amplified by directors' duties under the *Caremark* case.[118] Under *Caremark*, directors may be in breach of their fiduciary duties if they do not consider the opportunities for a reduced sentence under the Guidelines.[119]

The changes to the Guidelines to achieve the Commission's goal — to encourage firms to adopt programs that actually work — are supported by research from management scholars.[120] Although most compliance programs have characteristics of both compliance-based and integrity-based programs, the most successful programs are those where the characteristics of an integrity-based approach dominate.[121] One of the most important factors is that of management commitment. When management demonstrates a commitment to ethics, then all members of the organization are more likely to view ethics as a key organizational

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Compliance Programs, THE CORP. GOVERNANCE ADVISOR, Nov./Dec. 2004, at 10-11.

116. Thompson Memo, *supra* note 35; *see also* Frank O. Bowman III, *Drifting Down the Dnieper with Prince Potemkin: Some Skeptical Reflections About the Place of Compliance Programs in Federal Criminal Sentencing*, 39 WAKE FOREST L. REV. 671 (2004).

117. Bowman, *supra* note 116, at 672.

118. *In re* Caremark*,* 698 A.2d 959 (Del. Ct. Chan. 1996).

119. *Id.* at 961.

120. For a general review of the research in this area, see LINDA KLEBE TREVINO & GARY R. WEAVER, MANAGING ETHICS IN BUSINESS ORGANIZATIONS: SOCIAL SCIENTIFIC PERSPECTIVES (2003).

121. *See* Paine, *supra* note 37.

value and take legal compliance initiatives more seriously.[122] The new Guidelines expand the roles of top management by requiring them to participate in training. The Guidelines also create a duty for top management to ensure the effectiveness of the program.[123]

Commitment means more than just enforcing a program, however. As with the 1991 Guidelines, employees may still view compliance programs as attempts to protect management.[124] Management commitment includes actions beyond the establishment of the program. For example, researchers have also identified the following factors as important for a successful, integrity-based program: fair treatment of employees, open discussions of ethics in the organization, and rewarding ethical behavior (such as an employee reporting the unethical behavior of a co-worker) and not just self-interest.[125]

Requiring organizations to treat their employees "fairly" is likely beyond the ability of the law to monitor and enforce consistently. However, the Guidelines do take steps towards creating an environment for an open discussion of ethics by requiring ongoing training and the involvement of top management in training.[126] In addition, the Guidelines specifically require organizations to provide positive incentives for ethical behavior — another component of an effective integrity-based compliance program.[127] With the use of reward systems, the organization is more likely to involve its Human Resources department, which brings a different perspective to the compliance program than the Legal department.[128] According to Trevino and Weaver, the involvement of a Human Resources department goes a long way towards developing an integrity-based program. [129]

There are, of course, limits to what the law can accomplish. For example, if the goal is to develop an integrity-based program (where employees willingly adopt the values of legal compliance and ethics and

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122. Linda Klebe Trevino et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CALIF. MGMT. REV. 131 (1999).

123. U.S. SENTENCING GUIDELINES MANUAL § 8B.2.1(b) (2004).

124. *See* Laufer, *supra* note 34, at 652.

125. Trevino et al., *supra* note 48, at 447; Trevino et al., *supra* note 122, at 131.

126. U.S. SENTENCING GUIDELINES MANUAL § 8B.2.1(b)(4)(A).

127. *Id.* § 8B2.1(b)(6).

128. TREVINO and WEAVER, *supra* note 120, at 146-47.

129. *Id.* at 97.

participate in developing the rules/norms of the organization), do the Guidelines actually work against that goal by developing even more stringent guidelines? Can these external inducements "force" a company to create an ethical organizational culture? Likewise, how should the law balance between giving firms the flexibility to develop integrity-based programs and mandating best-practices, which can stifle experimentation on what works best for the firm's particular situation?

In the next section, we develop the idea that the new Guidelines can be seen as an attempt to restore trust in free market systems and in corporations in particular. The new Guidelines, along with the Sarbanes-Oxley Act,[130] changes to Securities and Exchange Commission regulations,[131] and other government actions,[132] are an attempt to develop trust between corporations and the public. For the Guidelines to be effective, however, there must also be trust within the organization, as seen generally by the importance of fairness in an organization for a successful compliance program. The next section develops the concept of trust in that context for the purpose of both providing management with guidance in how to comply with the Guidelines, as well as helping to understand what role the law can play in creating ethical organizations.

III. THE 2004 AMENDMENTS AND PUBLIC TRUST IN BUSINESS

A. Hard Conviction, Real Confidence, and Good Faith

There are multiple ways to attempt to restore trust. One way to accomplish the re-creation of public trust is to insist upon stricter legal requirements. This is the approach taken by the Guidelines and its amendments,[133] as well as a myriad of other mechanisms including Sarbanes-Oxley,[134] for example. Another approach is one that is

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130. Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7201 (2002).

131. 68 Fed. Reg. 5110, 5118 (Jan. 31, 2003) (including disclosure requirements on codes of ethics).

132. *See* Pamela H. Bucy, *"Carrots and Sticks": Post-Enron Regulatory Initiatives*, 8 BUFF. CRIM. L. REV. 277 (2004) (reviewing reforms at all three branches of government that are aimed at reducing corporate corruption).

133. *See generally* U.S. SENTENCING GUIDELINES MANUAL § 8 (2004).

134. 15 U.S.C. § 7201.

typically taken by schools of management, both from social scientific and normative perspectives, in which trust derives from the practice of certain virtues, whether production of quality products or simple honesty, and thereby creates social capital.[135] Still a third approach relies more motivationally on the kinds of passions that engender ethical behavior. This approach depends on the development of trust through passionate commitment to being a certain kind of person or company. Rather than generally suggesting that corporations need to restore public trust, it may be useful for corporations following the 2004 Amendments[136] to conceive of their task as fostering three related but distinct kinds of trust. One could characterize them as Hard Conviction, Real Confidence, and Good Faith.

Hard Conviction concerns how to make sure that people do what they are supposed to do. This is the approach to trust most closely associated with the field of law and economics. Under this approach, trust is a rational, calculated choice based on deterrence and cost-benefit analyses.[137] An individual can be trusted if the situation is such that it is in his or her own self-interest to act in a way consistent with being trustworthy.[138] For example, I can be trusted not to steal from you if there are sufficiently strong penalties for theft.[139]

The initial reaction of Congress to the scandals of Enron, Worldcom, and Global Crossing[140] was to increase the penalties for fraudulent behavior through new crimes and enhanced penalties for

135. *See generally* LaRue Tone Hosmer, *Trust: The Connecting Link Between Organizational Theory and Philosophical Ethics*, 20 ACADEMY OF MGMT. REV. 379 (1995) (reviewing the different approaches to trust within management scholarship).

136. U.S. SENTENCING GUIDELINES MANUAL § 8 (2004).

137. Roderick M. Kramer, *Trust and Distrust in Organizations: Emerging Perspectives, Enduring Questions*, 50 ANN. REV. OF PSYCHOL. 569, 572 (1999).

138. *Id.*

139. Some argue that this is an ironic view of the term "trust," as "trust is the very opposite of control." Fernando Flores & Robert C. Solomon, *Creating Trust*, 8 BUS. ETHICS Q. 205, 206, 226 (1998). In the area of corporate law, some view the law as providing a necessary "backstop" against which trust can develop. Larry E. Ribstein, *Law v. Trust*, 81 B.U. L. REV. 553, 574-75 (2001) (discussing the works of Lawrence Mitchell and William Bratton).

140. For a review of these scandals, see Lawrence A. Cunningham, *The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And it Just Might Work)*, 35 CONN. L. REV. 915, 923-36 (2003).

existing crimes.[141] In large part, most of what these turn-of-the-century scandals were about was a breach of fiduciary duty. Rather than looking out for the interests of shareholders, executives were more interested in their own personal well-being, even at the expense of their shareholders.[142] The duty of loyalty and the duty of care are well-established legal constraints regulating the behavior of directors of corporations.[143] So too, now, the aforementioned provisions of the Guidelines provide legal constraints regulating the behavior of directors of corporations.[144] In the past, other laws have resulted in constraints on corporate behavior, such as those related to securities fraud,[145] unsafe working practices,[146] unsafe products,[147] and collusion.[148] The harshness of this approach is that there are clear legal punishments if a company does not implement what is called an "effective" program. It may be that internally-driven programs tap more deeply into employee values than do externally driven ones,[149] but laws help to ensure the public that

141. For a critical review of this deterrence response, *see, e.g.*, Michael A. Perino, *Enron's Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN'S L. REV. 671 (2002) (arguing that economic theory suggests that increasing deterrence will have little impact on executives' behavior); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 IOWA J. CORP. L. 1, 36-44 (2002) (outlining the costs associated with increased liability and regulation); Jennifer S. Recine, *Examination of the White Collar Crime Penalty Enhancements in the Sarbanes-Oxley Act*, 39 AM. CRIM. L. REV. 1535 (2002) (reviewing evidence that penalty enhancements will not deter white collar crime).

142. *See* David A. Westbrook, *Corporation Law After Enron: The Possibility of a Capitalist Reimagination*, 92 GEO. L.J. 61, 88 (2003) (noting that Andrew Fastow, the Chief Financial Officer of Enron, engaged in transactions that benefited himself at the expense of Enron shareholders). For a complete discussion of Andrew Fastow's self-dealing at Enron and whether or not it was a breach of the duty of loyalty, see William W. Bratton, *Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders? Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275, 1309-14 (2002).

143. *See* FRANKLIN A. GEVURTZ, CORPORATION LAW 273-386 (2000) (providing a thorough review of directors' and officers' duties of care and loyalty).

144. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(2)(B) (2004).

145. Rule 10b-5 of the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (2001).

146. Occupational Safety and Health Act of 1970, 29 U.S.C. § 651-677 (2000).

147. Consumer Product Safety Act, 15 U.S.C. § 2051-2084 (2000).

148. Sherman Antitrust Act, 15 U.S.C. 1 et seq. (2000).

149. *See* Paine, *supra* note 39, at 110-13.

their voice is also heard by companies.

The 2004 Amendments to the Federal Sentencing Guidelines reflect an attempt to reinforce Hard Conviction in order to assure compliance.[150] The route they take, however, interestingly relies on softer notions of culture and ethics because of a belief that reliance on coercion will not be sufficient to achieve corporate compliance.[151] Thus, conceptually, in addition to Hard Conviction, the Amendments have added what might be called Real Confidence.

Real Confidence is what most people think of when they hear the term "trust," at least in business.[152] Real Confidence is about people living up to the promises they made, being honest, treating others fairly, and producing products and services that are of high enough quality to satisfy customers.[153] Whereas Hard Conviction concerns a conscious consideration of the risk of punishment, Real Confidence is about social relationships.[154]

The academic foundations of Real Confidence lie in studies of social capital by sociologists, political scientists, and, increasingly, management scholars.[155] Social capital derives from the work of scholars such as Robert Putnam.[156] Drawing on metaphors of financial capital[157] and human capital,[158] these scholars look at the network of relationships that occur in certain kinds of communities that allow

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150. U.S. SENTENCING GUIDELINES MANUAL § 8C4.10 (2004).

151. *See infra* notes 155-63 and accompanying text.

152. *See infra* notes 153-64 and accompanying text for an explanation of Real Confidence.

153. *See generally* F.A. HAYEK, THE FATAL CONCEIT: THE ERRORS OF SOCIALISM (W.W. Bartley ed., 1988) (arguing from a strictly economic basis, the market works best when there is trust between actors in the economy).

154. *See* Kramer, *supra* note 137, at 573.

155. *Id.*

156. *See generally* ROBERT PUTNAM, BOWLING ALONE (2000) (discussing the power of social networks in creating a happy, well educated, healthy and safe society). *See also* James S. Coleman, *Social Capital in the Creation of Human Capital,* 94 AM. J. SOC. 95 (1998); Mark Granovetter, *The Strength of Weak Ties*, 78 AM. J. SOC. 1360 (1973).

157. *See* PUTNAM, *supra* note 156, at 18-20 (referring to the financial savings, resources, and leverage that can be utilized in productive capacities).

158. *See id.* (referring to the capabilities of individuals that can be utilized in productive capacities, such as advanced educational training).

individuals to flourish in economic systems.[159] Such networks thrive on a developed sense of reciprocity, particularly in long-term forms.[160] Speaking more naturalistically, they build on Robert Axelrod's notions that, in the long term, advantageous survival strategies call for reciprocal tit-for-tat.[161] It is not in an individual's self-interest to take advantage of others in the society, although there is always a temptation to do so if it can be accomplished without getting caught,[162] but instead to act in ways that contribute to a network of relationships where certain virtues become the expected norm of behavior and, in the long run, pay off. Or, to push the naturalistic evidence further, the notion of generous tit-for-tat argues that not only should one mirror the actions of others, as Axelrod suggests, but also, to avoid a degenerative spiral of feud-like behavior that erodes trust, a point of forgiveness for past actions can reverse the spiral.[163]

Creating conditions that foster Real Confidence thus stresses acting fairly, and, by doing so, creates social capital so that integrity becomes a reinforced practice, and moves past a calculative self-interest basis for trust. This requires rewarding people for doing the right thing. Because social capital and Real Confidence trade on notions of fairness, normative considerations must also be present. Thus, corporate consideration of what is fair would be a necessary part of developing a culture of ethics and compliance.[164]

Several years ago, LaRue Hosmer developed a small vignette based on the real experience of a recent MBA graduate who worked for a department store in the gourmet foods section.[165] One of the items the store sold was individually wrapped and sealed specialty cookies.

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159. *See id.* at 319-25.

160. *See id.* at 18-27.

161. ROBERT AXELROD, THE EVOLUTION OF COOPERATION 20-22 (1984).

162. *See* HAYEK, *supra* note 153, at 70 (arguing for norms of reciprocity and integrity virtues such as truth-telling, promise keeping, and protection of contracts and property but while also recognizing that these virtues require coercive legal (and religious) enforcement because of the temptation to benefit from others practicing these virtues while behaving opportunistically whenever one can).

163. *See* AXELROD, *supra* note 161, at 54, 176-77.

164. *See* Trevino et al., *supra* note 122, at 131 (discussing their empirical studies that show the importance of treating employees fairly (for example, use of rewards and punishments, treating employees with respect, dignity, and so on) and following through on company policies for creating an effective compliance program).

165. LARUE TONE HOSMER, MORAL LEADERSHIP IN BUSINESS 86-87 (1994).

Unfortunately, some customers found bugs crawling around on the cookies when they opened the packages. The recent graduate's manager instructed her to "dump" the cookies, but the graduate soon discovered that this did not mean to throw the cookies in the trash. Instead, the manager stated that she knew of a convenience store in the inner city where they could sell the infested cookies at a discount, which would allow the store to salvage at least some money from the infested goods.[166]

From a twisted perspective, the supervisor's directive made sense because the manager's annual bonus was based on profitability per square foot, as was her future allocation of square footage in the store.[167] In short, the company rewarded her to maximize her profitability through whatever means were available. The manager, who did not seem to otherwise be an uncaring person,[168] simply followed the logic of the financial incentives.

One could easily argue that the manager still should not have sold the cookies. The point, however, is that if an organization wants to be an ethical one, then it cannot rely on individual managers and employees to regularly risk sacrificing their own financial well-being and career potential to make it happen. Instead, the organization must take on this responsibility. The firm must develop incentives that reward people for not selling infested cookies and punish them if they do. This means that ethics is not simply about hiring people with personal integrity; it means that ethics is also about organizational structures that reward the right behavior.[169] In other words, to foster integrity, one needs to address utilitarian considerations in which just treatment of stakeholders is rewarded so that the greatest good is achieved. Or, to put it in more conventional business terms, it is important to create win-win environments for multiple stakeholders. Through this process, social capital is established, which, in turn, builds Real Confidence and trust among stakeholders that the firm will treat them fairly.

In addition to providing the right types of rewards and punishments, firms must also attend to the affective component of organizational life.

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166. *Id.*

167. *Id.*

168. *Id.*

169. *See supra* notes 61-64 and accompanying text (providing examples of the unethical behavior associated with Enron's reward system).

That is, firms cannot simply hope that employees will embrace an active notion of corporate citizenship.[170] Instead, encouraging workplace behavior that goes "beyond the call of duty"[171] requires organizations to act in ways that inspire such aspirational behavior.[172] Such a connection between organizational structure and employee motivation is a critical feature of the final kind of trust, Good Faith. 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.[173]

The task of Good Faith is to foster, or liberate, passion shorn of its deleterious effects.[174] The aim of Good Faith is not only to engage personal meaningfulness and to integrate the individual into communities and causes that transcend oneself, but to do so in way that remains consistent with Hard Conviction — obeying just laws — and to build on the moral duties of Real Confidence. Two critical dimensions comprise Good Faith. The first is a spiritual and aesthetic, harmonic artfulness that defines a quest for moral excellence. The basic idea is that through commitment to a powerful good, individuals within the company can be energized to desire the pursuit of ethical business behavior in their work.[175] This is consistent with the normative ethical theory of virtue ethics and its focus, in part, on the quest for excellence and living "the good life."[176] Legal scholars studying corporate social responsibility have long recognized the inability of the law by itself to

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170. *See* Mark C. Bolino & William H. Turnley, *Going the Extra Mile: Cultivating and Managing Employee Citizenship Behavior*, 17 ACAD. MGMT. EXECUTIVE 60 (2003). Bolino and Turnley, of course, are not the only management scholars looking at such issues, but they do summarize corporate citizenship in a straightforward, helpful way.

171. *Id.* at 61.

172. *See generally id.* at 62-64.

173. *Id.* at 60-64.

174. *See generally id.*

175. *See generally* TIMOTHY L. FORT & CINDY A. SCHIPANI, THE ROLE OF BUSINESS IN FOSTERING PEACEFUL SOCIETIES (2004) (arguing that the goal of sustainable peace is both a possible aspirational goal as well as something led to by common ethical business practices).

176. *See* RAYMOND J. DEVETTERE, INTRODUCTION TO VIRTUE ETHICS: INSIGHTS OF THE ANCIENT GREEKS 5 (2002). For an application of virtue ethics to business life, see ROBERT C. SOLOMON, ETHICS AND EXCELLENCE: COOPERATION AND INTEGRITY IN BUSINESS (1993).

foster moral excellence in individuals and organizations.[177]

Social scientists may refer to the concept of Good Faith as an "intrinsic" motivation, where "there is an inherent satisfaction that is derived from pursuing the activity."[178] This is opposed to an "extrinsic" motivation, where an employee feels compelled to act in a certain way due to some external force, such as a monitoring and sanctioning system.[179] In many ways, extrinsic motivation crowds out internal motivation.[180]

This raises the issue of to what extent an individual is allowed to bring his or her own values into the organization. Some describe this as a "role morality" problem, where individuals make decisions on the corporation's behalf that they would not make on their own.[181] Part of the problem is that individuals do not feel responsible for their actions in large bureaucracies,[182] but also important is that individuals are often discouraged from using their personal values to critique actions that are requested of them.[183] This leads to the second dimension of the notion of Good Faith.

The second dimension is an organizational aspect where there are communal identities formed which dialectically interact with individuals.[184] This is a notion of "mediating institutions," which are particular kinds of communities that foster personal meaningfulness and moral identity.[185] Mediating institutions have both a descriptive and

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177. *See* CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 101 (1975); Lynn Sharpe Paine, *Law, Ethics and Managerial Judgment*, *in* A COMPANION TO BUSINESS ETHICS 194, 198 (Robert E. Frederick ed., 1994) ("There is no legal sanction for failing to be the best we can be or for failing to make a positive contribution to society").

178. Ann E. Tenbrunsel & David M. Messick, *Sanctioning Systems, Decision Frames, and Cooperation*, 44 ADMIN. SCI. Q. 684, 685 (1999).

179. *Id.*

180. *Id.*

181. CHRISTINE PARKER, THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY 33 (2002).

182. *See generally* David Luban et al., *Moral Responsibility in the Age of Bureaucracy,* 90 MICH. L. REV. 2348 (1992).

183. PARKER, *supra* note 181, at 33, 294-95.

184. Bolino & Turnley, *supra* note 170, at 67-68.

185. For a complete discussion of mediating institutions, see TIMOTHY L. FORT, ETHICS AND GOVERNANCE: BUSINESS AS MEDIATING INSTITUTION (2001).

normative element. Descriptively, research by anthropologists and psychologists suggests that human beings are hard-wired to live and work in relatively small communities.[186] When organized in communities that are too large, individuals do not see the consequences or efficacy of their actions and start to lose concern.[187] This breaks down the social capital-type aspects of Real Confidence discussed above. In smaller groups, however, moral behavior becomes important in order to sustain relationships.[188] For example, in a laboratory experiment involving a social dilemma game, changing the group size from three to seven players decreased the level of trust in the group.[189] Likely explanations for the result were lowered expectations that others would cooperate in the larger group and each individual's view that his or her actions would have little impact on the group.[190] Likewise, others have argued that the optimal group size for making decisions is four to six members.[191]

The anthropologist Robin Dunbar has conducted some of the most extensive research on this topic.[192] As a way to estimate the expected, natural size of a human group, Dunbar plotted the neocortex ratio of all primates against the empirical data on the size of groups the species naturally organized into.[193] Based on regression analysis, he estimated the optimal size of a human group to be 150.[194] Dunbar found that this number resonated with human experience. For example, he discovered studies that showed the number 150 to be the average number of names in an individual's address book and the size of a company unit in the military.[195] He also found a study done by the Church of England that attempted to estimate the optimal size of a congregation. To ensure that

186. *See id.* at 49-51.
187. *Id.*
188. *Id.*
189. K. Sato, *Trust and Group Size in a Social Dilemma*, 30 JAPANESE PSYCHOL. RES. 88, 92-93 (1988).
190. *Id.*
191. Gregory A. Johnson, *Information Sources and the Development of Decision-making Organizations*, *in* SOCIAL ARCHAEOLOGY: BEYOND SUBSISTENCE AND DATING 87 (Charles L. Redman et al., eds., 1978).
192. ROBIN DUNBAR, GROOMING GOSSIP AND THE EVOLUTION OF LANGUAGE (1996).
193. *Id.* at 63.
194. *Id.*
195. *Id.*

the congregation would not become so large that people would be unaware of the joys and concerns of parishioners, the study concluded that a number less than 200 was optimal.[196] Finally, Dunbar noted that this size is effective in business organizations because the organization needs to resort less to hierarchical orderings.[197]

Discussion of such anthropological and psychological data makes for interesting conversation, but the importance of these numbers reaches to business ethics as well. This is the normative dimension of mediating institutions.[198] As noted above, within small groups, people must consider the consequences of their actions. That does not mean that they necessarily must like each other — only that their actions matter because they must get along with others for the group to function. The normative argument is that human beings have their moral character formed in relatively small "mediating institutions."[199] Families, religious organizations, neighborhoods, and voluntary associations form moral character, at least in part, because individuals must deal with the consequences of actions; the groups are small enough and enduring enough so that one must seriously consider how one's behavior impacts communal relationships.[200]

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196. *Id.* at 74-76. Continuing the religious examples, he also found historical evidence that when Brigham Young moved five thousand Mormons from Nauvoo, Illinois to Salt Lake City, Utah, he divided them into self-coordinating groups of 150 and then managed the leaders of those groups. Dunbar notes that the Hutterites living in the western part of the United States insist on maintaining community sizes of 150 so that one does not need to resort to abstract rules to abide by, but instead, can rely on more informal interactions among the members. *Id.* at 71-73. Finally, Dunbar states that at any given time in a person's life, there are probably only 150 people that one feels closely connected to. Or more colloquially, Dunbar says that there are about 150 people who, if one saw one of them sitting at a bar, one would feel comfortable in just pulling up a chair and having a beer with them. *Id.* at 71-73.

197. *Id.* at 72.

198. *See supra* note 186 and accompanying text.

199. *See* PETER BERGER & RICHARD JOHN NEUHAUS, TO EMPOWER PEOPLE: THE ROLE OF MEDIATING STRUCTURES IN PUBLIC POLICY (1977).

200. These organizations also provide a "double-meaning" to their members. They provide an internal sense of moral identity within so that one has a sense of belonging. They also provide an external gateway to the larger world. The way in which they fulfill this role is complex and has been characterized as simply an enhancement of self-interest, as socialization groupings that teach individuals to reach beyond self-interest and consider their citizenship obligation to others, and as naturalistic reactions to an

That communities have a strong role in inculcating moral values in individuals is an Aristotelian conception of morality.[201] That individuals, in turn, affect the moral character of organizations in conjunction with the reciprocal experience of being shaped by those institutions gives rise to a dialectical sense of moral development.[202] Mediating institutions capture this dimension because families, neighborhoods, voluntary associations, and religious organizations all shape and are shaped by individual moral development.[203] Communitarians, such as Amitai Etzioni, also emphasize the importance of connecting individuals to organizations, but typically they do so by focusing on mammoth mega-structures such as the nation-state.[204] Yet, the anthropological data on the importance of small numbers suggest that there may be a particular kind of a community — a relatively small mediating institution — whereby moral character is optimally developed.[205] In short, a central dilemma for contemporary normative behavior is matching where people learn about ethics to where they are practiced in a way to foster a sentiment of caring about moral behavior.[206]

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urban world in terms of dysfunctional, anti-social groups (inner city youth gangs and rural militias) that provide identity *against* the outside world. In this last respect, the organizations might be more aptly called quarantining institutions rather than mediating institutions, because they discourage a mediated, constructed response to the outside world in favor of an exclusivist, confrontational and/or withdrawing relationship to the world. Phrased descriptively, human beings do seem to naturally group themselves. Phrased normatively, for human beings to group themselves in a way that is socially engaged, the institutions must mediate the relationship between the individual and the outside world rather than quarantine the individual from constructive relationship with it. *See generally id. See also* ALEXIS DETOQUEVILLE, DEMOCRACY IN AMERICA VOLUME 2 (Phillips Bradley, ed., 1945).

201. *See* FORT, *supra* note 185, at 43.

202. *See* ERROL E. HARRIS, FORMAL, TRANSCENDENTAL, AND DIALECTICAL LOGIC: LOGIC AND REALITY (1987).

203. *Id.*; *see also* BERGER & NEUHAUS, *supra* note 199.

204. *See generally* AMITAI ETZIONI, THE NEW GOLDEN RULE (1996). *See also* Timothy L. Fort, *On Golden Rules, Balancing Acts, and Finding the Right Size*, 8 BUS. ETHICS Q. 346 (1998) (critiquing Etzioni).

205. *See* Timothy L. Fort, *Goldilocks and Business Ethics: A Paradigm That Fits "Just Right"*, 23 IOWA J. CORP. L. 245, 264-67 (1998).

206. *See generally* ALASDAIR MACINTYRE, AFTER VIRTUE: A STUDY IN MORAL THEORY (1981) (arguing that a classic feature of modernity is that it asks individuals only to do the particular role asked of them rather than to ask overarching questions

The point is that fostering an affective culture of ethical behavior can be promoted by matching organizational dimensions, such as, but not limited to, sizing of groupings within organizations, while attending to negative dimensions that are associated with them. Thus, small groups within corporations may build a commitment of trust by clarifying to members of the group that their actions make a difference to others.

B. The Management Challenge

By requiring firms to build an ethical culture, the Guidelines are moving away from an approach that judges the effectiveness of programs based on easily auditable features.[207] Instead, it calls for an approach that is social science-based and integrates the three notions of trust described above. The challenge for management is finding the right balance of these notions of trust. For example, Hard Conviction is necessary to support notions of organizational justice (that is, that employees are conspicuously punished for their wrongful behavior), but the trust developed through Real Confidence is also necessary to ensure that employees understand why such punishment is occurring and to be accepting of it.[208] Too much control through monitoring and punishment can lead to distrust, however, as well as to a reduction in intrinsic motivations (and the notion of Good Faith).[209] For example, one laboratory study of a social dilemma game found that improperly designed sanctions for wrongful behavior actually led to less cooperation (and a lowered expectation that others would cooperate)

about the legitimacy of the activity).

207. *See* U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2004).

208. *See* TREVINO and WEAVER, *supra* note 120, at 212 ("When a values orientation is strong, compliance activities can be perceived as part of an overall system of support for ethical behavior"). In one study, Trevino and Weaver found that an effective whistle-blowing program (i.e., the reporting of unethical behavior to top management) required both Hard Conviction (employees seeking that justice takes place in their organization through the punishment of wrongdoers) and Real Confidence (trust that management will protect the whistleblower from retaliation and use the information appropriately). *See id.* at 201-02.

209. *See* Tenbrunsel & Messick, *supra* note 178, at 685. Improperly designed sanctioning systems (or Hard Conviction) may have the effect of increasing wrongful behavior, as employees no longer take responsibility for actions. *Id.*

than the same social dilemma without any sanctions.[210]

The presence of a control system in an organization can also influence how an employee views (or frames) a problem, which then shapes his or her subsequent response.[211] In some social dilemma games, an individual facing punishment for wrongful behavior will frame the dilemma in a way that is different from an individual who does not face such punishments. For example, the first individual may frame the dilemma as a "business situation" involving cost-benefit trade-offs, while the second individual (who does not face a potential punishment) may frame the dilemma as an ethical issue, which raises different issues for consideration and requires that individual to reflect on his or her values.[212]

C. The Role of the Law in Promoting Hard Conviction, Real Confidence, and Good Faith

The challenge the Guidelines have assumed is how to build trust within organizations. Typically, the law works by forcing structures and rules upon organizations. However, requiring firms to force compliance programs upon their employees runs the risk of developing distrust and working against the development of compliant and ethical organizations. The Guidelines attempt to walk this balance by requiring certain "best practices," while still leaving firms with flexibility in implementing compliance programs. This section takes an initial look at just a few of the ways the Guidelines can support the three notions of trust discussed above.[213]

C.1. The Expressive Function of the Law

One way to view how the law can support the development of trust through compliance programs is by viewing the new Guidelines as serving an "expressive" or "framing" function.[214] Viewed in this way,

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210. *Id.* at 695-96.
211. *Id.*
212. *Id.* at 696, 702.
213. *See supra* notes 133-39, 152-54, 170-72 and accompanying text.
214. *See generally* Robert Cooter, *Social Norms, Social Meaning, and the Economic Analysis of Law: A Conference Sponsored by the University of Chicago Law School and the John M. Olin Program In Law and Economics: Expressive Law and Economics*, 27

the new Guidelines operate not by threat of punishment for those firms that do not adopt the appropriate compliance program, but by the Guidelines' creation of awareness about an appropriate compliance program and the need for an ethical corporate culture. For example, in one laboratory study, psychologists had two groups of subjects play a version of the prisoner's dilemma game.[215] In this game, the players could either cooperate and seek joint gains with their partner, or they could defect and seek their highest personal gain without concern for the other player. When the subjects were told beforehand that they were playing the "community game," there was more than twice the level of cooperation than when the subjects were told they were playing the "Wall Street game."[216] The manipulation in the name of the game was found to be more important than an individual's character in determining cooperation.[217] This simple experiment demonstrates the potential power of the expressive function of law.[218]

Eisenberg provides a real world example of these ideas from the duty of care in corporate law.[219] He argued that, during the 1990s,

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J. LEGAL STUD. 585 (1998); Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. CHI. L. REV. 943 (1995); Richard H. McAdams, *The Legal Construction Of Norms: A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649 (2000); Cass R. Sunstein, *Law, Economics, & Norms: On the Expressive Function of Law*, 144 U. PA. L. REV. 2021 (1996). For a more general background see COLIN CAMERER, BEHAVIORAL GAME THEORY (2003); CHOICES, VALUES, & FRAMES (Daniel Kahneman & Amos Tversky eds., 2000).

215. Lee Ross & Donna Shestowsky, *Empirical Legal Realism: A New Social Scientific Assessment of Law and Human Behavior*, 97 NW. U. L. Rev. 1081, 1099-1100 (2003).

216. *See id.* For a similar finding, see Richard P. Larrick & Sally Blount, *The Claiming Effect: Why Players are More Generous in Social Dilemmas Than in Ultimatum Games,* 72 J. PERSONALITY & SOCIAL PSYCHOL. 810 (1997) (finding that the verbs used in describing a subject's actions in a study involving the ultimatum game changed how the individuals framed the game, which changed their willingness to cooperate (i.e., accept or offer fair distributions)).

217. Ross & Shestowsky, *supra* note 215, at 1099-1100. The researchers determined an individual's character by the perceptions of others on whether or not that person was likely to cooperate. *Id.*

218. Using the law to manipulate social norms to develop trust can also have unintended consequences or actually work to reduce trust. *See generally* Ribstein, *supra* note 139.

219. Melvin Aron Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV.

corporate directors began to take their duty of care more seriously. Rather than simply rubber-stamping the decisions of CEOs, directors became more active in setting the board's agenda and critically evaluating the performance of the CEO. Directors did not increase their vigilance due to a fear of increased liability, because that fear was reduced by state laws that allowed corporations to eliminate director liability for breaches of the duty of care.[220] Instead, Eisenberg argued that the reason for the change was "a shift in the social norm governing directorial duties, from a non-obligational practice norm that insulated inactive directors from criticism and self-criticism, to an obligational norm that requires a higher level of care."[221] This occurred from a "change in the belief-system of the business community" with respect to the role of directors.[222]

The main cause of this change in social norms was the law.[223] Although directors were essentially shielded from liability (due also to the business judgment rule),[224] the courts continued to define directors' obligations and how directors should "play" their roles.[225] Thus, the law can provide essential meaning for how actors are to perform in these situations. In addition, the law creates social norms that can be enforced by social sanctions. For example, "no smoking" signs are rarely enforced by legal sanctions,[226] but their presence allows others to "enforce" the smoking bans by "dirty looks" or "harsh words." With respect to compliance programs, the new Guidelines work towards creating new social norms that indicate that "paper" compliance

1253 (1999).

220. *Id.* at 1267-68.

221. *Id.* at 1268-69.

222. *Id.* at 1269.

223. For a similar line of analysis, see Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997).

224. 18 Am. Jur. 2d Corporations § 1470 (2006).

225. *See, e.g.*, Cort v. Ash, 422 U.S. 66, 84 (1975) ("Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that . . . state law will govern the internal affairs of the corporation."); U.S. Cent. Underwriters Agency, Inc. v. Hutchings, 952 S.W.2d 723 (Mo. Ct. App. 1997) (holding that corporations in essence are creatures of statute. As such, statutory law primarily defines the powers and duties of corporate officers and directors).

226. Alex Geisinger, *A Belief Change Theory of Expressive Law*, 88 IOWA L. REV. 35, 46-47 (2002) (summarizing a study discussed in Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1720 (2000)).

programs are not satisfactory,[227] and that all levels of management (including the board) must be involved in ethics and compliance training, among other related responsibilities.[228] This allows those, within (and outside) the organization, who support meaningful compliance programs, the standing and legitimacy to demand such changes if they are not being made. Perhaps more importantly, it helps reshape directors' and officers' views of compliance programs. Currently, these programs are simply viewed as risk-management tools.[229] If the law can change those views — and reconnect ethics and compliance programs with being a good corporate citizen — then there will be a significant impact on how these programs are implemented.

Over time, these norms should become institutionalized, and, it is hoped, will lead to more proactive compliance and ethics programs. This is supported by the research of management scholars which shows that changing the norms of appropriate behavior among officers and directors will have stronger impact on the effectiveness of compliance programs than coercive, external pressures.[230] Even the new Guidelines' discussion of an ethical organizational culture[231] could create new social norms and likely lead firms to engage with new consultants and utilize

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227. ADVISORY REPORT, *supra* note 24, at 62.

228. *See supra* Part II B; *see also* ADVISORY REPORT, *supra* note 24, at 61-62; U.S. SENTENCING GUIDELINES MANUAL § 8b2.1 (2004).

229. *See supra* notes 32-34 and accompanying text (noting the moral hazard problem identified by Laufer).

230. TREVINO and WEAVER, *supra* note 120, at 117-18, 141; Gary R. Weaver et al., *Integrated and Decoupled Corporate Social Performance: Management Values, External Pressures, and Corporate Ethics Practices*, 42 ACADEMY OF MGMT. J. 539 (1999); Gary R. Weaver et al., *Corporate Ethics Programs as Control Systems: Influences of Executive Commitment and Environmental Factors*, 42 ACADEMY OF MGMT. J. 41 (1999). For example, one study by Trevino and Weaver found that management commitment to ethics (measured by the frequency that top management discussed ethics related topics) was positively related to an ethics program that was integrated into the firm's operations. TREVINO and WEAVER, *supra* note 120, at 137-44. Although awareness of the guidelines also had a positive impact on the adoption of more integrated ethics programs, it had significantly less influence than management's commitment to ethics. TREVINO and WEAVER, *supra* note 120, at 144. The empirical question then is whether the changes in the content of the guidelines, which will require top management to discuss issues related to developing an ethical culture, will lead to more integrated ethics programs.

231. *See* U.S. SENTENCING GUIDELINES MANUAL § 8.

their Human Resources departments (instead of exclusively their legal departments).[232] These changes, along with those that emphasize rewarding ethical behavior and motivating employees to follow the compliance program, support the idea of establishing Real Confidence.

C.2. Insights from Mediating Institutions

The Guidelines can also support the mediating institutions insights into building Good Faith. For example, the new Guidelines require firms to conduct "effective training programs."[233] The Advisory Report indicates that an "effective" program does not simply educate employees about compliance but also motivates them to comply.[234] As the Committee notes in the Advisory Report, most transgressions are not due to ignorance, but to those "who may too readily yield to temptation or pressure to break the rules."[235] Although the Committee does not specify the form of training required, because it wanted to give firms flexibility based on their size and the nature of compliance risks they face, there is some indication that web-based training programs may not be sufficient.[236] The burden is on the firm to show that it believed its training to be effective. During the hearings, various experts debated the use of small-group training versus web-based training. Consistent with the idea of mediating institutions, one expert argued for small-group training "so people who are not aware of [the firm's] values have an opportunity to see that other people have those values and maybe they need to rethink where they are."[237]

In large group or web-based training programs, employees are typically passive learners that are not actively engaged in shaping the values of the organization or of their smaller work groups.[238] Based on the studies cited earlier, without a sense that their actions will make a

232. *See supra* note 129 and accompanying text.

233. U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(b)(4)(A).

234. ADVISORY REPORT, *supra* note 24, at 70.

235. *Id.* at 71 (quoting Joseph Murphy, Partner, Compliance Systems Legal Group (internal citations omitted)).

236. ADVISORY REPORT, *supra* note 24, at 71.

237. *Public Hearing Before the U.S. Sentencing Comm'n Ad Hoc Advisory Group on Organizational Sentencing Guidelines* 72-73 (Nov. 14, 2002) (testimony of Carole Basri, Executive Director, American Corporate Counsel Association of Greater New York), http://www.ussc.gov/corp/ph11_02/BRKOUT2.pdf.

238. *See generally supra* notes 24, 133 and accompanying text.

difference, employees will be less likely to cooperate (lowering Real Confidence in the organization as well as the intrinsic Good Faith motivation to act).[239] Moreover, these training programs often focus simply on learning the company's "correct" answer to a problem, rather than an open discussion of real ethical issues faced by employees and what values should guide the resolution of those dilemmas. By contrast, in the 1990s, Lockheed Martin gained significant attention for their innovative ethics program that seemed to adopt some of the insights of a mediating institutions approach. Part of their training program involved a board game (using the cartoon character Dilbert) that was conducted in small groups, that was led by the employees' supervisor (as opposed to an outside consultant), and that utilized open-ended discussion questions.[240] The role of the law is to encourage firms to adopt structures that support mediating institutions and to spread best practices between organizations. Organizations must be encouraged to record their best practices and attempt to measure the impact of their training methods. In addition, the Guidelines should rely on and encourage additional research by management and business ethics scholars to identify effective training practices.

IV. CONCLUSION

Overall, seeking effective compliance and ethics programs would be further enhanced by an authentic symbiotic corporate governance strategy that integrates the need for law, the social capital kinds of rewards that institutionalize societal norms (expressed through laws, financial markets, and non-financial markets), and structuring organizations to coincide with our innate, naturalistic predispositions. This paper is a step in the direction of showing how such a symbiotic integration is now both legally mandated as well as a potentially fruitful exercise of interdisciplinary academic inquiry. Thus, Hard Conviction, as defined here,[241] is an important step in that it insists on proper corporate behavior. But, as the 2004 Amendments implicitly recognize, there must be an integration of law with other dimensions. Real

239. *See supra* notes 133-34 and accompanying text.

240. Samuel Greengard, *Lockheed Martin is Game for Ethics*, WORKFORCE, Oct. 1997, at 51.

241. *See supra* notes 137-39.

Confidence emphasizes that the building of reliability and trust in an organization, through the practicing of normative behavior and the building of social capital, is important for the building of an ethical culture with an attitude toward achieving good citizenship. In addition, fostering the passion for ethics through Good Faith, by connecting our biological capabilities to our organizational structure, completes a tri-partite integration of corporate responsibility.

If the 2004 Amendments are a call to anything, they are a challenge to scholars in various fields to symbiotically synthesize their models. Legal scholars, management social scientists, normative philosophers, psychologists, and theologians have an opportunity — indeed corporations may have a legal necessity — to see these disciplines integrate their work in order to comply with the new Guidelines. The challenge we face is in finding the appropriate role for legal mandates in encouraging organizations to comply with the law — not just the letter of the law but the spirit of the law. The Commission enacted the new Guidelines both to solve the problem of cosmetic compliance programs and to encourage firms to adopt certain best practices. 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.