Preface to the Second Edition

ORGANIZATIONAL COMPLIANCE AND ETHICS AS A DISTINCT LEGAL DISCIPLINE

When the United States Sentencing Commission promulgated the first set of organizational sentencing guidelines in the early 1990s, it referred to them as a "carrot-and-stick scheme" aimed at encouraging corporations to self-police. The guidelines imposed severe sentences on corporations for federal crimes committed by their employees and agents, but also offered substantial leniency if a corporation maintained an effective self-policing function called a "compliance program."

In the intervening years, an accounting fraud scandal that shook public confidence in the securities markets, and a global financial crisis — both rooted in corporate misconduct — have convinced the U.S. government that corporate self-policing is necessary to maintain a stable, free enterprise system. Legislation that followed those events buttressed self-policing obligations of public companies and held senior corporate officers responsible for meeting those obligations. Courts have followed suit by holding that failure by a corporate board of directors to implement an effective compliance function can subject board members to personal liability. But by far the most consequential actions to compel corporate self-policing have come from the executive branch, whose agencies hold power over a corporation's very existence. The Department of Justice ("DOJ") and other executive agencies consider the existence and quality of a corporation's compliance program a key factor when deciding whether to initiate enforcement proceedings in light of evidence of a violation.

Most U.S. companies were slow to accept this new intrusion by government into how they structured and managed their operations. The compliance function in its early form was perceived as a diversion of corporate resources away from activities that generated value for shareholders. But this initial resistance turned to fear following waves of industry "sweeps" by the executive branch beginning in the mid-2000s. When the DOJ targets a company for investigation or indictment, it begins a countdown that can quickly end with that company's collapse. Investors flee, employees seek other opportunities, customers look for alternatives, and banks stop extending credit. That is why defending a federal indictment is almost never a rational option for a business enterprise. A case in point: the ultimate vindication of the venerable accounting firm Arthur Anderson by the Supreme Court in 2005 came two years after the firm's indictment caused it to shutter operations and lay off 80,000 employees.

Today, no sophisticated business enterprise questions the need for an effective compliance function. Rather, the focus has shifted to the optimal design and implementation of a program that achieves a dual objective: mitigate legal risk while generating economic value for the enterprise. Paradoxically, the empirical evidence shows that the best way to achieve that dual objective is to create, along with the rules and disciplinary measures, an organizational culture that puts ethics above profit.

In light of this evidence, the U.S. Sentencing Commission revised the organizational sentencing guidelines in 2004 to require a compliance and ethics program whose function, in addition to preventing violations of law, is to "promote an organizational culture that encourages ethical conduct." Although the revised guidelines do not define "ethical conduct," subsequent guidance issued by the executive branch points to a fundamental shift: corporations are responsible not only to their shareholders, but to all their stakeholders, defined as anyone who might be adversely impacted by their actions, including employees, consumers, the community at large, and even the environment. Thus, in addition to meeting their legal obligations, corporations must now put systems in place that measure and mitigate the potential adverse effects of their operations on different stakeholder groups.

IMPACT ON THE LEGAL PROFESSION

These developments have transformed the role of the legal profession in managing corporate legal risk. Lawyers have traditionally acted as generalists, waiting for the client to come to them with a problem. They are good at reconstructing the facts and analyzing the law to answer the binary question: was the conduct legal or illegal? By contrast, managing legal risk for a multinational enterprise is a dynamic process that links the economic value of business ventures with the risk that they might trigger a government investigation or enforcement action. The question "What happened?" has become "What can happen?"—requiring forward thinking and contingency planning.

Compounding this challenge is the ever-growing extraterritorial scope of U.S. laws. The Foreign Corrupt Practices Act ("FCPA"), export controls, and sanctions laws, among others, subject multinational enterprises and their worldwide affiliates to U.S. jurisdiction. This broad extraterritorial reach requires corporate lawyers to design complex systems that control risk across multiple entities, jurisdictions, and cultures.

A general counsel once told me that corporate lawyers can be divided into two groups: obstructionists and navigators. Navigators are skilled at exercising judgment and foresight. They are integrated into the strategic decision-making process and help steer the enterprise through a changing global landscape. Needless to say, training navigators must begin in law school.

THIS BOOK'S ORGANIZATION AND FOCUS

The book is designed to teach students how to assess legal risk as a quantifiable value that can be compared to other risks across a business enterprise and mitigated through processes known as "internal controls." It is organized into three parts.

Part 1 introduces students to the legal theories that underpin corporate criminal liability, and the way courts and prosecutors treat federal crimes committed by corporate employees and agents. This content teaches that, in order to avoid the potentially catastrophic consequences of a federal prosecution, a corporation must institute a well-designed and resourced compliance and ethics program, and cooperate with the government in the event of a violation. It examines in depth the organizational sentencing guidelines and the factors that influence federal prosecutors' exercise of discretion.

Part 2 is dedicated to the FCPA and the components of an effective anti-corruption compliance program. I chose the FCPA because it applies to all multinational enterprises and has been the subject of vigorous federal enforcement in the last 15 years. There is a wealth of official guidance explaining the meaning of the statute's terms and describing the type of compliance program that the U.S. government considers effective in preventing the statute's violation. This makes the FCPA ideal for showcasing the tools for legal risk management across transnational business operations. After completing Part II, students will learn how to analyze the substantive and jurisdictional provisions of the FCPA and build an effective anti-corruption compliance program for a multinational enterprise.

Part 3 examines the substantive ethical obligations of business enterprises and the components of a business ethics program designed to meet those obligations. Most of this content is based on guidelines issued by the U.S. Department of Commerce and the Organization for Economic Cooperation and Development. Students will learn how to conduct due diligence on corporate operations and supply chains to mitigate the risks of adverse impacts on stakeholders, and how to generate economic value by engaging with and meeting the reasonable expectations of stakeholders.

The book's teaching philosophy is to emphasize the practical application of legal concepts. Each section is followed by one or more hypotheticals involving multinational business operations, and each part is followed by a longer, exam-like hypothetical that requires simultaneous application of all major concepts covered in that part.

I hope that the book will be helpful to law professors who train future navigators.

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