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Corporate Compliance and Criminality: Does the Common Law Promote Culpable Blindness?

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Could corporate directors and officers face criminal liability for actions that ostensibly comport with common law fiduciary duties? Answering this rather odd question has gained paramount importance following the United States Justice Department's recent promulgation of aggressive new prosecution policies targeting individual officers and directors responsible for major corporate misconduct. In September 2015, former Deputy Attorney General Sally Yates disseminated an official policy memorandum entitled, Individual Accountability for Corporate Wrongdoing. The Yates Memo instructs federal prosecutors to ferret out and punish individual executives, officers, and board members who commit crimes on behalf of the corporation. The recent indictment of several Volkswagen executives connected with the auto emissions defeat device scandal represents a prominent example of the new prosecutorial philosophy.

The shift in prosecutorial focus by the DOJ pursuant to the Yates Memo has created a substantial jurisprudential rift between federal standards for criminal prosecution of corporate agents and common law standards for fulfilling the fiduciary duties of officers and directors. Prior to this new, zealous prosecution program, the common law presumption embodied in the "business judgment rule" regularly shielded directors and officers from liability for lax oversight practices, even with criminal activity running rampant throughout the corporation. Under the guidance of the Yates Memo, however, the government now holds directors and officers to higher standards of oversight than the common law requires. The implications of this jurisprudential rift between federal prosecutorial and common law fiduciary standards are incredibly important. At the outset, the common law standards surrounding the business judgment rule no longer provide sufficient guidance for avoiding civil or criminal liability. In addition, were a director or officer to face criminal sanctions for failed oversight, the very existence of criminal liability would likely result in an exception to the business judgment rule's application. As a result, what might have been a minimally compliant oversight system under the common law becomes actionable. Such bizarre *circularity makes the common law jurisprudentially schizophrenic. To the extent common law duties fail to align with federal standards, fiduciary duties regarding corporate compliance risk becoming unworkable and ultimately irrelevant. This Article argues that redirecting common law fiduciary duties to follow federal prosecution standards will better ensure corporate accountability, reduce acts of corporate misconduct, and promote trust in the capital markets.*

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MICHAEL R. SIEBECKER* & ANDREW M. BRANDES**

INTRODUCTION

Could corporate directors and officers face criminal liability for actions that ostensibly comport with common law fiduciary duties? Answering this rather odd question has gained paramount importance following the United States Justice Department's ("DOJ") recent promulgation of aggressive new prosecution policies targeting individual officers and directors responsible for major corporate misconduct. Most recently, in September 2015, former Deputy Attorney General Sally Yates disseminated an official policy memorandum entitled, *Individual Accountability for Corporate Wrongdoing* (the "Yates Memo").[1] The Yates Memo instructs federal prosecutors to ferret out and punish individual executives, officers, and board members who commit crimes on behalf of their corporations.[2] In the wake of several major banking scandals that undermined public confidence in the capital markets and justice system for failing to hold corporate executives responsible,[3] the prosecutorial policy shift embraced in the Yates Memo stemmed from the basic realization that

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1 Memorandum from Sally Q. Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Individual Accountability for Corp. Wrongdoing (Sept. 9, 2015), https://www.justice.gov/dag/file/769036/download [https://perma.cc/L762-ZQ3R]; *see also Individual Accountability*, U.S. DEP'T JUSTICE, https://www.justice.gov/dag/individual-accountability [https://perma.cc/23AB-EKPD] (detailing the six steps discussed in the Yates Memo to strengthen pursuit of individuals in corporate wrongdoing cases).

2 *See* Sally Q. Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Remarks at the N.Y.C. Bar Association White Collar Crime Conference (May 10, 2016), https://www.justice.gov/opa/speech/deputy-attorney-general-sally-q-yates-delivers-remarks-new-york-city-bar-association [https://perma.cc/X83L-PLZC] ("[H]olding accountable the people who committed the wrongdoing is essential if we are truly going to deter corporate misdeeds, have a real impact on corporate culture and ensure that the public has confidence in our justice system. We cannot have a different system of justice—or the perception of a different system of justice—for corporate executives than we do for everyone else.").

3 *See* Editorial, *No Crime, No Punishment*, N.Y. TIMES (Aug. 25, 2012), http://www.nytimes.com/2012/08/26/opinion/sunday/no-crime-no-punishment.html [https://perma.cc/4SF6-BJ7P] (discussing how no banks or executives would face criminal charges for the financial crisis and how this eroded public confidence in the law); *see also* Sarah White, *Not One Top Wall Street Executive Has Been Convicted of Criminal Charges Related to 2008 Crisis*, HUFFPOST (Sept. 13, 2013,

> [c]orporations can only commit crimes through flesh-and-blood people. It's only fair that the people who are responsible for committing those crimes be held accountable. The public needs to have confidence that there is one system of justice and it applies equally regardless of whether that crime occurs on a street corner or in a boardroom.[4]

By holding individuals to account for corporate criminality, the DOJ hoped to restore a crumbling public trust.[5]

Some initially remained skeptical of the impact of the Yates Memo on criminal prosecutions of individual corporate actors,[6] but little doubt about the effect of the policy shift remained following the arrests of several Volkswagen executives connected with the auto emissions defeat device ("Defeat Device") scandal.[7] In January 2017, Volkswagen agreed to plead guilty on three criminal felony counts and pay $4.3 billion in fines

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7:50 AM), http://www.huffingtonpost.com/2013/09/13/wall-street-prosecution_n_3919792.html [https://perma.cc/M7TQ-XTAM] (comparing various countries' handling of criminal charges after the crisis and what regulations led to the difference); Aruna Viswanatha, *Elizabeth Warren Says DOJ and SEC Are Lousy at Enforcement*, WALL ST. J. (Jan. 29, 2016, 3:14 PM), https://blogs.wsj.com/washwire/2016/01/29/elizabeth-warren-doj-and-sec-are-lousy-at-enforcement/ [https://perma.cc/VM2S-RVXH] (detailing Elizabeth Warren's comments on weak enforcement by the SEC).

4 William D. Cohan, *Justice Department Shift on White-Collar Crime Is Long Overdue*, N.Y. TIMES (Sept. 11, 2015), https://www.nytimes.com/2015/09/12/business/dealbook/justice-dept-shift-on-white-collar-crime-is-long-overdue.html [https://perma.cc/5RPX-R8B5].

5 Devlin Barrett, *Justice Department Renews Focus on White-Collar Cases*, WALL ST. J. (Sept. 10, 2015, 9:43 PM), https://www.wsj.com/articles/justice-department-renews-focus-on-white-collar-cases-1441849429 [https://perma.cc/C53W-VAV2].

6 *See* OFFICE OF SENATOR ELIZABETH WARREN, RIGGED JUSTICE: 2016 HOW WEAK ENFORCEMENT LETS CORPORATE OFFENDERS OFF EASY 4 (Jan. 2016), https://www.warren.senate.gov/files/documents/Rigged_Justice_2016.pdf [https://perma.cc/8T4N-MHAN] ("Despite this rhetoric, DOJ civil and criminal settlements—and enforcement actions by other federal agencies—continually fail to impose any serious threat of punishment on corporate offenders."); U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, DOJ'S NEW THRESHOLD FOR "COOPERATION" 4–5 (May 2016), http://www.instituteforlegalreform.com/uploads/sites/1/YatesMemoPaper_Pages_web.pdf [https://perma.cc/AEA8-B7A5]; David Woodcock & John T. Sullivan, *Individuals in the Cross Hairs, What This Means for Directors*, JONES DAY (Mar. 2016), http://www.jonesday.com/individuals-in-the-cross-hairs-what-this-means-for-directors-03-10-2016/ [https://perma.cc/75NS-YCEL] ("The Yates Memo has the potential to affect many aspects of corporate investigations and prosecutions, but it does not change the standards for proving criminal conduct beyond a reasonable doubt, which is a serious hurdle to proving individual liability. Nevertheless, the government's focus on individual liability creates additional risks."); Rena Steinzor, *White-Collar Reset: The DOJ's Yates Memo and its Potential to Protect Health, Safety, and the Environment*, 7 WAKE FOREST J.L. & POL'Y 39, 66–67 (2017).

7 *See* Hiroko Tabuchi et al., *6 Volkswagen Executives Charged as Company Pleads Guilty in Emissions Case*, N.Y. TIMES (Jan. 11, 2017), https://www.nytimes.com/2017/01/11/business/volkswagen-diesel-vw-settlement-charges-criminal.html [https://perma.cc/3VQU-PNHQ] (reporting criminal charges announced by federal prosecutors in the Volkswagen emissions cheating scandal); Jack Ewing et al., *Volkswagen Executive's Trip to U.S. Allowed F.B.I. to Pounce*, N.Y. TIMES (Jan. 9, 2017), https://www.nytimes.com/2017/01/09/business/volkswagen-emissions-scandal-oliver-schmidt.html [https://perma.cc/9XDW-STE6] (reporting the arrest of Oliver Schmidt in connection with Volkswagen's emissions cheating).

resulting from its use of an emissions-cheating device installed in thousands of diesel vehicles[8] and from obstructing justice in lying about the scheme.[9] In addition to securing the corporation's confession of guilt, the DOJ announced criminal charges against six Volkswagen executives for their individual roles in perpetuating the Defeat Device fraud.[10] Driving home the new focus on individual culpability, Deputy Attorney General Yates stated, "[t]his wasn't simply the action of some faceless, multinational corporation. . . . This conspiracy involved flesh-and-blood individuals . . . . We've followed the evidence—from the showroom to the boardroom—and it brought us to the people whose indictments we announce today."[11]

Many suspect that the government will use each arrest to climb farther up the corporate criminal ladder.[12] Although five of the individuals remain in Germany,[13] the F.B.I. arrested one executive in Florida, Oliver Schmidt, who previously served as Volkswagen's top emissions compliance officer in the United States.[14] Federal prosecutors charged Schmidt with eleven felony counts for which he faced up to 169 years in prison, if found guilty.[15] Perhaps as a result of such pressure, in early August 2017, Schmidt pleaded guilty to two felony counts.[16] Although sentencing will not occur until December 2017, Schmidt now faces seven years in prison, subsequent deportation, and a fine of up to $400,000.[17] Although it's unclear whether Schmidt will serve as a governmental witness against other Volkswagen executives as part of his plea bargain, because Mr. Schmidt "warned executives in Germany that the company could face

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[8] Tabuchi et al., *supra* note 7. For a detailed discussion of the Defeat Device Scandal, see Guilbert Gates et al., *How Volkswagen's "Defeat Devices" Worked*, N.Y. TIMES, https://www.nytimes.com/interactive/2015/business/international/vw-diesel-emissions-scandal-explained.html?mcubz=0 [https://perma.cc/P7AF-4VCP] (last updated Mar. 16, 2017).

[9] Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Volkswagen AG Agrees to Plead Guilty and Pay $4.3 Billion in Criminal and Civil Penalties; Six Volkswagen Executives and Employees are Indicted in Connection with Conspiracy to Cheat U.S. Emissions Tests (Jan. 11, 2017), https://www.justice.gov/opa/pr/volkswagen-ag-agrees-plead-guilty-and-pay-43-billion-criminal-and-civil-penalties-six [https://perma.cc/NGR5-6EFX].

[10] Tabuchi et al., *supra* note 7.

[11] Office of Pub. Affairs, *supra* note 9.

[12] For a general discussion of the Yates Memo's incentives to elicit information about higher ranking corporate executives, see Elizabeth E. Joh and Thomas W. Joo, *The Corporation as Snitch: The New DOJ Guidelines on Prosecuting White Collar Crime*, 101 VA. L. REV. ONLINE 51 (2015).

[13] Bill Vlasic, *Volkswagen Executive Pleads Guilty in Diesel Emissions Case*, N.Y. TIMES (Aug. 4, 2017), https://www.nytimes.com/2017/08/04/business/volkswagen-diesel-oliver-schmidt.html?_r=0 [https://perma.cc/VB6U-F9T8].

[14] *Id.*

[15] Nick Carey, *Volkswagen Executive Pleads Guilty in U.S. Emissions Cheating Case*, REUTERS (Aug. 4, 2017), https://www.reuters.com/article/us-volkwwagen-emissions-idUSKBN1AK1OY [https://perma.cc/B76G-MD4D].

[16] Vlasic, *supra* note 13.

[17] Carey, *supra* note 15.

criminal charges for its action,"[18] prosecutors hope he will be valuable in ongoing investigations of higher-ranking corporate officials regarding their own criminal complicity.[19] Along with the information received from a Volkswagen software engineer who pleaded guilty to conspiracy in September 2016,[20] the plea agreement with Schmidt emboldened the Department of Justice to redouble its pledge that "Schmidt, along with each and every official involved in this emissions scandal, will be held fully accountable for their actions by the Department of Justice as this investigation continues."[21]

The DOJ's targeting of individual wrongdoers responsible for perpetrating—or casting a blind eye to—Volkswagen's fraudulent scheme heralds a new era of heightened scrutiny of directors and officers regarding corporate oversight practices. Prior to this new, zealous prosecution program, the common law presumption embodied in the "business judgment rule"[22] regularly shielded directors and officers from liability for lax oversight practices, even with criminal activity running rampant throughout the corporation.[23] Except in cases involving fraud, illegality, conflicts of interest, or gross negligence,[24] courts would presume the decisions of corporate managers comported with their fiduciary duties owed to the corporation and its shareholders.[25] As a result, shareholders seeking redress for failed corporate oversight would not be able to recover

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[18] Ewing et al., *supra* note 7.

[19] *Id.*

[20] Samantha Masunaga & Del Quentin Wilber, *VW Engineer from California Pleads Guilty to Conspiracy in Emissions Scandal*, L.A. TIMES (Sept. 9, 2016, 2:55 PM), http://www.latimes.com/business/la-fi-volkswagen-engineer-20160909-snap-story.html [https://www.perma.cc/F89X-7EPG].

[21] Carey, *supra* note 15 (quoting Deputy Assistant Attorney General Jean Williams); *see also* Masunaga & Wilber, *supra* note 20 (predicting that Volkswagen employees cooperating with the U.S. Department of Justice means others will be charged); Gates et. al., *supra* note 8 (discussing the Volkswagen internal response).

[22] For a general discussion of the business judgment rule under Delaware law, see Michael R. Siebecker, *Bridging Troubled Waters: Linking Corporate Efficiency and Political Legitimacy Through a Discourse Theory of the Firm*, 75 OHIO ST. L.J. 103, 132 (2014); Michael R. Siebecker, *The Duty of Care and Data Control Systems in the Wake of Sarbanes-Oxley*, 84 CHI.-KENT L. REV. 821, 825–26 (2010).

[23] *See, e.g.*, BRANDON GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS, 17, 193 (2014) (describing how prosecutors may reveal malfeasance but subsequent punishments will rarely reform a firm's management).

[24] Michael R. Siebecker, *Political Insider Trading*, 85 FORDHAM L. REV. 2717, 2746 (2017).

[25] *See id.* (noting the exceptions to the business judgment rule); Edward B. Rock & Michael L. Wachter, *Islands for Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1668–69 (2001) (describing how courts presume that managers serve fiduciary duties and shareholders except when conflicts of interest arise).

even civil damages absent application of one of the business judgment rule exceptions.[26]

With respect to the duty of corporate managers to implement effective monitoring mechanisms to identify and stave off corporate wrongdoing, Delaware common law—which governs the vast majority of public companies in the United States—sets an incredibly low hurdle for directors and officers to overcome liability. Two prominent Delaware Supreme Court decisions, *In re Caremark International*[27] and *Stone v. Ritter*,[28] set forth the managerial baby steps directors and officers need to take to evade culpability.

In *Caremark*, shareholders of a health-care company brought a derivative suit alleging directors violated their fiduciary duties in failing to uncover an illegal kickback scheme used by company employees that eventually led the company to plead guilty to felony criminal charges.[29] In its determination that the board did not breach its fiduciary duties despite failing to detect and prevent the criminal misconduct, the Delaware Court of Chancery held "only a sustained or systematic failure of the board to exercise oversight—such as an *utter failure to attempt* to assure a reasonable information and reporting system exits—will establish the lack of good faith that is a necessary condition to liability."[30] In *Stone*, where shareholders of a bank claimed its directors failed to identify and prevent corporate employees from violating federal anti-money-laundering laws, the Delaware Supreme Court affirmed the *Caremark* standard.[31] Articulating a willful ignorance of "red flags" exception, the Court added that liability could also arise when, after implementing a minimally compliant information gathering system, a board "consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[32]

The "utter failure to attempt" threshold in *Caremark* and the "red flags" exception in *Stone* offer great insulation to officers and directors in the face of corporate criminality. At least as the contours of common law fiduciary duties are articulated in Delaware—by far the most important and influential corporate jurisdiction in the United States—corporate officers and directors rarely faced personal civil, let alone

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[26] *See* Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability Within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 215–16, 218–20, 222–23 (2010) (describing the business judgment rule exceptions and the difficulty shareholders face when pursuing these options).

[27] *In re* Caremark Int'l, 698 A.2d 959 (Del. Ch. 1996).

[28] Stone v. Ritter, 911 A.2d 362 (Del. 2006).

[29] *Caremark*, 698 A.2d at 961–62.

[30] *Id.* at 971 (emphasis added).

[31] *Stone*, 911 A.2d at 370.

[32] *Id.*

criminal, liability for corporate misdeeds.[33] Quite to the contrary, potentially liable directors and officers have generally enjoyed a cozy relationship with government prosecutors.[34] While individual executives certainly face intense media scrutiny in the midst of corporate scandals,[35] those same high-ranking corporate agents receive significant incentives for identifying institutional corporate wrongdoing in exchange for leniency regarding their individual complicity in the corporate crime.[36]

The shift in prosecutorial focus by the DOJ pursuant to the Yates Memo has created a substantial jurisprudential rift between federal standards for criminal prosecution of corporate agents and common law standards for fulfilling the fiduciary duties of officers and directors. As a result, the coziness between the government and ostensibly complicit corporate actors may indeed have come to an end. The changing tides result not simply from some attitudinal shift. Instead, the government now holds directors and officers to higher standards of oversight than the common law requires. Leniency for individual transgressions no longer comes with simple cooperation, but instead requires complete confession and compatriot implication. For instance, pursuant to the U.S. Attorney's Manual that guides DOJ prosecutions,

> [compliance programs must be] established by corporate management to prevent and detect misconduct and to ensure that corporate activities are conducted in accordance with applicable criminal and civil laws, regulations, and rules . . . . However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct undertaken by its officers, directors, employees, or agents.[37]

Moreover, the Yates Memo eliminates or severely restricts former officer and director safe havens such as corporate cooperation credits, individual plea-bargaining agreements, and the prioritization of prosecutions of companies over those that target individuals.[38]

The implications of this jurisprudential rift between federal prosecutorial and common law fiduciary standards are incredibly

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[33] *See* OFFICE OF SENATOR ELIZABETH WARREN, *supra* note 6, at 4 (discussing the importance of holding individuals accountable for corporate crime); Nees, *supra* note 26, at 215–24 (discussing the current state of director oversight liability).

[34] Nees, *supra* note 26, at 215–24.

[35] *Id.*

[36] *Id.*

[37] UNITED STATES DEP'T OF JUSTICE, UNITED STATES ATTORNEY MANUAL 9-28.800 (revised Nov. 2015), https://www.justice.gov/usam/usam-9-28000-principles-federal-prosecution-business-organizations #9-28.800 [https://www.perma.cc/JLP5-3QYT].

[38] *Id.*

important. At the outset, for those directors and officers at the vast majority of public companies incorporated in Delaware, *Caremark* and *Stone* do not provide reliable guidance for avoiding civil or criminal liability. Those cases articulate the contours of corporate fiduciary duties far out of line with what federal prosecutors demand. In light of the Yates Memo, corporate counsel suggest that public company directors implement corporate compliance systems far more stringent than required under Delaware common law.[39] In addition, were a director or officer to face criminal sanctions for failed oversight, the very existence of criminal liability would likely result in an exception to the business judgment rule's application. As a result, what might have been a minimally compliant oversight system under the common law becomes actionable. Such bizarre circularity makes Delaware law jurisprudentially schizophrenic. To the extent Delaware common law duties fail to align with federal standards, the fiduciary duties surrounding corporate compliance risk becoming unworkable and ultimately irrelevant. Only by bending to match the reality of federal compliance standards can Delaware common law fiduciary duties remain relevant for guiding corporate managers.

To assess why Delaware common law fiduciary duties must change to reflect heightened prosecutorial standards, Part I of this Article, "The Common Law of Compliance," discusses the evolution of lax common law standards regarding corporate compliance that have provided ample protection to officers and directors even in cases of criminal wrongdoing. Part II, "Corporate Criminality in the Crosshairs," describes the incremental shift in DOJ prosecutorial focus towards individual culpability resulting from numerous high-profile corporate scandals and increasing public demands for accountability. Part III, "Directorial Duties Redirected," outlines three potential alternatives to Delaware's current business judgment rule standards that would align common law fiduciary duties with the Yates Memo's directives. Part IV, "Implications," explores a variety of potential advantages and drawbacks to changing common law standards to comport with the reality of current prosecution policies. Finally, the Article concludes that redirecting Delaware common law fiduciary duties to follow federal prosecution standards will better ensure corporate accountability, reduce acts of corporate misconduct, and promote trust in the capital markets.

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[39] *See, e.g.*, Michael W. Peregrine, *Beyond Caremark: Individual and Corporate Liability Considerations*, COMPLIANCE & ENFORCEMENT (Dec. 7, 2016), https://wp.nyu.edu/compliance_enforcement/2016/12/07/beyond-caremark-individual-and-corporate-liability-considerations [https://www.perma.cc/82KJ-4M65]; Michael Volkov, *Corporate Directors in the Enforcement Cross-Hairs*, CORRUPTION, CRIME & COMPLIANCE (Mar. 23, 2016), http://blog.volkovlaw.com/2016/03/corporate-directors-enforcement-cross-hairs/ [https://www.perma.cc/8JFG-8TPQ]; Woodcock & Sullivan, *supra* note 6.

I. THE COMMON LAW OF COMPLIANCE

The Delaware court system has come to be known as the "Mother Court of corporate law."[40] More than 60% of Fortune 500 companies are incorporated in Delaware[41] and since 2003, the state held nearly 75% of all initial public offerings in the United States.[42] In fact, the number of public companies incorporated in Delaware is thirteen times more than the number of public companies incorporated in California, which is striking given that there are forty-three times more public companies headquartered in California than there are in Delaware.[43] With this established prominence in the corporate field, Delaware offers significant and unique benefits for those companies that incorporate in that jurisdiction.[44]

One of the allures for these companies incorporating in Delaware is the manner in which the common law offers protection for directors and officers under the business judgment rule.[45] The business judgment rule extends liability protection to officers and directors that act in good faith if their decisions are ultimately shown to be unsound or erroneous.[46] The rule is based on the idea that business decisions should not be subject to after-the-fact second-guessing by judicial bodies because it would prevent officers and directors from taking the risks necessary to engage in business.[47] In Delaware, the business judgment rule has been defined to

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[40] Kamen v. Kemper Fin. Serv's, Inc., 908 F.2d 1338, 1343 (7th Cir. 1990); Jerue v. Millett, 66 P.3d 736, 745 (Alaska 2003); Stephen A. Radin, *The New Stage of Corporate Governance Litigation: Section 220 Demands*, 28 CARDOZO L. REV. 1287, 1287–88 (2006).

[41] Robert Hennelly, *Is Delaware Home to a "Grand Corruption"?*, CBS NEWS (Feb. 19, 2016), http://www.cbsnews.com/news/is-delaware-home-to-a-grand-corruption/ [https://www.perma.cc/Y8XS-S562].

[42] BRENT A. OLSON, PUBLICLY TRADED CORPORATIONS HANDBOOK § 3:1 (2016) (citing William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing Success,"* 2009 U. ILL. L. REV. 95, 99 (2009)).

[43] *Id.* (citing Robert Anderson IV & Jeffrey Mannis, *The Delaware Delusion*, 93 N.C.L. REV. 1049, 1055 (2015)).

[44] *See* Alana Semuels, *The Tiny State Whose Laws Affect Workers Everywhere*, THE ATLANTIC (Oct. 3, 2016), https://www.theatlantic.com/business/archive/2016/10/corporate-governance/502487/ [https://www.perma.cc/A6K6-EG7H] (explaining that corporations want to incorporate in the state of Delaware because the state's Court of Chancery is favorable to business).

[45] *Id.*

[46] Lori McMillan, *The Business Judgment Rule as an Immunity Doctrine*, 4 WM. & MARY BUS. L. REV. 521, 526–27 (2013).

[47] McMillan, *supra* note 46 (citing *In re* Citigroup, 964 A.2d 106, 126 (Del. Ch. 2009)); *see also* Alex Righi, *Shareholders on Shaky Ground: Section 271's Remaining Loophole*, 108 NW. U.L. REV. 1451, 1464–65 (2014) (citing E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1413 (2005)) ("Delaware courts view the business judgment rule as 'a presumption that courts will not interfere with, or second guess, decision making by directors,' unless there is clear cause to do so.").

"protect and promote the full and free exercise of the managerial power granted to Delaware directors."[48]

For the purposes of this article, the application of the business judgment rule in the context of business oversight and compliance is especially important and will serve as the primary topic of analysis. The Delaware Court of Chancery's decision in *In re Caremark International* in 1996 and the Delaware Supreme Court's decision in *Stone v. Ritter* in 2006 exemplify the business judgment rule's benefits for directors and officers in relation to business oversight.

Caremark and *Stone* also represent an extremely low threshold for directors and officers[49] to achieve in order to avail themselves of the protections from liability under the business judgment rule for violations of state law. This standard permits those individuals to mount only minimal efforts in order to qualify for oversight protection and the benefit of Delaware's generous business judgment rule protection. However, the Yates Memo represents a ground shift that demands much more from directors and officers than ever before. While the Yates Memo relates to federal enforcement authority, it is nevertheless important in guiding a director's or officer's actions in performing oversight duties prior to any regulatory investigation. The Yates Memo is also important to determining a director's or officer's ability to avoid personal liability under both state and federal law. Accordingly, reviewing the current standards from Delaware courts in *Caremark* and *Stone* lays the foundation for an examination of the differences between the current, more lenient common law standard and the markedly more demanding investigatory and enforcement standards announced in the Yates Memo.

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[48] Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1975); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1747–48 (2006).

[49] It is important to note that the holdings in *Caremark* and *Stone* are not explicitly applicable to both directors and officers. *See* Stone v. Ritter, 911 A.2d 362, 373 (Del. 2006) (applying standards of oversight to director conduct); *In re* Caremark Int'l, 698 A.2d 959, 970 (Del. Ch. 1996) (articulating only the directors' duty of care standard without specific reference to officers). However, the Delaware Supreme Court held in 2009 that the *Caremark* standards of oversight apply not only to directors, but also to officers. Gantler v. Stephens, 965 A.2d 695, 708–09 (Del. 2009); *see also* Verity Winship, *Jurisdiction Over Corporate Officers and the Incoherence of Implied Consent*, 2013 U. ILL. L. REV. 1171, 1173 n.6 (2013) (citing *Gantler*, 965 A.2d at 708–09) (explaining that *Gantler* was the first case in which the equivalence of director and officer duty was explicitly stated by a court); Lawrence A. Hamermesh & A. Gilchrist Sparks III, *Corporate Officers and the Business Judgment Rule: A Reply to Professor Johnson*, 60 BUS. LAW. 865, 876 (2005) (arguing that the policies underlying the business judgment rule apply with "equal force" to both directors and officers); Darren Guttenberg, Note, *Waiving Farewell Without Saying Goodbye: The Waiver of Fiduciary Duties in Limited Liability Companies in Delaware, and the Call for Mandatory Disclosure*, 86 S. CAL. L. REV. 869, 877 n.31 (2013) (reviewing case law suggesting that directors and officers are afforded the same presumption of competence under the business judgment rule).

A. *The* Caremark *Approach*

In re Caremark International is widely considered to be the most important decision on directors' liability for failing to act in accordance with their compliance and business oversight obligations.[50] *Caremark* involved a health-care company's compliance with health-care regulations and its alleged involvement with "kickback" payments given to physicians in exchange for referrals to Caremark facilities.[51] The alleged kickback scheme, if substantiated, would have violated Caremark's policy against "quid pro quo" payments, as well as federal statutes which prohibited health-care providers from making payments for referral of Medicare or Medicaid patients.[52] The company previously issued an internal manual to govern employees entering into contracts with physicians and hospitals.[53] The manual noted that no payments would be made in exchange or as a reward for referrals, but it was not clear whether other quid pro quo benefits were explicitly prohibited by the internal policy.[54]

Eventually, the DOJ and the Department of Health and Human Services Office of the Inspector General ("OIG") investigated Caremark for illegal kickback payments.[55] The Caremark board then began a review of its internal policies and procedures, eventually producing a revised guide on contractual relationships with physicians—the updated guide established a policy of increased managerial oversight for these agreements, and added approval mechanisms accordingly.[56] The board received reports on the investigation, continued to institute new policies, and increased its management supervision.[57] However, the regulatory investigations culminated in a federal grand jury indictment charging Caremark and two of its officers with violating federal anti-kickback statutes.[58] According to the indictment, the alleged kickback payments continued even after the board was alerted to the risks, in spite of its increased focus on compliance and internal training.[59] Caremark eventually settled various state and federal matters against it[60] by paying significant

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[50] *See* JAMES D. COX & THOMAS LEE HAZEN, TREATISE ON THE LAW OF CORPORATIONS § 10:4 (3d ed. 2016); DAVID G. EPSTEIN ET AL., BUSINESS STRUCTURES 224 (3d ed. 2010) (describing *Caremark* as the "'seminal modern case on directors' liability for failure to act").

[51] *Caremark*, 698 A.2d at 961–62.

[52] *Id.*

[53] *Id.* at 962.

[54] *Id.*

[55] *Id.*

[56] *Id.* at 963.

[57] *Id.*

[58] *Id.* at 963–64.

[59] *See id.* (describing how the allegations of the indictment spanned the years in which Caremark was increasing its oversight and control over physician contracts).

[60] *Id.* at 965–66.

criminal and civil fines.[61] The matter at issue for the court at trial was whether the proposed settlement of claims against Caremark was "fair to the corporation and its absent shareholders."[62] However, the underlying issues of importance to matters of corporate governance were: (1) under which standard Caremark's directors and officers should be evaluated; and (2) whether these directors and officers failed to adequately supervise the conduct of the company's employees or institute corrective measures that ultimately resulted in fines and penalties.[63] In their complaint, shareholders alleged that the directors breached their "duty of attention or care" by allowing the situation to "develop and continue; [resulting in] enormous legal liability" stemming from their failure to actively monitor corporate performance.[64]

Ultimately, the Delaware Court of Chancery held that the proposed settlement was fair for the company and the absent shareholders.[65] However, more important to this analysis, the court held that when it pertains to board oversight, "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exits—will establish the lack of good faith that is a necessary condition to liability."[66] In addition, the court also expanded upon its prior decision in *Graham v. Allis-Chalmers* stating that "absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."[67]

The holding in *Caremark* is extremely significant because of its instructive value for directors and officers in establishing their companies' oversight and compliance systems. By the decision's own terms, "[only] an utter failure to attempt" to oversee a company's employees will result in liability for directors under the Delaware business judgment rule.[68] Further, even in cases where the company is subject to criminal and civil discipline, the court will defer to the minimalist oversight functions that are instituted as sufficient, resulting in a significant benefit for high-level employees.[69] The court's standard requires no qualitative analysis of the

[61] *Id.* at 965 n.10.
[62] *Id.* at 961.
[63] *Id.* at 967, 970–71.
[64] *Id.* at 967.
[65] *Id.* at 972.
[66] *Id.* at 971.
[67] *Id.* at 969 (citing Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130–31 (Del. 1963)) (holding that the *Graham* decision stood for the proposition stated above based on the court's review in *Caremark*).
[68] *Id.* at 971.
[69] *Id.*

oversight measures, but simply offers a binary, "all or nothing" standard in which any effort to oversee the business operations is generally sufficient.[70]

The decision to insulate directors and officers from personal liability based on these facts is even more problematic considering the federal settlement Caremark agreed to the year before the decision was announced. As part of a separate series of settlements with the DOJ, the Department of Health and Human Services ("HHS"), and the Federal Bureau of Investigation ("FBI"), Caremark agreed to make various payments totaling approximately $250 million.[71] Of that amount, $161 million of the settlement accounted for criminal fines, civil restitution, and damages for Caremark's actions.[72] At the time, it was the second-largest settlement ever recorded in the health-care industry.[73]

The DOJ would ultimately indict four Caremark employees,[74] including its head of sales and marketing.[75] While these four employees were later acquitted, they remained employed at Caremark during the legal proceedings and kept their jobs after the trial.[76] As a result of the indictments' announcement in August of 1994, Caremark's publicly-traded shares dropped ten percentage points.[77] Overall, the impact on Caremark was significant to its day-to-day business operations and its shareholders'

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[70] *Caremark*, 698 A.2d at 971. The "utter failure to attempt" standard outlined in *Caremark* permits companies to skirt qualitative analysis beyond answering the binary question of whether there was an attempt to provide oversight or not. This results in an "all or nothing" compromise where a company that engages in a form of oversight will benefit from the business judgment rule and vice versa.

[71] Press Release, U.S. Dep't of Justice, Caremark to Pay $161 Million in Fraud and Kickback Cases (June 16, 1995), https://www.justice.gov/archive/opa/pr/Pre_96/June95/342.txt.html [https://www.perma.cc/Q82K-KS2X].

[72] *Id.*

[73] Kathleen Day, *Drug Executives Cleared in Kickback Case*, WASH. POST (Oct. 4, 1995), https://www.washingtonpost.com/archive/business/1995/10/04/drug-executives-cleared-in-kickback-case/586dcb19-5ef9-4da3-baa0-2f030c60fb9a/?utm_term=.732f32f3fb9575b [https://www.perma.cc/QAZ5-UKN6].

[74] It is important to note that no officer-level executives or directors were indicted. *See* Jan Crawford Greenburg, *Healthy Penalties in* Caremark *Fraud Case*, CHI. TRIB. (June 17, 1995), http://articles.chicagotribune.com/1995-06-17/news/9506170105_1_health-care-fraud-caremark-international-government-medical-programs [https://www.perma.cc/622L-YXNZ]; *see also* Hillary A. Sale, *Monitoring* Caremark's *Good Faith*, 32 DEL. J. CORP. L. 719, 726 (2007) ("Importantly, no senior officers of directors were cited for wrongdoing . . . . ").

[75] Day, *supra* note 73.

[76] *Id.*

[77] *See* Milt Freudenheim, *Caremark Is Indicted in Kickbacks*, N.Y. TIMES (Aug. 5, 1994), http://www.nytimes.com/1994/08/05/business/company-news-caremark-is-indicted-in-kickbacks.html?mcubz=1 [https://www.perma.cc/X4CK-FFN3] ("Caremark's shares fell $2.375 . . . to $21.125, in heavy trading on the New York Stock Exchange . . . .").

financial interests, yet none of the executives or officers were found individually culpable for their acts or omissions by the Delaware court.[78]

While the chronology of the case shows that the DOJ's indictments took place prior to Delaware's legal proceedings, the fact that the outcomes were so different is telling. The court's decision offers little analysis on the Caremark board's oversight actions aside from a brief mention of the board's awareness of the pending investigations and the finding that once the issues were identified, the board took action by updating its guides and increasing its policy to demand more regular reporting and oversight on the matter to supervisors.[79] For ten years after the decision in *Caremark*, directors and officers took solace in the fact that the business judgment rule would protect them if they mounted even minimal efforts at oversight. Then, the Delaware Supreme Court offered its decision in *Stone* and further galvanized these protections.[80]

B. Stone*: Reaffirming* Caremark *and Then Some*

A decade after *Caremark*, the Delaware Supreme Court announced its decision in *Stone*, which clarified a number of lingering questions about director oversight liability.[81] The case came to the Delaware Supreme Court as an appeal from the Chancery Court's decision dismissing a shareholder's derivative complaint against current and former directors for their failure to stop a money-laundering scheme that resulted in significant penalties and fines incurred by the defendant banking corporation, AmSouth.[82]

The facts of the case were largely unimportant in *Stone* and the Delaware Supreme Court apportioned the majority of the opinion to analyzing the Chancery Court's prior decision in the *Caremark* case.[83] Ultimately, the court held that the Chancery Court's holding in *Caremark* reflected the correct standard for boards of directors seeking business

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[78] Sale, *supra* note 74, at 726–27.

[79] *See In re* Caremark Int'l, 698 A.2d 959, 963 (Del. Ch. 1996) ("Caremark's Board took several additional steps consistent with an effort to assure compliance with company policies concerning the ARPL and the contractual forms in the Guide. In April 1992, Caremark published a fourth revised version of its Guide apparently designed to assure that its agreements either complied with the ARPL and regulations or excluded Medicare and Medicaid patients altogether. In addition, in September 1992, Caremark instituted a policy requiring its regional officers, Zone Presidents, to approve each contractual relationship entered into by Caremark with a physician.").

[80] Stone v. Ritter, 911 A.2d 362, 372–73 (Del. 2006).

[81] Andrew D. Appleby & Matthew D. Montaigne, *Three's Company:* Stone v. Ritter *and the Improper Characterization of Good Faith in the Fiduciary Duty "Triad,"* 62 ARK. L. REV. 431, 431–33, 437 (2009) (discussing how the longstanding debate was settled and observing that "[t]he *Stone* court finally cleared up some doctrinal issues when it explicitly stated that good faith is not a freestanding duty on the level of care and loyalty").

[82] *Stone*, 911 A.2d at 364–65, 373.

[83] *Id.* at 364–65, 367–70.

judgment rule protection in relation to oversight liability.[84] In adopting the *Caremark* rule, the court expanded its position on the necessary conditions for director oversight.[85] In order to be culpable under a director oversight theory, a director must either: (1) utterly fail to implement any reporting information system or controls as stated under *Caremark*; or (2) "having implemented such a system or controls, consciously fail[] to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[86] Importantly, the court held that in either case, the directors must know that they are "not discharging their fiduciary obligations" in order to be liable for failing to provide proper oversight.[87] Only then, when "the directors fail to act in the face of a known duty to act . . . demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."[88]

In applying this "red flags" exception to the case, the *Stone* court found that the plaintiffs did not plead the existence of any facts that otherwise indicated that the AmSouth directors were aware that AmSouth's internal controls were incapable of stopping the illegal activity.[89] The court noted the Chancery Court's findings in the case were correct: the directors' oversight actions were sufficient and their failure to affirmatively detect the illegal activity did not meet the *Caremark* standard for culpability.[90] Therefore, the directors were not personally liable for the money-laundering scheme that occurred under their watch and they executed their obligations in fulfillment of the proper standards.[91]

In sharp contrast to the findings of the Delaware Supreme Court in *Stone*, the U.S. Attorney's Office ("USAO"), Federal Reserve's Financial Crimes Enforcement Network ("FinCEN"), and the Alabama Banking Department found that AmSouth's board did indeed fall short when executing its oversight responsibilities.[92] The federal government found that AmSouth relied on misrepresentations by the actors involved in the money-laundering scheme and failed to file the requisite documents according to federal law.[93]

While the USAO opted to not hold any individual officer or director culpable specifically, FinCEN found that "AmSouth's [compliance]

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[84] *Id.* at 369–70.
[85] *Id.* at 370.
[86] *Id.*
[87] *Id.*
[88] *Id.*
[89] *Id.* at 370–71.
[90] *Id.* at 372–73.
[91] *Id.* at 373.
[92] *Id.* at 366.
[93] *Id.*

program lacked adequate board and management oversight" and "reporting to management for the purposes of monitoring and oversight of compliance activities was materially deficient."[94] Nevertheless, the government did not fine or sanction AmSouth's individual directors at the conclusion of its investigation.[95] Instead, it opted to pursue fines and penalties against the corporation itself.[96]

C. *The Legacy of* Caremark *and* Stone

When considered against the Delaware courts' standards, the facts in *Caremark* and *Stone* represent instances where the board exceeded the requisite obligations to qualify for the protection of the business judgment rule.[97] However, both of the defendant companies suffered meaningful losses in the related civil and criminal settlements under federal law.[98] For shareholders, the outcomes in these proceedings stand as an affront to the very essence of what directors and officers are charged to do.[99] According to the investigatory outcomes from the federal government, these individuals failed to identify wrongdoing and act in the best interest of the shareholders.[100]

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[94] *Id.* at 366.

[95] *Id.* at 365.

[96] *Id.*

[97] *See In re* Caremark Int'l, 698 A.2d 959, 971–72 (Del. Ch. 1996) ("Here the record supplies essentially no evidence that the director defendants were guilty of a sustained failure to exercise their oversight function. To the contrary, insofar as I am able to tell on this record, the corporation's information systems appear to have represented a good faith attempt to be informed of relevant facts. If the directors did not know the specifics of the activities that lead to the indictments, they cannot be faulted."); *Stone*, 911 A.2d at 372–73 ("[T]he Board received and approved relevant policies and procedures, delegated to certain employees and departments the responsibility for filing SARs and monitoring compliance, and exercised oversight by relying on periodic reports from them. Although there ultimately may have been failures by employees to report deficiencies to the Board, there is no basis for an oversight claim seeking to hold the directors personally liable for such failures by the employees.").

[98] *See supra* text accompanying notes 71–73 (describing the $161 settlement as the second largest settlement in the health-care industry); *see also Stone*, 911 A.2d at 365 (noting AmSouth and AmSouth Bank paid out $40 million and $10 million in civil penalties).

[99] *See* Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559, 560–61 (2008) (citing Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1494 (1984)) (noting that "most of what boards do 'does not consist of taking affirmative action on individual matters' but rather consists of a 'continuing flow of supervisory process'"); *id.* (citing Jonathan L. Johnson et. al., *Boards of Directors: A Review and Research Agenda*, 22 J. MGMT. 409, 411 (1996)) (finding that "[m]onitoring the performance of corporate management is not just one of the board's three principal functions, it is, arguably, *prima inter pares*").

[100] *Stone*, 911 A.2d at 366 ("FinCEN found that AmSouth violated the suspicious activity reporting requirements of the Bank Secrecy Act, and that . . . AmSouth has been in violation of the anti-money-laundering program requirements of the Bank Secrecy Act. Among FinCEN's specific determinations were its conclusions that AmSouth's [AML compliance] program lacked adequate board and management oversight, and that reporting to management for the purposes of monitoring and

Yet the Delaware court found that these same individuals properly executed their business oversight obligations.[101] For directors and officers, the ability to avoid personal liability when their company and company's shareholders suffer financial losses is problematic. Perhaps these officers and directors eventually lost their positions or had difficulties in securing future jobs from the reputational impact of the scandals, but by that time, the damage to the companies and shareholders was already done. To find that these individuals suffered no (or minimal) direct personal ramifications from the misbehavior that occurred under their watch underscores the dysfunctional nature of these Delaware standards. However, as mentioned above, the decisions remain good law and, in the case of *Caremark* specifically, academics and practitioners alike revere the decisions for their precedential value and longstanding functionality.[102]

The fact that the directors and officers suffered no personal liability even at the hands of federal regulators that found the companies culpable overall may have been reassuring in earlier times. This result reflects the federal regulatory regime and its priorities during a period when businesses were extended the benefit of the doubt.[103] However, with the advent of more stringent investigatory and enforcement standards under the Yates Memo, the oversight obligations under these two cases must evolve to better prepare companies and their decision makers to act prophylactically by: (1) designing and implementing effective oversight policies and procedures; (2) engaging in proactive review of the investigatory functions; and (3) when problems are discovered, taking definitive steps to remedy the situation.

While *Caremark* and *Stone* achieve the Delaware courts' goal of establishing a duty of oversight while simultaneously avoiding excessive judicial interference with the boardroom decision-making process, the decisions do not provide adequate direction to compel directors and officers to actively and authoritatively protect companies from misconduct. The *Caremark* duty to oversee legal compliance is not sufficiently specific to demand active director oversight of investigations. Further, it permits timid or self-preserving directors to avoid clashes with management that

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oversight of compliance activities was materially deficient." (internal quotation marks omitted)); Press Release, *supra* note 71 ("Caremark agreed to plead guilty to two one-count informations charging that it defrauded federal health-care programs by making improper payments to induce doctors and other professionals to refer patients to Caremark.").

[101] *See Caremark*, 698 A.2d at 971–72; *Stone*, 911 A.2d at 372–73.

[102] Sale, *supra* note 74, at 720–21, 755.

[103] *See* Daniel J.H. Greenwood, *Enronitis: Why Good Corporations Go Bad*, 2004 COLUM. BUS. L. REV. 773, 793–94 (2004) (noting that a climate supportive of the idea that "businesses-can-do-no-wrong" permitted Enron and companies like it to overpower regulatory measures).

could otherwise prevent costly investigations and legal proceedings in the future.[104]

One could argue, anecdotally, that since the advent of these oversight decisions under Delaware law, we have seen numerous instances of companies committing culpable actions that might have been stopped under a more rigorous oversight regime. In 2015, 66% of all Fortune 500 companies were incorporated under Delaware law, a figure that is up from 58% in 2000.[105] This represents a significant percentage of American businesses and, presumably, a number of these entities engaged in illegal conduct during this time. Additionally, Delaware judges are among the most renowned experts in business law.[106] Therefore, given its unique insight into complex business law, Delaware should be leading the pack to shift its policies as the federal government seeks to target individuals at an unprecedented rate.

The idea that Delaware must strike a balance between having legal standards that reflect pro-business principles on the one hand, and providing some means of redress for shareholders after acts of misconduct on the other, has been called into question in recent years.[107] The scandals of Enron,[108] WorldCom,[109] Tyco,[110] Volkswagen,[111] and Wells Fargo[112] all

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[104] Jennifer Arlen, *The Story of* Allis-Chalmers*,* Caremark*, and* Stone*: Directors' Evolving Duty to Monitor* 4–5 (N.Y.U. Law & Econ., Paper No. 160, 2008), http://lsr.nellco.org/nyu_lewp/160/ [https://www.perma.cc/7NBW-VAST].

[105] JEFFREY W. BULLOCK, DEL. DIV. OF CORP., DELAWARE DIVISION OF CORPORATIONS 2015 ANNUAL REPORT (2015), https://corp.delaware.gov/Corporations_2015%20Annual%20Report.pdf [https://www.perma.cc/E99M-VFXW].

[106] Semuels, *supra* note 44.

[107] *See id.* (noting Delaware has "little desire to change its laws to make them more employee-friendly"); *see also* Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1590 (2005) (noting that Delaware "cannot effectively regulate certain types of misconduct").

[108] *See* WILLIAM C. POWERS, REPORT OF THE SPECIAL INVESTIGATIVE COMMITTEE 22 (2002), http://i.cnn.net/cnn/2002/LAW/02/02/enron.report/powers.report.pdf [https://www.perma.cc/B8HU-PKRK] (determining the Enron Board of Directors failed in its oversight duties); *see also* S. REP. NO. 107-70, at 3, 13–14, 23 (2002), https://www.gpo.gov/fdsys/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf [https://www.perma.cc/P2BJ-5JGC] (concluding that the Enron Board of Directors failed to safeguard Enron shareholders).

[109] *See* DENNIS R. BERESFORD, NICHOLAS DEB. KATZENBACH & C.B. ROGERS, JR., REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE BOARD OF DIRECTORS OF WORLDCOM, INC. 30–33 (2003), https://www.sec.gov/Archives/edgar/data/723527/000093176303001862/dex991.htm [https://www.perma.cc/2V7C-57VC] (concluding "[t]he Board and its Committees did not function in a way that made it likely that they would notice red flags"); DICK THORNBURGH, FIRST INTERIM REPORT OF DICK THORNBURGH, BANKRUPTCY COURT EXAMINER IN RE: WORLDCOM, INC., ET. AL., (2002), http://news.findlaw.com/wsj/docs/worldcom/thornburgh1strpt.pdf [https://www.perma.cc/YPA8-L5K6] (noting the Audit Committee "did not appear to operate effectively").

[110] *See* Joann S. Lublin & Jerry Guidera, *Tyco's Board Is Criticized for Kozlowski Dealings*, WALL ST. J. (June 7, 2002), https://www.wsj.com/articles/SB1023407877377626960 [https://www.perma.cc/9VNS-26N8] (noting experts generally agreed the board was "far too unquestioning" and lacked sufficient oversight); William C. Symonds, *Commentary: Tyco: How Did*

reflect corporate decision-making environments where there was only minimal oversight. In response to these scandals, the federal government has acted in kind by attempting to change the rules of the game to facilitate better regulation and ultimately prevent misbehavior. Congress held hearings and ultimately passed the Sarbanes-Oxley Act.[113] The Securities and Exchange Commission ("SEC") has adopted new regulations and guidance since the early 2000s in an ongoing attempt to accelerate corporate oversight reform.[114] Even individual states passed new laws or sought criminal charges against executives that took part in the scandals.[115]

All the while, Delaware common law remains largely unchanged.[116] The bases of its legal standards have stayed the same over the past two decades while the federal regulatory standards have experienced an extensive overhaul.[117] This may be a result of the institutional mechanisms at work in Delaware. The courts' and legislature's most powerful constituents are the businesses that pay handsomely to incorporate within the state.[118] As evidence of the power corporations wield within the state, Delaware's Division of Corporations general fund revenue topped $1 billion in 2015, which accounts for 26% of the State of Delaware's

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They Miss a Scam So Big?, BLOOMBERG BUSINESSWEEK (Sept. 29, 2002), https://www.bloomberg.com/news/articles/2002-09-29/commentary-tyco-how-did-they-miss-a-scam-so-big [https://www.perma.cc/7K8P-N826] (commenting that the scandal would not have occurred had the board's oversight been adequate).

[111] See James B. Stewart, *Problems at Volkswagen Start in the Boardroom*, N.Y. TIMES (Sept. 24, 2015), https://www.nytimes.com/2015/09/25/business/international/problems-at-volkswagen-start-in-the-boardroom.html [https://www.perma.cc/Qm8Q-GJWD] (noting a scandal was "all but inevitable" due, in part, to its "clannish board"); Patrick Ambrosio, *Volkswagen Executives Implicated in Diesel-Cheating Scandal*, BLOOMBERG BNA (June 19, 2016), https://www.bna.com/volkswagen-executives-implicated-b73014445007 [https://www.perma.cc/MR5Y-B5H5] (noting there were "years of illegal activity that dozens of employees, corporate officers, and senior executives were aware of").

[112] *See* Andrew Ross Sorkin, *Pervasive Sham Deals at Wells Fargo, and No One Noticed?*, N.Y. TIMES (Sept. 12, 2016), https://www.nytimes.com/2016/09/13/business/dealbook/pervasive-sham-deals-at-wells-fargo-and-no-one-noticed.html [https://www.perma.cc/QK72-MHHA] (highlighting the disconnect between what the CEO "was telling the public and what was actually going on"); Michael Corkery, *Wells Fargo Fined $185 Million for Fraudulently Opening Accounts*, N.Y. TIMES (Sept. 8, 2016), https://www.nytimes.com/2016/09/09/business/dealbook/wells-fargo-fined-for-years-of-harm-to-customers.html?mcubz=0 [https://www.perma.cc/W4BH-G8L2] (noting the scandal "reflected serious flaws in the . . . oversight at Wells Fargo").

[113] Kahan & Rock, *supra* note 107, at 1617.

[114] *Id.*

[115] *Id.*

[116] *Id.*

[117] *Id.*

[118] In 2015, Delaware registered 480 companies per day and as of 2016, Delaware was home to more businesses (around 1.1 million) than residents (around 935,000). David Kocieniewski, *Delaware's $1 Billion Incorporation Machine*, BLOOMBERG (Apr. 27, 2016) https://www.bloomberg.com/news/articles/2016-04-27/delaware-s-1-billion-opacity-industry-gives-u-s-onshore-haven [https://www.perma.cc/2DXH-37EF].

general fund revenue.[119] This money comes directly from those companies that must pay business incorporation costs, taxes, and franchise fees in order to operate as Delaware companies.[120] Further, the court system is known for addressing controversy only when it is presented with a legal dispute on point in order to provide continuity.[121] However, Delaware continues to move forward without implementing overarching changes; instead, it offers methodical, incremental shifts over many years.[122]

From one perspective, Delaware may need to react soon to the changing tides or face the prospect of becoming irrelevant in the realm of director and officer oversight. As these acts of corporate malfeasance continue, it becomes increasingly likely that the Delaware common law oversight standards will fall upon deaf ears because they fail to effectuate adequate protection for the entity and its shareholders.[123] The common law may also be found to represent such a low bar when it comes to business oversight that it no longer has its intended legal value of establishing standards of behavior.[124]

Some commentators argue that *Caremark* already represents an irrelevant standard due to the fact that federal regulatory policy already established new, more rigorous requirements that make Delaware common law standards a mere afterthought.[125] In his article, Mercer Bullard argues that despite its "iconic status," *Caremark* plays only a small role in the application of corporate compliance programs because rational corporate actors seek to mitigate the risks that result in the greatest cost.[126] From Bullard's perspective, rational corporate actors are more likely to analyze oversight obligation decisions as one would evaluate free-market forces.[127] Under this theory, the Delaware courts' decisions in *Caremark* and *Stone* offer negligible guidance because the ultimate standards by which directors and officers are judged under federal regulatory law are much more

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[119] Bullock, *supra* note 105; *see* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 694 (2002) ("Delaware residents derive financial gains from providing professional services to public corporations incorporated in the state.")

[120] Semuels, *supra* note 44.

[121] Kahan & Rock, *supra* note 107, at 1617.

[122] *Id.* at 1576. Part of the reason for this slow evolution of Delaware law is its lack of competition from other state corporate courts. This preeminence is based on a number of "political and economic factors" including a specialized business court and its "extensive and widely known corporate case law." Kahan & Kamar, *supra* note 119, at 725–26.

[123] Mercer Bullard, Caremark*'s Irrelevance*, 10 BERKELEY BUS. L.J. 15, 19 (2013).

[124] *See id.* at 20 (noting administrative guidelines are more motivating than common law liability); *see also* Julian J. Z. Polaris, *Backstop Ambiguity: A Proposal for Balance Specificity and Ambiguity in Financial Regulation*, 33 YALE L. & POL'Y REV. 231, 262–63 (2014) ("Boards have a fiduciary duty to monitor for illegal conduct, but the monitoring system need only comport with the minimally adequate standard of the business judgment rule.").

[125] *See* Bullard, *supra* note 123, at 19–20.

[126] *Id.* at 16.

[127] *Id.* at 19.

imposing.[128] While Bullard's thesis may give some directors and officers more credit for their decision-making rationales than they deserve, the ultimate outcome is instructive: a director or officer that conforms his behavior to anything but the highest applicable standards leaves his company, and arguably himself, vulnerable to subsequent legal action.

While it remains unclear whether Delaware will ultimately change course and adapt to the changing regulatory environment, the court's prominent reputation stands to suffer if its decisions lack meaningful application to companies and their decision makers. The outcomes in the criminal prosecutions for the entities in *Caremark* and *Stone* support this assertion. Thus, it is with this mindset that we must evaluate just how the federal regulatory environment continues to evolve and incorporate more stringent standards for seeking personal liability, as it is likely that such standards are increasingly at odds with those found in Delaware.

II. CORPORATE CRIMINALITY IN THE CROSSHAIRS

The Yates Memo is the product of a regulatory environment that increasingly focused on the need for more criminal liability for corporate officers and executives in the face of scandal.[129] During that time, at least twenty-six Fortune 100 corporations were subject to federal criminal investigations.[130] However, instead of those investigations resulting in prison sentences for individual directors and officers of the companies, they largely resulted in the execution of non-prosecution agreements, deferred-prosecution agreements, or plea agreements.[131]

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[128] *Id.*

[129] *See* Michael P. Kelly & Ruth E. Mandelbaum, *Are the Yates Memorandum and the Federal Judiciary's Concerns About Over-Criminalization Destined to Collide?*, 53 AM. CRIM. L. REV., 899, 901–02 (2016) (noting that the DOJ was heavily criticized for not holding individuals criminally liable despite securing significant amounts of money through fines and penalties for corporate entity misbehavior).

[130] *Id.*

[131] *Id.*; *see also, e.g.*, *The Yates Memo*, FCPA PROFESSOR (Sept. 11, 2015), http://www.fcpaprofessor.com/the-yates-memo/ [https://www.perma.cc/7SBA-2AQT] (stating that between 2008 and 2014, 75% of corporate enforcement actions stemming from the Foreign Corrupt Practices Act failed to include charges against individual defendants); *see also* Michael C. Gross, Carolyn H. Kendall & Aaron S. Mapes, *Will Volkswagen Executives Be the Yates Memo's First Casualties?*, BLOOMBERG BNA, 2 (Jan. 4, 2016), http://www.postschell.com/site/files/post__schell__will_volkswagen_executives_be_the_yates_memos_first_casualties__bloomberg_bna__dec_15.pdf [https://www.perma.cc/FM7U-QKZF] (citing the Deferred Prosecution Agreements for JPMorgan Chase Bank from January 6, 2015, and General Motors Co. from September 17, 2015, as examples demonstrating that the government "has pursued only the company and resolved the case through a non- or deferred prosecution agreement imposing substantial corporate financial penalties but no jail time for executives").

For the DOJ, agreeing to alternative forms of punishment allowed it to collect extensive fines and effectuate other headline-grabbing penalties,[132] but it failed in its overarching goal to secure more criminal liability in a crusade that has stretched the administrations of multiple presidents and numerous Attorneys General.[133] The Yates Memo stands to change this dynamic by emphasizing individual liability without reducing the attention afforded to prosecutions of culpable entities.[134] As such, the Yates Memo signals a shift from the more entity-centric prosecutions of the past to incorporate a more individual-focused model moving forward.[135] In order to best analyze this movement, the Yates Memo must be reviewed against its predecessors to determine if the DOJ is indeed signaling a pending ground shift in policy to which corporations nationwide should react.

A. *Federal Targeting of Corporate Wrongdoing*

The custom of composing DOJ memos by sitting Deputy Attorneys General appears to have started with then-Deputy Attorney General Eric Holder in 1999.[136] Since then, many—but not all—Deputy Attorneys General have used the eponymous memo-writing process to announce

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[132] *See* Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Justice Department Collects More than $15.3 Billion in Civil and Criminal Cases in Fiscal Year 2016 (Dec. 14, 2016), https://www.justice.gov/opa/pr/justice-department-collects-more-153-billion-civil-and-criminal-cases-fiscal-year-2016 [https://www.perma.cc/SJR6-WV2X] (noting that the DOJ's collections in FY 2016 ending on September 30, 2016, totaled $15.3 billion and "represent[] more than five times the approximately $3 billion appropriated budget" for the department generally); Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Justice Department Collects More than $23 Billion in Civil and Criminal Cases in Fiscal Year 2015 (Dec. 3, 2015), https://www.justice.gov/opa/pr/justice-department-collects-more-23-billion-civil-and-criminal-cases-fiscal-year-2015 [https://www.perma.cc/U3R4-8SZJ] (noting that the DOJ's collections in FY 2015 ending on September 30, 2015, totaled $23 billion, including an $8.2 billion settlement in August with Bank of America for its actions leading up to the 2008 financial crisis).

[133] *See, e.g.*, Memorandum from Mark Filip, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys (Aug. 28, 2008), https://www.justice.gov/sites/default/files/dag/legacy/2008/11/03/dag-memo-08282008.pdf [https:/www.perma.cc/YA64-JRKX] (noting that the DOJ policy to hold individuals accountable for corporate misconduct has been in place for many years). The Filip Memo, released in 2008, noted: "Where a decision is made to charge a corporation, it does not necessarily follow that individual directors, officers, employees, or shareholders should not also be charged. Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation." *Id.*

[134] Yates, *supra* note 1.

[135] *See id.* at 4 ("[B]y focusing on individuals from the very beginning of an investigation, we maximize the chances that the final resolution of an investigation uncovering the misconduct will include civil or criminal charges against not just the corporation but against culpable individuals as well."); Brandon L. Garrett, *The Corporate Criminal as Scapegoat*, 101 VA. L. REV. 1789, 1794 (2015) (citing a new DOJ memorandum "amending its guidelines to reflect a focus on individual accountability for corporate crimes").

[136] Jim Letten & Carol Montgomery, *The Yates Memo: What New Challenges to Expect*, LAW 360 (Jan. 3, 2016), https://www.law360.com/articles/738741/the-yates-memo-what-new-challenges-to-expect [https://www.perma.cc/XP85-HHLM].

general policies and identify any long-term goals.[137] All the while, the political environment in Washington, D.C., continues to change, making it difficult to determine if the priorities under one administration will carry on to the next. Along those lines, despite a fear by some that the Trump Administration might not take prosecution of individual corporate wrongdoers seriously,[138] Attorney General Jeff Sessions vowed in April 2016 that "[t]he Department of Justice will continue to emphasize the importance of holding individuals accountable for corporate misconduct. It is not merely companies, but specific individuals, who break the law. We will work closely with our law enforcement partners, both here and abroad, to bring these persons to justice."[139] Therefore, despite the inevitable degree of uncertainty regarding how vigorously the current or any subsequent administration might adhere to long-term policy commitments embodied in prior DOJ memos, a brief review of those DOJ memos over the past twenty years uncovers some key principles that animate prevailing prosecutorial practices.

1. *The Holder Memo (1999)*

The Holder Memo stemmed from the efforts of a working group coordinated by the DOJ that also included representatives from the

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[137] *See, e.g.*, Memorandum from James M. Cole, Deputy Att'y Gen., U.S. Dep't of Justice, to All U.S. Att'ys (Aug. 29, 2013), https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf [https://www.perma.cc/S6UR-K5V4] (offering guidance regarding marijuana enforcement); Memorandum from David W. Ogden, Deputy Att'y Gen., U.S. Dep't of Justice, to Selected U.S. Att'ys (Oct. 19, 2009), https://www.justice.gov/sites/default/files/opa/legacy/2009/10/19/medical-marijuana.pdf [https://www.perma.cc/BY2L-ADUZ] (announcing formal guidelines for federal prosecutors in states that authorize the medical use of marijuana); Memorandum from Paul J. McNulty, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys (Dec. 12, 2006), https://www.justice.gov/sites/default/files/dag/legacy/2007/07/05/mcnulty_memo.pdf [https://www.perma.cc/7SYX-YJYL] (offering guidance on DOJ policy regarding the prosecution of business organizations). The foregoing examples demonstrate that numerous former Deputy Attorneys General have issued memorandums to announce new Department of Justice policies.

[138] *See, e.g.*, Bethany McLean, *Why White-Collar Crooks May Be Cheering This Jeff Sessions Memo*, YAHOO FINANCE (Mar. 21, 2017), https://finance.yahoo.com/news/why-white-collar-crooks-may-be-cheering-this-jeff-sessions-memo-133115487.html [https://www.perma.cc/57QX-628S] (noting that Attorney General Jeff Sessions's March 8 memo "directs prosecutors to focus not on corporate crime, but on violent crime").

[139] Jeff Sessions, Att'y Gen., Dep't of Justice, Remarks at Ethics and Compliance Initiative Annual Conference (Apr. 24, 2017), https://www.justice.gov/opa/speech/attorney-general-jeff-sessions-delivers-remarks-ethics-and-compliance-initiative-annual [https://www.perma.cc/HQL2-CYLT]; *see also* Matt Zapotosky, *Sessions: Focus on Violent Crime Doesn't Mean Lax Enforcement for White-Collar Offenses*, WASH. POST (Apr. 24, 2017), https://www.washingtonpost.com/world/national-security/sessions-focus-on-violent-crime-doesnt-mean-lax-enforcement-for-white-collar-offenses/2017/04/24/d36d4034-2906-11e7-be51-b3fc6ff7faee_story.html?nid&utm_term=.5106977a04a5/ [https://www.perma.cc/PE4Z-F8EZ] ("Attorney General Jeff Sessions vowed Monday not to diminish the Justice Department's focus on corporate fraud, asserting that a vigorous interest in violent crime would not diminish its long-standing mission to prosecute white-collar offenders.").

USAO.[140] While the Holder Memo was the DOJ's first statement on how to create uniform guidelines on corporate prosecution,[141] it received little fanfare initially because the United States was thriving economically and prosecuting corporations was not "en vogue."[142] Nevertheless, Holder drafted the Holder Memo in response to complaints about the lack of a uniform approach to charging corporations for their misbehavior.[143]

The Holder Memo included eight factors to guide prosecutors' analysis of whether to bring charges against a corporation in a particular case.[144] As such, the memo and the factors therein were not compulsory.[145] The memo highlighted the deterrence value of bringing suit against corporations and the idea that setting an example will ultimately lead to a change in the culture of indicted corporations and their employees.[146]

The primary focus of the memo was to provide guidance on the prosecution of corporations, and importantly, it included a reminder in Section I, subsection (B) that "[c]harging a corporation, however, does not mean that individual directors, officers, employees, or shareholders should not also be charged."[147] The memo went on to note that corporations alone do not engage in criminal conduct and are only culpable for acts of natural persons.[148] Therefore, the acts of management personnel of culpable corporations should be analyzed, but very little guidance was offered in determining if individuals should be formally prosecuted.[149]

It is also important to note that the Holder Memo intended to direct line prosecutors to follow specific guidance on how to prioritize DOJ policies and determine when to be lenient with corporations under

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[140] Memorandum from Eric Holder, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys 1 (June 16, 1999), https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2010/04/11/charging-corps.PDF [https://www.perma.cc/SN27-46X8] (noting that the ad hoc working group included USAO members, the Executive Office of U.S. Attorneys, and Divisions within the Department with criminal law enforcement responsibilities).

[141] Cindy A. Schipani, *The Future of the Attorney-Client Privilege in Corporate Criminal Investigations*, 34 DEL. J. CORP. L. 921, 945 n.167 (2009) (citing Lawrence D. Finder, *Internal Investigations: Consequences of the Federal Deputation of Corporate America*, 45 S. TEX. L. REV. 111, 113–14 (2003)).

[142] Erik Paulsen, *Imposing Limits on Prosecutorial Discretion in Corporate Prosecution Agreements*, 82 N.Y.U. L. REV. 1434, 1449 (2007).

[143] Nicole T. Amsler, *Leveling the Playing Field: Applying Federal Corporate Charging Considerations to Individuals*, 66 DUKE L.J. 169, 190 n.133 (2016) (citing Peter Lattman, *The Holder Memo and Its Progeny*, WALL ST. J. (Dec. 13, 2006), http://blogs.wsj.com/law/2006/12/13/the-holder-memo/ [https://www.perma.cc/KFB9-2YM7]).

[144] Holder, *supra* note 140, at 3.

[145] *Id.*

[146] *Id.* at 2.

[147] *See id.* at 2–3 (stating that prosecutors should evaluate the "pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management").

[148] *Id.* at 4.

[149] *Id.*

investigation.[150] While the eight factors informed prosecutors' decisions of whether to bring charges,[151] they also suggested that corporate prosecutions could be deferred if the corporation took appropriate steps to prevent the wrongdoing.[152] Specifically, the factors focused on the "pervasiveness of the wrongdoing" within the organization,[153] the corporation's "timely and voluntary disclosure" of wrongdoing and cooperation in the investigation,[154] "the existence and adequacy of the corporation's compliance program,"[155] and the corporation's attempts to remedy the situation by creating or improving its compliance program or addressing personnel issues.[156] Together, these factors largely focused on the ability of a corporation to limit its own criminal liability and, at least contextually, it appeared that the criminal prosecution of individual actors was a second-tier priority.

2. *The Thompson Memo (2003)*

Shortly after the release of the Holder Memo, the economic prosperity enjoyed throughout the late 1990s and early 2000s gave way to a series of serious public accounting scandals involving economic powers such as Enron and WorldCom.[157] These scandals and others that came to light during this period made it evident that further reforms were needed in the area of corporate prosecutions.[158] Specifically, the DOJ sought to address a pervasive corporate culture determined to make profits at all costs.[159] Based on these concerns, sitting Deputy Attorney General Larry Thompson composed the Thompson Memo by amending the Holder Memo's initial directives.[160]

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[150] *See* Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 968 n.122, 969 (2009) (citing Michael Siegel, *Corporate America Fights Back: The Battle over Waiver of the Attorney-Client Privilege*, 49 B.C. L. REV. 1, 3–4 (2009) ("Prior to 1998, DOJ had no set policy regarding the prosecution of corporations . . . .")).

[151] Holder, *supra* note 140, at 3.

[152] *See id.* at 3 (stating that what the company is doing to correct its behaviors should be taken under consideration when deciding how to proceed with a corporate target); *see also* Baer, *supra* note 150, at 968–69.

[153] Holder, *supra* note 140, at 3.

[154] *Id.*

[155] *Id.*

[156] *Id.*

[157] Paulsen, *supra* note 142, at 1449–50.

[158] *See id.* at 1450 (stating that after a series of corporate crimes were committed, the DOJ reprioritized how it dealt with corporate crimes).

[159] *Id.*

[160] Beth A. Wilkinson & Alex Young K. Oh, *The Principles of Federal Prosecution of Business Organizations: A Ten-Year Anniversary Perspective*, 27 N.Y. ST. B. ASS'N INSIDE 8; *see* Amsler, *supra* note 143 (stating that the Thompson Memo was published in 2003 as part of a renewed effort by the Department of Justice).

The Thompson Memo emphasized the concept of corporate cooperation during the investigatory process.[161] Specifically, the memo sought to increase the quality and authenticity of a corporation's cooperation when the federal government investigated it for wrongdoing.[162] At issue was the fact that many corporations cooperated facially with investigations while behind the scenes they were intentionally impeding investigations altogether.[163] The memo stated that corporations that do offer timely, voluntary, and truthful disclosures should benefit in order to encourage adherence to the policy.[164]

Additionally, the Thompson Memo escalated the Holder Memo's eight factors from optional guidelines[165] to binding requirements.[166] The Thompson Memo also added a ninth factor to be considered: "the adequacy of the prosecution of individuals responsible for the corporation's malfeasance."[167] This ninth factor indicated that the DOJ intended to include the severity of punishment incurred by individuals in the consideration of the entity's culpability and vice versa. Boosting the emphasis on individual liability, the memo also stated that only in rare situations would individuals not be pursued, even if a corporation offered to plead guilty.[168]

The Thompson Memo represented a significant shift because it coincided with both a simultaneous rise in the number of prosecutions of the United States' largest public companies and an ever-more hostile

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[161] Memorandum from Larry Thompson, Deputy Att'y Gen., U.S. Dep't of Justice, to Heads of Dep't Components and U.S. Att'ys 1 (Jan. 20, 2003), https://www.americanbar.org/content/dam/aba/migrated/poladv/priorities/privilegewaiver/2003jan20_privwaiv_dojthomp.authcheckdam.pdf [https://www.perma.cc/G6F2-VJJU].

[162] *Id.*

[163] *See id.* at 6–8 (providing examples such as broad assertions, directions to employees to not cooperate, and incomplete production of records).

[164] *See id.* at 3, 6–8 (stating that in some instances, immunity or amnesty is considered when a corporation voluntarily discloses information).

[165] *See* Holder, *supra* note 140, at 1 ("Federal prosecutors are not required to reference these factors in a particular case, nor are they required to document the weight they accorded specific factors in reaching their decision.").

[166] *See* United States v. Stein, 435 F. Supp. 2d 330, 338 (S.D.N.Y. 2006), *aff'd*, 541 F.3d 130 (2d Cir. 2008) ("Unlike its predecessor, however, the Thompson Memorandum is binding on all federal prosecutors."); *id.* at 338 n.12 ("The Thompson Memorandum sets forth nine factors that federal prosecutors must consider in determining whether to charge a corporation or other business organization." (citing U.S. DEPARTMENT OF JUSTICE, CRIMINAL RESOURCE MANUAL § 163 (2005))); *see also* John Power, *Show Me the Money: The Thompson Memo,* Stein*, and an Employee's Right to the Advancement of Legal Fees Under the McNulty Memo*, 64 WASH. & LEE L. REV. 1205, 1217 (2007) ("Unlike the Holder Memo, intended only to provide guidance, the Thompson Memo was binding on all federal prosecutors.").

[167] Thompson, *supra* note 161, at 3.

[168] *See id.* at 1 ("Only rarely should provable individual culpability not be pursued, even in the face of offers of corporate guilty pleas.").

regulatory environment.[169] The DOJ incorporated the nine factors identified in the memo in the U.S. Attorney's Manual in response to "concerns regarding attorney-client privilege and corporate payment of attorney's fees."[170] The Thompson Memo's drafting process also reflected a more holistic effort politically. Less than six months before the release of the Thompson Memo, President George W. Bush established his Corporate Fraud Task Force "in order to strengthen the efforts of the Department of Justice and . . . to investigate and prosecute significant financial crimes . . . ."[171] President Bush's Corporate Fraud Task Force worked closely with the DOJ and the Attorney General's Advisory Committee to draft the Thompson Memo.[172]

With this growing momentum, prosecutors interpreted the memo as an implied grant of power to reach further than they had previously in order to secure cooperation.[173]

This emphasis on cooperation manifested itself under the application of the fourth factor due to its relation to the waiver of attorney-client privilege and work product protection.[174] The Thompson Memo noted that frequently "business organizations, while purporting to cooperate with a Department investigation, in fact take steps to impede the quick and effect exposure of the complete scope of wrongdoing under investigation."[175] To combat these issues, the memo listed four sub-factors under the fourth factor on cooperation, including the corporation's willingness to: (1) "identify the culprits within the corporation"; (2) "make witnesses available"; (3) "disclose complete results of its internal investigation"; and (4) "waive attorney-client privilege and work product protection."[176]

These sub-factors were the source of significant criticism, especially given their implications on "the rights, privileges, and interests of the corporation and those of its employees."[177] Ultimately, the Thompson Memo faced immense backlash from a variety of sources alleging that the

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[169] *See* Brandon L. Garrett, *The Metamorphosis of Corporate Criminal Prosecutions*, 101 VA. L. REV. ONLINE 60, 63 (2016) (noting that the guidelines for corporations shifted from a more lenient structure under the Leniency Program to a strict structure under the Thompson Memo).

[170] *Id.* at 63–64.

[171] Exec. Order No. 13,271, 67 Fed. Reg. 46,091 (July 11, 2002).

[172] *See* Thompson, *supra* note 161 (stating that the DOJ worked in conjunction with the Corporate Fraud Task Force and the Attorney General's Advisory Committee to create the memorandum).

[173] *See* Baer, *supra* note 150, at 969–70 ("The Thompson Memorandum's ostensible guidance to prosecutors was understood as the government's attempt to flex its muscle and force corporations to hand over otherwise protected documents . . . ."); Schipani, *supra* note 141, at 948 ("[T]he Thompson Memorandum shifts the prosecutor's focus further to the evaluation of cooperation.").

[174] Thompson, *supra* note 161, at 3 ("[T]he corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection . . . .").

[175] *Id.* at i.

[176] *Id.* at 6.

[177] Schipani, *supra* note 141, at 949.

DOJ was abusing its power by compromising protected legal rights.[178] The American Civil Liberties Union, American Bar Association, National Association of Manufacturers, and the U.S. Chamber of Commerce combined to lobby against the measures.[179] Senator Arlen Spector introduced new legislation that would amend the DOJ's policy under the Thompson Memo.[180] Due to the pressure, the DOJ finally released a new memo in 2006.[181]

3. *The McNulty Memo (2006)*[182]

Paul McNulty, the Deputy Attorney General from 2005 to 2006,[183] announced a policy shift in the way that the attorney-client privilege waiver was handled by the DOJ and the USAO under the Thompson Memo.[184] The McNulty Memo followed significant criticism of the Thompson Memo's provisions pertaining to attorney-client privilege and the potential impact that waiver had during regulatory investigations.[185] After a coalition of business and legal organizations expressed concerns about the provisions in the Thompson Memo,[186] the Senate Committee on the Judiciary held hearings to enact the Attorney-Client Privilege Act of 2006.[187]

Then, on December 12, 2006, the DOJ released the McNulty Memo, incorporating the key aspects of the policy announced in the Attorney-Client Privilege Act.[188] The McNulty Memo stated that federal prosecutors seeking privileged attorney-client communications or legal

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[178] Paulsen, *supra* note 142, at 1435.

[179] *Id.* at 1435 n.5 (citing Jason McLure, *Coalition Scores Major Victory in Policy Retreat: How Business, Civil Liberties Groups Pushed DOJ to Alter Fraud Stance*, LEGAL TIMES (Dec. 18, 2006), http://advance.lexis.com/ (search in search bar: "LNSDUID-ALM-LGLTME-LT_2006_12_14609350324372541469")).

[180] *Id.* (citing Lynnley Browning, *Senator Calls for an Easing of Corporate-Wrongdoing Rules*, N.Y. TIMES, Dec. 8, 2006, at C3 (noting that the proposed bill would amend the "nine factors that prosecutors must consider when weighing whether to indict" and "is the latest challenge to the tactics, which have come under scrutiny from trade groups, former United States attorneys general and a prominent federal judge")).

[181] *See* N. Richard Janis, *The McNulty Memorandum: Much Ado About Nothing*, WASH. LAW., Feb. 2007, at 37 ("As a result of these pressures . . . the Department of Justice, with great fanfare, on December 12, 2006, replaced the Thompson Memorandum . . . .").

[182] *See* Letten & Montgomery, *supra* note 136 (noting that the Thompson Memo "for the most part remained in effect" through Deputy Attorney General James (Jim) B. Comey's tenure from 2003–05).

[183] *Id.*

[184] *See* McNulty, supra note 137, at 8 n.2 ("The reference to consideration of a corporation's waiver of attorney-client . . . protections in reducing a corporation's culpability score . . . was deleted effective November 1, 2006.").

[185] Janis, *supra* note 181, at 35.

[186] McLure, *supra* note 179.

[187] Janis, *supra* note 181, at 37.

[188] *Id.* at 37, 39.

advice given to a company had to first secure written approval from the Deputy Attorney General.[189] Also, the McNulty Memo included direction that emphasized the DOJ's consideration of a corporation's meaningful compliance programs.[190] These provisions were directly related to the perception that the Thompson Memo had gone too far in its policies relating to the waiver of attorney-client privilege, and demonstrated the power of industry maintaining a watchful eye on the DOJ moving forward.[191]

However, even under the McNulty Memo's new terms, prosecutors and corporations continued to battle over attorney-client privilege problems that doomed the Thompson Memo.[192] The clamor for change eventually led the House Judiciary Committee's Subcommittee on Crime, Terrorism, and Homeland Security to hold hearings in 2007 to determine whether the McNulty Memo's guidance did enough to resolve the concerns stemming from the Thompson Memo.[193] When Congress threatened new legislation addressing the lingering concerns in the McNulty Memo, the DOJ reacted with yet another revision.[194]

4. *The Filip Memo (2008)*

The most recent memo, preceding the Yates memo, comes from Deputy Attorney General Mark Filip, who served from 2008 to 2009.[195] The Filip Memo's most important revision focused once again on cooperation credit and whether credit is dependent upon a waiver of attorney-client privilege.[196] The memo stated that waiver of privilege was not, and had never been, a prerequisite to the subject of an investigation being viewed as cooperative.[197] The memo went on to state that a prosecutor should never ask a corporation to waive its protections under attorney-client privilege.[198] Rather, the memo clarified that the emphasis

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[189] McNulty, *supra* note 137, at 10.

[190] Letten & Montgomery, *supra* note 136.

[191] Janis, *supra* note 181, at 37–38.

[192] Baer, *supra* note 150, at 970 (citing Sarah Helene Duggin, *The McNulty Memorandum, the* KPMG *Decision and Corporate Cooperation: Individual Rights and Legal Ethics*, 21 GEO. J. LEGAL ETHICS 341, 364 (2008)).

[193] *The McNulty Memorandum's Effect on the Right to Counsel in Corporate Investigations: Hearing Before the Subcomm. on Crime, Terrorism, and Homeland Security of the H. Comm. on the Judiciary*, 110th Cong. 1–2 (2007); Lynnley Browning, *Some Lawyers Urge More Safeguards on Rights in Corporate Fraud Cases*, N.Y. TIMES (March 8, 2007), https://www.nytimes.com/2007/03/08/business/08legal.html?mtrref=www.google.com&gwh=1DD1D4C05FB9A3180C308E75CB4410D7&gwt [https://www.perma.cc/LT2U-2TJP].

[194] Baer, *supra* note 150, at 970–71.

[195] Letten & Montgomery, *supra* note 136.

[196] Filip, *supra* note 133, at 1, 9.

[197] *Id.* at 8.

[198] *Id.* at 9.

should be on whether the corporation provided investigators with all relevant facts.[199]

In addition to announcing that attorney-client privilege was not a consideration in determining whether to charge an entity, the Filip Memo stated that a company's determination that it would pay its employees' legal fees was also not a consideration for cooperation credit.[200] The Filip Memo's changes marked a significant winnowing down of the considerations available to prosecutors when determining whether to charge companies for misconduct. However, cooperation credit remained an extremely important tool for companies under investigation to potentially limit liability.[201] As the legality of prior policies came under fire, the DOJ was forced to react in kind. Thus, by the time the Filip Memo was released, the "cooperation" in cooperation credit consisted of the disclosure of all relevant factual information to the investigation, but it did not include the waiver of any privileges.[202]

B. *The Yates Memo*

The directives in the memos leading up to the Yates Memo share a number of collective principles, but they largely reflect a slow, methodical shift toward securing increased individual accountability for wrongdoing. This is to be expected given that the memos typically revise or build upon, instead of wholly replace, their predecessors' policies.[203] Therefore, the announcement of the Yates Memo was especially significant because it foreshadows another significant ground shift specifically targeting criminally culpable corporate actors.[204]

When the DOJ issued the Yates Memo on September 9, 2015,[205] it represented the fifth such memo in fifteen years to address the prosecution of wrongdoing by corporate entities and individuals.[206] The Yates Memo is

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[199] *Id.*

[200] *Id.* at 13.

[201] *Id.* at 7–8.

[202] *See id.* at 7–12, 14 (describing how the government does not seek a "waiver of those protections, but rather the facts known to the corporation" in its investigations).

[203] *See* Lawrence D. Finder, *Internal Investigations: Consequences of the Federal Deputation of Corporate America*, 45 S. TEX. L. REV. 111, 115–16 (2003) (providing an example of replacing and revising a DOJ memo).

[204] *See* William Ortman, *The Yates Memo Versus Administrative Law*, 165 U. PA. L. REV. ONLINE 191, 192–93 (2017) (describing how the Yates memo was "a continuation" of previous DOJ memos but created a "'substantial shift' in policy").

[205] Yates, *supra* note 1.

[206] Michael J. Shepard, Samuel Welch & Beau Shaw, *The Future of Internal Investigations After Yates Memorandum*, 48 BNA ENV'T REP. 259, 259 (2017); David N. Mahler, *Recent DOJ Memos and Investigations into Corporate Wrongdoing*, ABA (Dec. 4, 2015), https://www.americanbar.org/groups/litigation/committees/securities/practice/2015/recent-doj-memos-and-investigations-into-corporate-wrongdoing.html [https://www.perma.cc/653X-CGRT].

broken up into six directives that have already been incorporated into the U.S. Attorney's Manual.[207] The Yates Memo states that it will apply to both criminal and civil corporate investigations that occur both in the future and those pending as of the date of the Yates Memo's release.[208]

This section will first describe each of the directives in greater detail. In order to determine the viability of the Yates Memo's effectiveness, a brief discussion of the initial commentary will follow. The section will culminate with a discussion of how the Yates Memo interacts with the current standards used to govern federal oversight investigations.

1. *Cooperation Credit*

The Yates Memo's most striking policy change pertains to the extension of cooperation credit for companies that are under investigation.[209] The policy states that in order "[t]o be eligible for any cooperation credit, corporations must provide to the Department [of Justice] all relevant facts about the individuals involved in corporate misconduct."[210] Cooperation credit is used by the DOJ and other regulatory bodies to lower the liability for corporations that provide timely and thorough disclosures of all facts pertaining to the matter at issue.[211] This disclosure requirement also pertains to facts about culpable individuals from the outset.[212]

If the directive is strictly interpreted, it will require companies seeking cooperation credit to not only disclose what they know about the actions taken to date, but also to engage in the process of learning the facts necessary to meet the DOJ's needs.[213] Only then, once the company has met this new threshold test, can the company even be considered eligible to receive cooperation credit according to the "other traditionally applied factors."[214] This policy represents a sharp change from memos in the past. As Deputy Attorney General Yates stated:

> In the past, cooperation credit was a sliding scale of sorts and companies could still receive at least some credit . . . even if they failed to fully disclose all facts about individuals. That's

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[207] Yates, *supra* note 1, at 2–3. It is interesting to note that the Thompson Memo, McNulty Memo, and Filip Memo shared the uniform subject of "*Principles of Federal Prosecution of Business Organizations*." In contrast, the Yates Memo's subject is "*Individual Accountability for Corporate Wrongdoing*," perhaps representing how the newest iteration will differ from its predecessors in more ways than one.

[208] *Id.* at 3.

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] *Id.* at 3–4.

[213] *Id.* at 3.

[214] Kelly & Mandelbaum, *supra* note 129, at 906–07.

> changed now. . . . [P]roviding complete information about individuals' involvement in wrongdoing is a threshold hurdle that must be crossed before we'll consider any cooperation credit.[215]

Commentators have labeled this an "all-or-nothing" proposition[216] that assumes that companies are currently withholding significant information from investigators.[217] While the validity of this concern might vary on a case-by-case basis, a company faces the difficult task of proceeding without cooperation credit that was once a key mitigation benefit used by corporations for leverage in negotiating less severe penalties. Also, the policy significantly increases the burden for corporations to find information about culpable individuals.[218] Rather than settling with a company's stated failure to find culpable individuals, the new guidance basically requires the company to bring forth an individual or group of individuals, or disclose all of the information used to determine that no culpable individual was involved. This disclosure may include information that is or is not privileged,[219] reintroducing problems of the not-so-distant past.

There are numerous implications for companies under the new application of the cooperation policy. First, engaging in potential "life or death" investigations may require incredible expense and longer periods of investigation.[220] This could be detrimental to normal business operations, which ultimately hurts not just the company but also its shareholders. Second, because of its all-or-nothing structure, companies can no longer receive partial credit for partial disclosure.[221] Therefore, some companies may determine that engaging in the process as defined under the Yates Memo is too costly and decide to go silent or not fully engage in the process.[222] This would require the DOJ to conduct a full investigation with little chance of receiving internal assistance without compromising its goal

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[215] Sally Q. Yates, Deputy Att'y Gen., U.S. Dep't of Justice, Remarks at American Banking Association and American Bar Association Money Laundering Enforcement Conference (Nov. 16, 2015), http://www.justice.gov/opa/speech/deputy-attorney-general-sally-quillian-yates-delivers-remarks-american-banking-0 [https://www.perma.cc/32QH-AF88].

[216] Ryan Hedges & Kirsten Konar, *Yates Memo Creates a Privilege Paradox for GCs*, LAW360 (Feb. 5, 2016, 1:00 PM), http://www.law360.com/articles/755157/yates-memo-creates-a-privilege-paradox-for-gcs [https://www.perma.cc/EGG4-2K3Y]; Kelly & Mandelbaum, *supra* note 129, at 906.

[217] Kelly & Mandelbaum, *supra* note 129, at 907.

[218] *Id.* at 909.

[219] G. Douglas Jones & Christopher J. Nicholson, *The Rules Have Just Changed: DOJ Issues New Guidance Targeting Individuals in Corporation Investigations*, 77 ALA. LAW. 264, 268 (2016).

[220] *See* Kelly & Mandelbaum, *supra* note 129, at 909–10 (noting that the increasing emphasis on internal investigations will result in companies being compelled to offer separate attorneys at an earlier stage, increasing expenses and slowing down the overall investigatory process).

[221] Jones & Nicholson, *supra* note 219, at 267.

[222] Kelly & Mandelbaum, *supra* note 129, at 910.

of prosecuting all culpable parties. If this strategy is initially successful in stifling regulatory action, it could also become the norm, which would defeat the policy's overall goal. Third, the process of engaging in an internal investigation that employees know is intended to identify and isolate culpable individuals will likely encounter resistance.[223] Employees will be less inclined to cooperate with management without hiring their own personal counsel, and lower level employees that cannot afford to do so may determine that it is in their best interest to not participate at all.

Despite these potential concerns, the cooperation credit policy delivers an undeniably strong message that the DOJ wants to increase personal liability at all costs. For those officers and directors tasked with designing and implementing oversight programs, the cooperation credit policy provides an added incentive to design a program that can quickly and definitively identify culpable individuals. Once a DOJ investigation is underway, this will permit the board and management to react swiftly and present investigators with the information needed to benefit from the cooperation policy. However, if these systems of oversight are not yet in place, the prospect of going without cooperation credit becomes much more likely as the DOJ will no longer accept marginal or incomplete information.

2. *Individual Culpability*

The second directive also speaks directly to the DOJ's desire to increase individual liability. The policy states that both "criminal and civil corporate investigations should focus on individuals from the inception of the investigation."[224] While early directives like the Holder Memo or the Thompson Memo merely alluded to personal liability as an ancillary part of a DOJ investigation, this policy reflects the idea that if individuals are targeted at the outset, it is more likely that they will be held culpable at the end when charges are filed.[225]

The Yates Memo identifies three goals in relation to the policy.[226] First, the policy seeks to maximize the discovery of corporate wrongdoing, because the corporation itself can only act through individuals.[227] Second, the policy increases the likelihood that individuals with knowledge of the facts at issue will cooperate and provide information on other culpable individuals further up the managerial hierarchy.[228] This goal is especially important in the context of corporate oversight as lower-tier employees

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[223] Hedges & Konar, *supra* note 216.
[224] Yates, *supra* note 1, at 2.
[225] *Id.* at 4.
[226] *Id.*
[227] *Id.*
[228] *Id.*

may be more inclined to provide incriminating information against those that hold positions of power. Third, the policy increases the chance that the ultimate resolution of the investigation will result in criminal and/or civil charges being filed not only against the company, but also against culpable individuals.[229]

From the perspective of company employees, this policy presents challenges because investigators must be dissuaded of their initial conceptions of events rather than being led naturally to make reasonable assessments from facts as they are discovered. If an actor is identified at the outset of an investigation as being potentially culpable, that individual must either convince investigators that he or she is not involved in the misconduct, or in the alternative, provide information that would inculpate another. Again, this dynamic has the potential to dramatically shift the internal relations of a company and might make it costlier to defend.

3. *Investigator Communication*

The third policy prioritizes the need for the DOJ to maximize the efficacy of its resources by demanding that "[c]riminal and civil attorneys handling corporate investigations . . . be in routine communication with one another."[230] This policy is by no means revolutionary, but its inclusion in the Yates Memo reflects the idea that the DOJ seeks to formalize its investigatory and prosecutorial processes in order to effectuate the best results. It also signals that the DOJ is preparing for an increased workload and wants to make sure that its policies and procedures foster efficiency and communication.

Practically speaking, the policy will require attorneys at the beginning of a respective case to contact the "other side of the house" about the investigation.[231] While this may present potential issues regarding the permissible disclosures stemming from the civil side to the criminal side, and vice versa, the goal is to exchange as much information as possible under the direction of the law.[232]

4. *Individual Immunity*

The fourth policy states that "[a]bsent extraordinary circumstances, no corporate resolution will provide protection from criminal or civil liability for any individuals."[233] While the actual application of the other policies may result in more anxiety for directors and officers, this policy is extremely concerning for corporate personnel on its face. Under the

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[229] *Id.*
[230] *Id.*
[231] Jones & Nicholson, *supra* note 219, at 269.
[232] *Id.*
[233] Yates, *supra* note 1, at 5.

directive, the government will not enter into any agreement with a company where immunity is offered or other charges are dismissed for potentially culpable individuals unless there are "extraordinary circumstances."[234] Although it is unclear what extraordinary circumstances might be in practice, the fact that these exculpatory "deals" are only available now in special cases is concerning for directors and officers. As evidence of the procedural hurdles that must be cleared to offer such benefits, the prosecutor must secure personal approval in writing from the relevant supervising Assistant Attorney General or U.S. Attorney on the case in order to grant immunity.[235] This is a high threshold that indicates that immunity will no longer be granted without sufficient justification that furthers the DOJ's overarching goals.

5. *Exculpatory Limitations*

The fifth policy outlined by the Yates Memo relates strongly to the fourth policy and requires corporate cases to "not be resolved without a clear plan to resolve individual cases before the statute of limitations expires and declinations as to individuals in such cases must be memorialized."[236] This policy basically removes any excuse the DOJ might have for missing out on an opportunity to prosecute an otherwise culpable individual.[237]

Specifically, the policy requires that when a company resolves its offenses at a time before the resolution of all related individual investigations or prosecutions, the DOJ attorney must include a number of key facts in the prosecution or corporate authorization memorandum.[238] First, the attorney must include a discussion of any potentially liable individuals.[239] Second, the attorney must include a description of the current status of the investigation of individuals and any ongoing work that is still not complete.[240] Third, the attorney must include a plan to bring the investigation to a close within the applicable statute of limitations period.[241] This largely procedural policy indicates that the DOJ will not permit cases of potentially culpable individuals to go stale and result in a missed opportunity. This represents a strong rhetorical device that motivates DOJ personnel to maintain a close eye on drawn-out investigations and also indicates to potentially culpable individuals that they are unlikely to sneak by on a technicality.

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[234] *Id.*
[235] *Id.*
[236] *Id.* at 6.
[237] *Id.*
[238] *Id.*
[239] *Id.*
[240] *Id.*
[241] *Id.*

6. *Irrelevance of Ability to Pay*

The final policy directs DOJ civil attorneys to no longer consider a potentially culpable individual's ability to pay a fine when deciding whether to bring suit. Instead, the attorneys should give equal weight to the deterrent value of the proposed civil action, the value of a winning recovery at trial, and the ability for a civil penalty to take away any benefit the suspect has garnered via his misconduct to ensure that the individual cannot profit from his wrongdoing.[242] The Yates Memo also looks at the practical effects that engaging in a civil suit might have on individuals.[243] The benefit that is achieved in deterring similar behavior and also disclosing to the public that its resources are being protected is important to changing the current perceptions about corporate legal action.

When considered together, the Yates Memo's six policies carry a strong and frightening message to all levels of company actors: the rules have changed. However, the real implications of the Yates Memo have yet to be seen. The best indication of the Yates Memo's efficacy at this time is garnered through a review of commentators' projections and how companies are interpreting the policies.

C. *Applying Yates: More Bark than Bite?*

The Yates Memo's release resulted in responses from the legal community that ran the gamut from the perspective that the policies are nothing new and will have no impact to extreme concern that the corporate liability structure as we know it is about to fall to pieces.[244]

A significant number of commentators expressed their belief that the Yates Memo will do what it sets out to do—at least to varying degrees. The commentators on this side of the debate are far more cautious about the extent to which the Yates Memo will work given that it was just recently released. They also defer to the need for patience, as the Yates Memo will take time to enact and produce identifiable results.[245]

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[242] *Id.*

[243] *See id.* at 7 ("Although in the short term certain cases against individuals may not provide as robust as a monetary return on the Department's investment, pursuing individual actions in civil corporate matters will result in significant long-term deterrence.").

[244] Robert R. Stauffer & William C. Pericak, *Twenty Questions Raised by the Justice Department's Yates Memorandum*, BNA (May 18, 2016), https://jenner.com/system/assets/publications/15188/original/Stauffer_Pericak_Bloomberg_May_2016.pdf?1463730304 [https://www.perma.cc/6SNK-VML9].

[245] *See* Maria E. Douvas et al., *The Yates Memo: Six Months Later*, PAUL HASTINGS: INSIGHTS (Mar. 9, 2016), https://www.paulhastings.com/publications-items/details?id=a7b1e869-2334-6428-811c-ff00004cbded [https://www.perma.cc/9NVP-AZRD] (discussing the practical implications of the Yates memo); Michael W. Peregrine, *Is the Risk of Director Liability Really a "Myth"?*, LAW360 (Nov. 23, 2015, 10:24 AM), https://www.law360.com/articles/730046 [https://www.perma.cc/MRH5-VTCW] (stating that the uncertainty surrounding the Yates memo could add to liability concerns).

The Yates Memo's primary goal is to signal a change in policy where individual liability is a strong priority.[246] Also, because of the Yates Memo's explicit terms, the expectations for companies conducting internal investigations have never been clearer.[247] Whereas other prosecutorial directives have included similarly—or even the same—strong language, the simultaneous public relations campaign that followed the Yates Memo's release supports the idea that the DOJ means business.[248] Further, the consequences for failing to meet those expectations are also explicitly clear,[249] leaving directors and officers to seek out additional information from counsel about the Yates Memo's implications.

As such, a number of commentators included their ideas on what companies should prepare for.[250] The primary message advises directors and officers to plan for the very real possibility that they will face individual liability.[251] This message has two applications. First, directors and officers should review the company's compliance and oversight programs.[252] Being able to exercise oversight with or without significant warnings will provide additional protection by showing that the board and management were fully engaged. In addition, the oversight and compliance programs should be able to quickly react to the needs of the company under an internal investigation based on the higher standards announced in the Yates Memo.[253] Second, directors and officers should review their liability packages to understand the increased risks under the Yates Memo's policies.[254] Specifically, attention should be given to determining whether penalties and fines are covered if assessed by the regulatory agency, and how prosecutions involving multiple defendants under the same plan affect an individual's coverage.[255]

While the preparations outlined above imply that commentators believe that the Yates Memo will have an impact on business oversight, it is unclear when this will occur. The reaction throughout the legal

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[246] Peter J. Henning, *The Prospects for Pursuing Corporate Executives*, N.Y. TIMES (Sept. 14, 2015), https://www.nytimes.com/2015/09/15/business/dealbook/theprospects-for-pursuing-corporate-executives.html [https://www.perma.cc/PGW5-JSBH].

[247] Hedges & Konar, *supra* note 216.

[248] *Id.*

[249] *Id.*

[250] *See, e.g.*, Donna C. Boehme, *1 Year After Yates Memo: The Wrong Internal Investigation*, LAW360 (Oct. 3, 2016, 12:13 PM), https://www.law360.com/articles/839077/1-year-after-yates-memo-the-wrong-internal-investigation [https://www.perma.cc/G8MR-ULVM] ("At a minimum, companies will want to be able to demonstrate that their compliance investigations are robust and likely to bring the relevant facts to decision-makers."); Peregrine, *supra* note 245 (outlining ways to mitigate individual director liability risks).

[251] Peregrine, *supra* note 245.

[252] *Id.*

[253] Boehme, *supra* note 250.

[254] Peregrine, *supra* note 245.

[255] *Id.*

community seems to imply that the Yates Memo has already had a modest impact based on the preparatory actions taken by many companies, but it will be some time before we can conduct any empirical analysis. For companies and their directors and officers, the prospect of falling behind may be too risky to wait and see how the Yates Memo's policies are interpreted. Therefore, engaging in preemptive reviews of company oversight and compliance policies, as well as the director and officer protections, are prudent measures.

On the other hand, the primary concerns from commentators that believe the Yates Memo will be ineffective start with the idea that its primary goal is nothing new.[256] This perspective relies on the fact that many of the memos from prior Deputy Attorneys General had similar aspirations of increasing individual liability.[257] However, none of these memos contain the same degree of explicit language that escalates personal liability to the same priority level as attaining liability for companies. The Yates Memo states in no uncertain terms that individual liability is equally as important as company liability. It then goes on to reinforce this premise with six concise policies that directly speak to that goal.

Other commentators believe the Yates Memo will be ineffective because of its practical impediments.[258] The policies under prior memos also encouraged company cooperation, and while the new policies under the Yates Memo add requirements, the situation remains the same: the DOJ can only make a case based on the information made available to it.[259] Again, while this critique is warranted, the added pressure for companies to open up to the investigators or suffer the consequences results in a high-stakes gamble. This pressure is also extended to individuals more directly under the new policies and may drive increased disclosures.

Another practical complication raised by more skeptical commentators as well as those that believe the policies will work is the potential that the Yates Memo's directives will consume too many DOJ resources to remain sustainable.[260] Again, only time will tell the validity of this concern. If the DOJ's directives are interpreted to require prosecutions in each and every situation where culpable individuals are found, the requisite manpower will

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[256] *See* Joseph W. Yockey, *Beyond Yates: From Engagement to Accountability in Corporate Crime*, 12 N.Y.U. J.L. & BUS. 407, 411 (2016) ("[T]he memo represents little more than a written statement of how the game has always been played."); Kirby Behre et al., *A Review of Government Cases Against Execs in Q1*, LAW360 (Apr. 21, 2016, 5:54 PM), https://www.law360.com/articles/787663/a-review-of-gov-t-cases-against-execs-in-q1 [https:www.perma.cc/AWF3-KGJ2] (noting that "critics continue to label the Yates memo a potentially meaningless prosecutorial policy that is nothing more than an 'empty threat'").

[257] Yockey, *supra* note 256, at 411.

[258] *Id.* at 413.

[259] *Id.* at 412–13.

[260] Jones & Nicholson, *supra* note 219, at 272.

be immense. However, it should also be noted that the policies under the Yates Memo require investigations to be carried out largely by the companies themselves. Assuming that this is an effective and trustworthy process, the obligations of the DOJ during an investigation may lessen and allow DOJ personnel to engage in the pursuit of other directives.

The reception of the Yates Memo upon its announcement reflects the impact that new policies can have on the market. While some have dismissed the Yates Memo as more of the same old policy seen in other DOJ memos, others have reacted strongly by advising companies to review their internal policies in preparation for potential problems. For Delaware, the prospect of waiting until the companies incorporated within the state are being subjected to personal criminal liability could be a significant risk. With its prominent position in the field of corporate law and its heavy reliance on the revenues it receives as the business law leader,[261] Delaware would be best suited to look closely at the Yates Memo and incorporate the necessary changes to its oversight standards to best protect against individual culpability.

III. DIRECTORIAL DUTIES REDIRECTED

In what way, if any, should Delaware common law react to the Yates Memo's stringent prosecutorial posture towards corporate criminality? Some already suggest a significant retooling of Delaware's existing fiduciary duty framework is necessary because *Caremark* and *Stone* provide precious little guidance regarding the necessary steps directors and officers must take to exercise sufficient oversight.[262] Under the existing common law approach, "[i]n theory, directors face potential liability for failed oversight. But in practice it is viewed as an unworkable and virtually meaningless standard where liability exists only within a very narrow procedural footing."[263] As the Delaware Supreme Court stated in *Caremark*, a claim based on failed oversight is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[264] Indeed, Delaware courts continue to place strict limits on establishing oversight liability that effectively immunize directors from responsibility except when "directors knowingly and completely fail"[265] to act in light of obvious corporate misconduct.

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[261] Bullock, *supra* note 105.

[262] Eric J. Pan, *Rethinking the Board's Duty to Monitor: A Critical Assessment of the Delaware Doctrine*, 38 FLA. ST. U.L. REV. 209, 217 (2011); Martin Petrin, *Assessing Delaware's Oversight Jurisprudence: A Policy and Theory Perspective*, 5 VA. L. & BUS. REV. 433, 473 (2011); Nees, *supra* note 26, at 204–05.

[263] Nees, *supra* note 26, at 205.

[264] *In re* Caremark Int'l, 698 A.2d 959, 967 (Del. Ch. 1996).

[265] Petrin, *supra* note 262, at 456.

The shortcomings under the rather lax Delaware common law approach to oversight become especially pronounced in light of the potential for criminal prosecution. If a director could remain insulated from civil liability under *Caremark* and *Stone* yet face criminal culpability under state or federal law, the guidance provided by Delaware common law regarding oversight obligations seems almost irrelevant if not bizarre. Avoiding jail seems a far greater priority than suffering some economic loss, which might in any case be covered by a blanket director and officer ("D&O") liability insurance policy.[266] Indeed, as a result of the prosecutorial shift under the Yates Memo,

> allegations of director oversight conduct that would not have been sufficient to withstand a motion to dismiss in the Caremark "bad faith/conscious disregard" context, would nevertheless be enough for the DOJ expert to argue that the company's compliance program was ineffective (because of inadequate board oversight), and for government attorneys to persist in an investigation of potential individual or organizational liability.[267]

Moreover, the imposition of criminal liability on a director would likely trigger an exception to the business judgment rule and remove the presumption that the director's oversight practices comported with common law fiduciary obligations.[268] In that respect, the Delaware common law appears rather schizophrenic: oversight practices that arguably passed fiduciary muster retroactively fail the same test once criminal liability attaches on other grounds.

To prevent such bizarre outcomes, Delaware common law must bend to fit the reality of the prosecutorial climate currently facing directors and officers. Gaining confidence in that conclusion requires a brief explication of some various options Delaware courts and the legislature might pursue. The first involves a simple stand-still where Delaware continues on its common law course as if the actions of government prosecutors have no impact on the import and application of Delaware law. The second option involves extending the "bad faith" exception to the business judgment rule that would proactively involve a consideration of the potential criminality of otherwise protected oversight practices. The third, and most cogent approach, involves enhancing the content of the common law standards articulated in *Caremark* and *Stone* to reflect the oversight obligations directors and officers actually face.

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[266] *Id.* at 449–50.

[267] Peregrine, *supra* note 39.

[268] Lisa M. Fairfax, *On the Sufficiency of Corporate Regulation as an Alternative to Corporate Criminal Liability*, 41 STETSON L. REV. 117, 118 (2011).

A. *Delaware Stands Its Ground*

Doing nothing represents the easiest but most dangerous course for Delaware to pursue. Retaining, unchanged, the holdings in *Caremark* and *Stone* would cast a blind eye to the change in prosecutorial policies and double down on the notion that directors and officers enjoy the protection of the business judgment rule—and therefore escape civil liability—with little oversight effort.[269] To the extent a glaring incongruity develops between the guidance Delaware fiduciary duties provide to officers and directors and the ultimate civil and criminal liability those corporate managers face, Delaware law will lose its place as the primary standard for guiding corporate behavior.[270]

Perhaps the stand-still approach would reflect a calculation that the Yates Memo will not have its anticipated impact and the frequency of finding individually culpable directors and officers in both the criminal and civil context will remain low.[271] However, if Delaware gambles on this outcome and the Yates Memo is modestly enforced, there will be a significant gap between the standards outlined in *Caremark* and *Stone*, and those required from officers and directors by the DOJ.[272] Unlike the application of *Caremark*, where directors and officers were found to not be criminally liable for their failure to properly administer the company's oversight program,[273] future cases could involve high-level personnel partaking in civil trials after being found to be criminally culpable for failing to engage in proper oversight.[274] Furthermore, if the lax oversight systems established under current Delaware law are not subject to additional requirements, the Yates Memo's directives for cooperation and investigatory assistance will leave many of Delaware's companies without

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[269] *See* Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis,* 2013 U. ILL. L. REV. 859, 861–63 (2013).

[270] Sue Reisinger, *A Year Later, GCs Say Yates Memo Undermining Their Roles*, CORPORATE COUNSEL (Sept. 18, 2016), http://advance.lexis.com/ (search in search bar: "LNSDUID-ALM-CORPCM-1202766991930").

[271] *See, e.g.*, Douvas et al., *supra* note 245 (explaining that the Yates Memo has not yet had lasting effect); *see also* Pal Monnin & Eric D. Stolze, *Everything Old is New Again: Why the Yates Memo is Constitutionally Suspect*, PAUL HASTINGS: INSIGHTS, (Jan. 10, 2016), https://www.paulhastings.com/publications-items/details/?id=5cffe769-2334-6428-811c-ff00004cbded [https://www.perma.cc/76EP-RVGT] (explaining that the impact of the Yates Memo will likely only be felt over time and through its application in prosecutions).

[272] Jay Dubow et al., *The Spring Meeting Confronts the Yates Memo: Execs in the Front lines of Corporate Criminal Responsibility; Presentation of the Business Law Section's Director and Officer Liability Committee*, BUS. L. TODAY (Aug. 8, 2016), http://www.americanbar.org/publications/blt/2016/08/08_dubow.html [https://www.perma.cc/5PHV-DMRH].

[273] Stone v. Ritter, 911 A.2d 362, 372–73 (Del. 2006); *In re* Caremark Int'l Inc., 698 A.2d 959, 971–72 (Del. Ch. 1996).

[274] Paul J. Larkin, Jr. & John-Michael Seiblier, *All Stick and No Carrot: The Yates Memorandum and Corporate Criminal Liability*, 46 STETSON L. REV. 7, 22–25 (2016).

sufficient systems to qualify for cooperation credits that lower their exposure and liability.

The implications for the business community in general are also an important consideration. As the Yates Memo is implemented, any number of these companies' directors and officers might be subject to criminal liability, but remain civilly protected by the business judgment rule. While this may be acceptable for some companies, others will seek to conform to the law that best represents the most stringent requirements applicable. In that case, Delaware's reputation is likely to suffer and it could see a decrease in the number of entities incorporating there annually. For those companies that continue to incorporate in Delaware and adhere to the less stringent requirements, the potential of suffering federal liability is significant. In 2015, Delaware had 1.18 million entities incorporated under its law.[275] With such a substantial percentage of American businesses adopting Delaware standards as their state law, many public companies could be vulnerable to federal liability.

B. *The Bad Faith Exception*

A second option for Delaware is to apply the business judgment rule's bad faith or illegality exception.[276] Delaware's business judgment rule includes a presumption that directors of a corporation make decisions on "an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[277] However, this presumption may be rebutted "if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or *acted in bad faith*."[278] Under these Delaware cases, the showing of illegal activity by a plaintiff should preclude the use of the business judgment rule for protection against personal liability.[279]

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[275] Bullock, *supra* note 105.

[276] *See* Wheeler v. The Pullman Iron & Steel Co., 32 N.E. 420, 423 (Ill. 1892) (explaining that the decisions of the board of directors must be allowed to control the business unless "in violation of its charter, or some public law, or corruptly or fraudulently subversive of the rights and interest of the corporation"); Shlensky v. Wrigley, 237 N.E.2d 776, 778 (Ill. App. 1968) (stating the rule that courts will not interfere with the decisions of the board of directors, whether good or bad, unless those decisions are made in bad faith).

[277] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[278] *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 52 (Del. 2006) (emphasis added).

[279] *See* Thomas A. Uebler, *Shareholder Police Power: Shareholders' Ability to Hold Directors Accountable for Intentional Violations of Law*, 33 DEL. J. CORP. L. 199, 214 (2008) ("[A] showing of illegality by the plaintiff—alone—should rebut the presumptions of the business judgment rule."); *see also* Stephen Bainbridge, *Does an Intentional Violation of Law = Bad Faith?*, PROFESSORBAINBRIDGE.COM (June 8, 2006), http://www.professorbainbridge.com/professorbainbridgecom/2006/06/does-an-intentional-violation-of-law-bad-faith.html [https://www.perma.cc/LTM6-KLSJ] ("[T]he Third Circuit held that the business judgment rule did not insulate . . . directors from liability for illegal acts . . . .").

In order for Delaware to apply the exception, it must be assumed that the criminal proceeding against a company and its directors and officers has already come to a conclusion by the time a civil trial commences. In *Caremark*[280] and *Stone*,[281] the results of the criminal proceedings were already known to the court when the civil trials took place under Delaware law. Thus, the Delaware court could then determine if criminally culpable behavior took place according to the outcome of the criminal proceedings against the defendant and then determine if the business judgment rule would apply in the civil proceeding.[282] And of course, in *Caremark* and *Stone*, the directors faced no liability for failed oversight despite the rampant criminal activity afoot within the corporation.[283]

If a director or officer were tried criminally prior to a civil suit, a conviction should be permissible evidence to support a finding that illegal behavior took place when adjudicated in the civil proceeding.[284] Similarly, a criminal acquittal should not be used to prove that the individual's behavior was legal in a civil proceeding, and a plea bargain should not bar a finding that the individual did not engage in illegal behavior either.[285] In each scenario, the outcome of the criminal trial should simply stand as evidence, but the plaintiff in the criminal proceeding would have to still mount a winning case. This would help winnow out cases that lack sufficient evidence and prevent a deluge of derivative lawsuits from shareholders hoping to capitalize on the lower evidentiary threshold.

In cases where a criminal proceeding has not reached its ultimate conclusion, a corporation or potentially liable individuals could consider requesting a stay of a related civil proceeding until after the criminal trial.[286] The decision of whether to stay a civil proceeding is likely

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[280] *See In re* Caremark Int'l Inc., 698 A.2d 959, 965–66 (Del. Ch. Ct. 1996) (stating that the criminal trial outcome had already been announced to the public).

[281] *See* Stone v. Ritter, 911 A.2d 362, 365–366 (Del. 2006) (relating that it was public knowledge that AmSouth was being investigated and what its criminal fines were).

[282] Kevin LaCroix, *The Business Judgment Rule Under Attack*, THE D&O DIARY (Jan. 24, 2014), http://www.dandodiary.com/2014/01/articles/director-and-officer-liability/guest-post-the-business-judgment-rule-under-attack/ [https://www.perma.cc/5H4F-K5VP].

[283] *See supra* notes 71–73 and accompanying text (describing the civil and criminal penalties levied against Caremark and its executives); *see also Stone*, 911 A.2d at 365 (holding that the directors of a company where violations of the law were occurring were not liable).

[284] *See* Larkin & Seibler, *supra* note 274, at 36–38 (discussing potential benefits to prosecutors of sharing criminal and civil investigative information).

[285] *See id.* (discussing the importance of strengthening prosecutors' ability to investigate and prosecute directors who have acted illegally).

[286] William Sullivan, *Yates Memo: Increasing the Perils of Parallel Proceedings*, LAW360 (Nov. 3, 2015), https://www.law360.com/articles/720868/yates-memo-increasing-the-perils-of-parallel-proceedings [https:www.perma.cc/9MFR-RBNJ]; s*ee also* Tony Maida & Rebecca C. Martin, *The Perils of Parallel Proceedings: To Stay or Not to Stay*, MCDERMOTT WILL & EMORY: FCA UPDATE (Sept. 22, 2016), http://www.fcaupdate.com/2016/09/the-perils-of-parallel-proceedings-to-stay-or-not-to-stay/ [https://www.perma.cc/LR2N-RNZR] (noting examples of stay requests for civil trials until after the related criminal trial under the application of the False Claims Act).

dependent in part on the amount of overlap between the facts of the related criminal and civil trials.[287] If a corporation or individual believes that the facts support a finding of not guilty in the criminal context, then it might be favorable to wait until after the criminal proceeding is completed. However, if they believe that they will lose, then staying the decision would grant plaintiffs an opportunity to use that information against them.

Regardless of the procedural complexities regarding the application of the bad faith exception, the approach still misses the essential point that absent some strengthening of Delaware common law oversight obligations, the fiduciary duty framework will no longer provide relevant guidance to officers and directors. Instead, corporate counsel will need to look to a variety of other state and federal laws dealing with oversight obligations to determine the minimal steps necessary to avoid civil and criminal liability.[288] Quite simply, absent significant enhancement of the current common law standards, Delaware fiduciary principles regarding corporate oversight obligations will get cast to the periphery of relevance.

C. *Enhancing* Caremark *and* Stone

By enhancing the oversight standards articulated *Caremark* and *Stone*, Delaware courts could adopt a more rigorous set of guidelines for business oversight that reflect the reality of the world directors and officers inhabit. But what would a revamping of *Caremark* and *Stone* actually entail? Any effort that falls short of the what the Yates Memo reflects would still risk the obsolescence of Delaware fiduciary standards. Therefore, retaining the preeminence of Delaware law as the guiding light of corporate behavior, the common law standards governing corporate compliance should closely reflect the standards for oversight stated in the U.S. Attorney's Manual ("USAM"), as amended in the wake of the release of the Yates Memo.

USAM § 9-28.800 provides the provisions relating to the Yates Memo's Corporate Compliance Programs.[289] The section states that corporate management systems are meant to "prevent and detect misconduct" and "ensure that corporate activities are conducted in accordance with applicable criminal and civil laws, regulations, and

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[287] Maida & Martin, *supra* note 286.

[288] William F. Johnson, *Analyzing Early Returns on the Yates Memo; Corporate Crime*, N.Y. L.J. ONLINE (Mar. 3, 2016), http://advance.lexis.com/ (search in the search bar: "LNSDUID-ALM-NYLAWJ-1202751162691"); Marc S. Raspanti, *What the Yates Memo Means for Federal Criminal and Civil Corporate Investigations*, WHITE-COLLARED (Dec. 4, 2015, 9:18 AM), http://www.white-collared.com/blog/2015/12/4/what-the-yates-memo-means-for-federal-criminal-and-civil-cor.html [https://www.perma.cc/744J-8ER2]; LaCroix, *supra* note 282.

[289] UNITED STATES DEP'T OF JUSTICE, *supra* note 37, § 9-28.800.

rules."[290] These provisions are standard and would largely reflect even the current law from *Caremark* and *Stone*. However, the USAM goes on to state that "the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct undertaken by its officers, directors, employees, or agents."[291] This provision would require an overhaul of the first prong of *Caremark*, which states in part that "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is necessary to condition liability."[292] Similarly, *Stone*'s first prong is equally incongruent with the USAM directive, stating that a director must "utterly fail[] to implement any reporting system or controls" thereof to be culpable.[293]

In order to better reflect the Yates Memo's directives and provide both an adequate warning and establish a proper floor for a Delaware company to abide by federal law, the Delaware courts would have to engage in a qualitative analysis of the oversight system that is in place. Although engaging in such substantive review certainly represents a shift in how the common law presumption of the business judgment rule gets applied, permitting the floor for oversight activity to remain so insubstantial is incongruent with the USAM requirements. Nonetheless, no need for violent jurisprudential shockwaves exists. With a narrow set of facts related specifically to egregious oversight (arguably subject to criminal liability in the federal prosecutorial context), the exception for willful blindness under *Stone* could be expanded quite easily.[294] Luckily, Delaware courts are well suited to engage in such a far-reaching endeavor based on their structure and ability to create judge-made law.[295] Indeed, the Delaware courts often instigate reform outside the legislative process in order to ensure the efficiency and efficacy of standards guiding business practices.[296]

To provide additional direction to the Delaware court in conceiving the language of the new rule, the USAM provides two factors of analysis used to evaluate any oversight program.[297] First, is whether "the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees."[298] Second, is whether the corporate

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[290] *Id.*
[291] *Id.*
[292] *In re* Caremark Int'l Inc., 698 A.2d 959, 971 (Del. Ch. 1996).
[293] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).
[294] *See id.* at 369–72 (describing the exception for willful blindness).
[295] Kahan & Rock, *supra* note 107, at 1576, 1590–91.
[296] *Id.* at 1591.
[297] UNITED STATES DEP'T OF JUSTICE, *supra* note 37, §9-28.800 (B).
[298] *Id.*

management is "enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives."[299] Taken together, these two factors require active engagement with the oversight system implemented by a company in order to even begin an analysis of whether director and officers are potentially liable.

The second factor is especially relevant to addressing the second prong of *Stone*, which required a director or officer to "consciously fail[] to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[300] Under the second factor of the USAM, the second prong of *Stone* would be insufficient in its oversight requirements. Instead, directors and officers would be expected to enforce the program and react quickly and decisively to stop any perceived misconduct.

The degree to which Delaware wholly adopts the USAM directives would depend on the apparent vulnerability of the companies subject to the new regulatory framework. If the Yates Memo is seen as being applicable to every company equally, then Delaware should take great care to adopt a broad version of the USAM standard. If the Yates Memo is only likely to apply to corporations within the Fortune 500, Delaware can adjust the language of the resulting rule to exclude closely held entities and those that have only minute oversight liability.

Ultimately, the best alternative for Delaware would be to enhance significantly the oversight standards articulated in *Caremark* and *Stone*. By adopting more robust oversight requirements that mirror the Yates Memo's requirements, Delaware would offer the best protection for companies incorporated in the state with fewer obstacles than the other two alternatives. Not engaging in any fiduciary law reform leaves Delaware companies extremely vulnerable to liability under the Yates Memo's new directives. Also, failing to react to the new policies could cause Delaware's law to become irrelevant as corporate counsel realize they cannot protect their clients by seeking the flimsy umbrella of protection afforded under the business judgment rule.[301]

In addition, the prospect of using the illegality exception to the business judgment rule has weaknesses. First, there may be evidentiary obstacles to using the evidence or convictions from criminal proceedings against defendants in civil trials. For example, under Federal Rule of Criminal Procedure 6(e), criminal prosecutors are generally precluded from sharing evidence garnered during a grand jury hearing with civil

[299] *Id.*

[300] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

[301] Kelly & Mandelbaum, *supra* note 129, at 899.

prosecutors.[302] Another consideration is the use of strategic stays to protect the over extension of access to evidence through discovery. Due to the more expansive scope of the civil discovery process when compared to the criminal discovery process, defendants might attempt to use a stay in the civil proceeding so that the criminal proceeding is not tainted by evidence that would not be otherwise discoverable.[303] Second, there are potential concerns relating to the manner in which the civil and criminal investigations might interact.[304] For the DOJ, the ability to rely on the two investigatory bodies is a great benefit and helps increase efficiency. However, from a business's perspective, the prospect of abiding by the Yates Memo's cooperation policies in order to receive credit in a criminal proceeding only to have the information that is disclosed be used against it in the civil context will make the new system untenable. It would be much more likely that corporations would decide to go silent and not engage in any exchange of information in order to avoid potentially incurring liability on both the civil and criminal fronts.[305]

Under Delaware's more rigorous, new standard, the obligation for officers and directors to actively engage in the oversight process could generate positive benefits for companies of all sizes.[306] The board and management would be far more likely to be aware of any issues that present risks to the company if the failure to monitor or oversee operations exposed directors and officers to personal liability. This is true whether the entity is large or small because the obligation is the same across the board. Further, if the company identified an internal scandal, it would be in position to address it immediately rather than having it linger and potentially spread. This could preclude subsequent investigations or suits under the Yates Memo's new terms simply by addressing the problem before it reached a critical mass.

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[302] James Koukios, *3 Ways the Yates Memo May Affect FCA Cases*, LAW360 (Feb. 16, 2016), https://www.law360.com/articles/759309/3-ways-the-yates-memo-may-affect-fca-cases [https://www.perma.cc/52J8-THVL].

[303] *See* Sullivan et al., *supra* note 286 ("Because pre-trial discovery rules for civil proceedings are much broader than for criminal proceedings, providing discovery in a civil proceeding may prove disadvantageous. While courts are not required to stay civil proceedings in the absence of 'substantial prejudice,' courts have discretion to enter a stay based on a particularized inquiry into the circumstances of each case.").

[304] Maida & Martin, *supra* note 286.

[305] Kelly & Mandelbaum, *supra* note 129, at 936; *see also* Ted Banks & James Lord, *Compliance Programs, Individual Liability, and the Yates Memo: Has Anything Changed?*, AM. BAR ASS'N (June 2016), http://www.americanbar.org/publications/blt/2016/06/03_lord.html [https://www.perma.cc/STN3-KJU3] ("[T]here may be situations where the proper legal defense strategy is to force a prosecutor to prove his or her case, without cooperation.").

[306] *See, e.g.*, Banks & Lord, *supra* note 305, at 3 ("[B]y cooperating fully (including identifying all culpable individuals), a company can send a useful message to its workforce of what happens when one does not follow the compliance program: the corporation will not bail you out.").

The new standard would also bolster Delaware's business judgment rule jurisprudence and perform the standard-setting function that is currently missing. Perhaps most importantly, the rules create a synergy between the obligations expected from the Delaware courts and the federal regulatory entities. The likelihood that a director or officer would be subject to criminal liability under federal law and be protected by the business judgment rule under Delaware law is greatly diminished. While there may be costs to the Delaware court system initially, the eventual changes that will occur when directors and officers prioritize business oversight from a preemptive perspective, instead of a reactive perspective, are significant.

IV. IMPLICATIONS

Enhancing Delaware's common law standards regarding compliance and oversight would produce significant advantages for the public, Delaware corporations, and officers and directors. Although some risks certainly exist as well,[307] the drawbacks fail to tip the scale in favor of jurisprudential stasis.

A. *More Successful Prosecutions of Individuals*

Under a system that effectively melds the federal standards outlined in the Yates Memo and the Delaware common law regarding managerial oversight, it will be more likely that criminal prosecutions of individuals will result in guilty verdicts. The reason for this is twofold. First, as the new Delaware standard is accounted for in board rooms throughout the country, companies are more likely to incorporate stronger, more effective oversight systems in order to comply with the law.[308] These systems will be better suited to identify problems in a company's operations and will also alert the board and directors to misconduct among low-level and middle-level employees. Because these employees' liability is often easier to identify,[309] more mundane infractions will be discovered, addressed internally, and reported voluntarily based on the desire to benefit from

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[307] *See* Kelly & Mandelbaum, *supra* note 129, at 900 (explaining that stock prices increase after a settlement, and trust in the company decreases based on prosecutions); Monnin & Stolze, *supra* note 271 (noting how the Yates Memo destabilizes corporate decision making and affects the integrity of prosecutions).

[308] *See* Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REG. (Jan. 2, 2015), https://corpgov.law.harvard.edu/2015/01/02/delaware-and-the-transformation-of-corporate-governance/ [https://www.perma.cc/K3M9-LZN7] (noting that Delaware is a leading influencer in the transformation of corporate governance without taking direct action and instead relying on its overarching impact).

[309] Gross et al., *supra* note 131, at 5.

cooperation credit.[310] As these systems winnow down the number of actionable instances of misconduct, the DOJ is more likely to engage in investigations of alleged misconduct against companies that have committed serious offenses simply because the other, less-severe actions are more easily identified and handled by the entity itself.[311]

Second, in sharp contrast, the companies that are most vulnerable are those that do not have compliance systems or have systems that are so mismanaged, neglected, or dysfunctional that they offer no benefit to either the entity by deterring and identifying misbehavior or to DOJ investigators as a benefit used to grant cooperation credit.[312] As such, these companies and their directors and officers are far more likely to fall victim to the investigatory pitfalls outlined, which the Yates Memo seeks to punish. These directors and officers are also less likely to prevail at trial because they will not benefit from cooperation credits and their internal investigations will reap less useful evidence than those entities with established systems.[313]

The DOJ is also likely to become more efficient in its investigatory process as time passes. By encouraging companies to have strong, established business oversight policies, the DOJ is facilitating the oversight process and also setting the table for internal investigations. For those companies that comply and still encounter problems, the DOJ will have a streamlined set of standards that they can use to review the company's actions and determine who knew what and when, resulting in more personal liability with less work for DOJ personnel. By engaging and benefitting from a company's own investigatory resources, the DOJ also saves time and money at the initial stages of a prosecution. Ultimately, this will result in culpable individuals within the company being subject to personal liability on both the civil and criminal fronts.

B. *Increased Investor Confidence*

The stakes are also high for the market under the new standard. Delaware law has enormous implications for public companies traded on the global financial markets. Historically, investor confidence ebbs and flows based on the latest corporate scandal that comes to light and thus

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[310] Banks & Lord, *supra* note 305, at 1.

[311] *See id.* ("A company implementing an 'effective' compliance program under the Federal Sentencing Guidelines does so to demonstrate that it used due diligence to "prevent and detect wrongdoing.").

[312] *See* Yockey, *supra* note 256, at 411 (noting that prior DOJ directives engaging in some form of compliance permitted consideration of cooperation credits, but under the Yates Memo a corporation or individual must comply in order to be considered for cooperation).

[313] *See* Jones & Nicholson, *supra* note 219, at 271 (finding that corporations that want to preserve the option to benefit from cooperation credit will create compliance regimes and internal investigations that generate evidence of individual wrongdoing).

erodes investor confidence.[314] By adopting clearly articulated and reasonable standards, companies can better adapt their policies to the rules of the game. This will create more stability and over time, lower the number of market-shaking scandals. By actively engaging in oversight and in some cases, hiring compliance personnel to prevent misconduct, companies might also use their clean records as a means of showing their investors that they are trustworthy and engaging in business the right way.[315]

As major corporate scandals have shown, the financial markets are becoming increasingly inaccessible to the lower and middle classes.[316] Part of this stems from a lack of confidence in corporate management to do the right thing and address serious issues before massive legal expenses are incurred and regulatory fines are levied. Instead, a select few collect a disproportionate amount of the wealth and common stakeholders are left to pick up the costs for misconduct in the form of legal fees, fines, and settlements.[317] This all-too-frequent problem betrays the notion that society confers special benefits upon corporations with the idea that they exist for legal convenience and not for the purposes of engaging in unregulated misconduct and abuse.[318] By using criminal and civil law in tandem as

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[314] *See, e.g.*, Nicholas Brautlecht & Alessandro Speciale, *German Investor Confidence Drops as Volkswagen Woes Damp Outlook*, BLOOMBERG L. (Oct. 13, 2015), https://www.bloomberg.com/news/articles/2015-10-13/german-investor-confidence-drops-as-volkswagen-woes-damp-outlook [https://www.perma.cc/75M5-BFS7] (noting that investor confidence in Volkswagen dropped significantly after the emission defeat device scandal became public in September 2015); D.M. Levine, *Barclays Scandal Bad News for Investor Confidence*, HUFFPOST (July 5, 2012, 6:31 PM), http://www.huffingtonpost.com/2012/07/03/barclays-scandal-investor-confidence_n_1647715.html [https://www.perma.cc/9975-68WU] (reflecting the string of Wall Street scandals that preceded the 2008 financial crisis, such as the Facebook IPO and banking scandals at JPMorgan Chase and Barclays, as having a negative impact on investor confidence); Gary Strauss, *Scandal Further Decimates Investor Confidence*, USA TODAY (June 27, 2002), http://usatoday30.usatoday.com/money/general/2002/06/27/confidence.htm#more [https://www.perma.cc/M69Z-LUVE] (finding that the allegations of then-recent corporate scandals including WorldCom, Enron, Tyco, and others were more influential on investor confidence than even the September 11, 2001, terrorist attacks).

[315] *See* Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Remarks at Regulatory Compliance Association Program on Regulation, Operations & Compliance (Apr. 18, 2013), https://www.sec.gov/news/speech/2013-spch041813laahtm [https://www.perma.cc/3S36-P6GK] (noting that having robust compliance systems can be beneficial to protect business and prevent reputational harm).

[316] *See* Paul Krugman, *For Richer*, N.Y. TIMES MAG. (Oct. 20, 2002), https://www.nytimes.com/2002/10/20/magazine/for-richer.html [https://www.perma.cc/9XC5-5NWD] (arguing that corporate scandals reflect an economic prioritization of wealthy insiders who have access to information that average citizens lack, and this advantage is often camouflaged in order to make the corporate structure seem more fair).

[317] *See id.* (arguing that executives cash in their stocks when the company declines, meaning the stakeholders are subject to higher costs due to the executives' misconduct).

[318] Corporations are granted special rights such as "limited liability, perpetual life, and favorable treatment of the accumulation and distribution of assets . . . that enhance their ability to attract capital and to deploy their resources . . . ." Tamara R. Piety, *Against Freedom of Commercial Expression*,

dependable deterrent devices to restore the equilibrium between corporate and societal benefits, investors may slowly return to the market and reintroduce capital that has been used elsewhere in recent years.[319]

C. *Increased Efficiency in Delaware Law*

Enhancing the content of Delaware fiduciary duties regarding managerial oversight and compliance will necessarily enhance corporate efficiency. Efficient corporate governance rules reflect what corporate managers, shareholders, and other non-shareholder constituencies would hypothetically negotiate in a world of perfect information, freedom of contract, and zero transaction costs.[320] Of course, the reality of our world prevents those conditions from being obtained. As a result, determining the content of the hypothetical bargain presents quite a challenge.

Even if the precise outcome of the bargain remains a mystery, however, maintaining a corporate culture that prevents employees and other corporate agents from producing negative externalities eventually borne by shareholders necessarily makes an efficient outcome more likely.[321] Why? If corporate managers are able to engage in illegal activity without any reproach from investors, they will have no incentive to avoid nefarious actions when determining which corporate path to pursue. On the other hand, the vulnerability to shareholder action made possible by more stringent common law oversight standards provides the opposite incentive to consider thoughtfully actual shareholder preferences. To the extent corporate rules facilitate the consideration of actual shareholder interests (whether on corporate oversight practices or any other concern), corporate

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29 CARDOZO L. REV. 2583, 2661 (2008). However, when the corporate form is used for abuse, corporate actors betray the responsibilities that accompany the grant of the special rights described above.

[319] Engaging a dual-front effort to reform corporate misbehavior can also help conserve resources and increase efficiency. Eli Ewing, *Too Close for Comfort:* United States v. Stringer *and* United States v. Scurshy *Impose a Stricter Standard on SEC/DOJ Parallel Proceedings*, 25 YALE L. & POL'Y REV. 217, 224 (2006).

[320] *See* Lawrence A. Hamermesh, *Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty*, 49 VAND. L. REV. 1087, 1153–54 (1996) (noting fiduciary principles provide what stockholders want regarding corporate information and the duty of directors); *see generally* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1199, 1201–03 (1999) (describing the areas expanded social disclosure ideally would include).

[321] *See* Iris H-Y Chiu, *Reviving Shareholder Stewardship: Critically Examining the Impact of Corporate Transparency Reforms in the UK*, 38 DEL. J. CORP. L. 983, 989 (2014) (arguing that mandatory disclosure cuts costs because it reduces the cost of shareholder monitoring and serves as support for the shareholders role of corporate governance); David A. Westbrook, *Telling All: The Sarbanes—Oxley Act and the Ideal of Transparency*, 2004 MICH. ST. L. REV. 441, 453 (2004) (noting mandatory disclosure requirements result in transparency and thus increase the informational efficiency of the market); Williams, *supra* note 320, at 1200 (noting financial transparency allows in-depth financial analysis of public companies).

managers more closely track the true preferences of shareholders rather than some stilted idea of shareholders' interest only in wealth maximization.[322] Because some shareholders possess (intense) preferences for a variety of environmental, social, or other political commitments related to compliance and oversight, ignoring the reality of their preferences in shaping corporate governance rules disconnects the content of the rule from what real parties to the bargain ultimately desire. An enhanced corporate compliance rule would more effectively engage corporate managers in a dialogue with shareholders about the extent to which corporations should even engage in oversight, perhaps even in excess of what current prosecutorial standards entail.[323] Through enhanced discourse that pays adequate fidelity to the interests of affected corporate constituencies, an efficient outcome regarding the content of corporate governance rules becomes more likely.

D. *Delaware Remains Relevant*

The final implication for the adoption of the new standards and increased synergy of the state and federal laws is that Delaware will remain relevant. As currently structured, fiduciary standards regarding corporate oversight offer little concrete guidance on what ultimately insulates directors and officers from liability. Without any bite, the business judgment rule does little to encourage companies to identify and quell acts of misconduct. As a result, public confidence in the justice system and investor confidence in the capital markets declines. By enhancing its common law standards for corporate compliance, Delaware could reclaim its place as the model for corporate law. Rather than being viewed as a governing structure that permits rampant illegality, the business judgment

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[322] *See* Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary Based Discourse*, 87 WASH. U.L. REV. 115, 163–64 (2009) (noting that facilitating dialogue between the corporation and its shareholders will allow the corporation to accurately gauge the shareholders' interests).

[323] For a discussion on the need to assess the actual preferences and profiles of diverse stakeholders in corporate law, see Helen Anderson, *Creditors' Rights of Recovery: Economic Theory, Corporate Jurisprudence and the Role of Fairness*, 30 MELB. U.L. REV. 1, 24 (2006) ("[T]he long-term viability of the corporate enterprise relies on the cooperation of a range of corporate stakeholders. In order to achieve this cooperation, ethics and fairness must be considered as a means of fostering trust and reducing risk and its associated costs. While directors are allowed to favour one cohort of corporate stakeholders over another, this is only permissible where this is in the long-term interests of the company."); *see also* Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 622, 635–36, 642–43 (2002) (addressing the need to take seriously all extant stakeholder interests in order to promote efficiency from a behaviorally sensitive standpoint); Cynthia Williams, *Corporate Social Responsibility in an Era of Economic Globalization,* 35 U.C. DAVIS L. REV. 705, 707 (2002) (promoting a dedication to actual stakeholder and shareholder interests in corporate decision making).

rule could be revamped as a tool to provide meaningful guidance in preventing corporate calamities and scandals.

CONCLUSION

The time to forge a new standard for business oversight liability has come in the form of the Yates Memo. The Delaware decisions in *Caremark* and *Stone* represent outdated standards that no longer provide a clear roadmap to business managers for evading civil or criminal liability. Modest changes could be made, however, that would align common law standards with the prevailing prosecutorial climate aimed at eradicating corporate criminality. In the end, redirecting Delaware common law fiduciary duties to follow federal prosecution standards will better ensure corporate accountability, render the common law more efficient, and restore public trust in the justice system and capital markets.