

'DON'T ASK, DON'T TELL' CORPORATE CRIME

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‘DON’T ASK, DON’T TELL’ CORPORATE CRIME

As illustrated by the 2015-17 Volkswagen emissions scandal and other large-scale corporate wrongdoing, we have created a ‘don’t ask, don’t tell’ system for corporate crime. By relying on disclosure-based regulation for prosecutions, we teach business organizations and top executives with disclosure duties to be willfully blind to what is happening inside their organizations. Under pressure for results without inquiry into methods, middle management is able to coordinate large-scale wrongdoing without consequence. Meanwhile, increasingly diverse and mandatory disclosure requirements, which place an enormous financial burden on companies, are not actually giving us the results that we want.

This Article proposes a new approach to prevent large-scale corporate wrongdoing. Instead of businesses, regulators should have the financial obligation of analyzing information about large-scale crimes, and in exchange have access to patterns in reports suppressed or not necessarily available at the entity level.

Introduction

In January 2017, in the last days of the Obama administration, federal prosecutors and Volkswagen Auto Group (VW AG¹ or VW) announced the \$4.3 billion settlement of criminal and civil charges against the company.² VW is enormous: the company employs 600,000 people worldwide, and in 2014 generated \$227 billion in revenue.³ The plea agreement statement of facts describes a more-than-ten-year scheme⁴ to develop illegal software that would enable VW vehicles to identify when they were being tested by regulators and perform differently under those conditions than when being driven by consumers on the road.⁵ Under testing conditions, the vehicles would emit less air pollution, enabling them to pass the regulators’ tests, but harming their engines in the process.⁶ Out on the road, the vehicles emitted up to forty times the legal pollution level.⁷ The software, known as an illegal emissions “defeat device” under the

¹ AG is a German abbreviation for Aktiengesellschaft, a public limited company whose shares are offered to the public and whose shareholders’ liability is limited to their investment. Investopedia.com.

² DOJ, Press Release, *Volkswagen AG Agrees to Plead Guilty and Pay \$4.3 Billion in Criminal and Civil Penalties* (Jan. 11, 2017), <https://www.justice.gov/opa/pr/volkswagen-ag-agrees-plead-guilty-and-pay-43-billion-criminal-and-civil-penalties-six>.

³ Dipti Kapadia, Video, *Volkswagen Emissions Scandal in Numbers*, WALL ST. J. (Oct. 9, 2015), <http://www.wsj.com/video/volkswagen-emissions-scandal-in-numbers/3B54B80D-4381-4813-AAED-8A5A2444F79A.html>.

⁴ The Volkswagen plea agreement identifies individuals as engaging in the conspiracy from May 2006. Rule 11 Plea Agreement, at Ex. 2-11, *U.S. v. Volkswagen, AG, et al.*, No. 16-cv-20394 (E.D. Mich. Jan. 11, 2016) [hereinafter *VW Plea*]. Other research suggests that the scheme dates back at least to 2005, when management pulled Volkswagen out of talks to use Daimler AG’s technology. Christoph Rauwald, *How a Top-Secret Deal Could Have Stopped VW’s Diesel Scandal*, BLOOMBERG (Jan. 12, 2017), <https://www.bloomberg.com/news/articles/2017-01-13/vw-pulled-out-of-daimler-deal-before-embarking-on-diesel-cheat>. Yet the fraud may have been on-going by other calculations for seventeen years. The multi-district litigation discussed *infra* pp. 42–44 alleges that a part of VW AG, Audi, had developed a version of the illegal software by 1999. Am. Consol. Consumer Class Action Compl. (Redacted) at 140, Doc. No. 1804, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Sept. 2, 2016) [hereinafter *Consol. Compl.*]. It was this Audi version that then spread across the rest of VW AG. *Id.* at 135-36; *accord VW Plea, supra*, at Ex. 2-13.

⁵ *VW Plea, supra* note 4, at Ex. 2-12–13.

⁶ *Id.* at Ex. 2-18.

⁷ *Id.* at Ex. 2-21.

Clean Air Act,⁸ was refined in multiple forms and eventually installed on almost 600,000 vehicles sold in the U.S.⁹

There have now been at least five types of defeat devices discovered in VW AG cars, across multiple brand names.¹⁰ Even before revelations of the third fraud,¹¹ a joint MIT/Harvard study concluded that the extra air pollution from VW's actions had contributed to the early deaths of sixty people in the U.S.¹² Worldwide, the defeat devices were installed in at least 11 million vehicles, and are likely responsible for the early deaths of tens of thousands of people from illegal air pollution.¹³ Nitrogen oxide (NOx), the main pollutant that the defeat devices enable the cars to emit, is a highly toxic substance that converts quickly into nitrogen dioxide, recognizable as a "reddish-brown gas with a pungent odor" that absorbs sunlight "to transform into the yellow-brown haze that blankets cities."¹⁴ The smog exacerbates "dozens of health problems, including asthma, bronchitis and emphysema."¹⁵ Nitrogen dioxide also washes "into the ground in the form of acid rain, which can kill plants and animals."¹⁶ These forms of environmental damages are especially dangerous because "there is no antidote" to them.¹⁷ An early analysis estimates that VW's 11 million cars may be "responsible for nearly 1m tonnes of air pollution every year, roughly the same as the UK's combined emissions for all power stations, vehicles, industry and agriculture."¹⁸ Within the United States alone, the environmental damage from VW's fraud is estimated to exceed \$450 million.¹⁹

The VW scandal, however, has not been limited to VW. In February 2017, the German engine supplier Robert Bosch GmbH²⁰ and its American subsidiary Robert Bosch LLC (collectively Bosch) agreed to pay \$327.5 million in compensation to U.S. consumers for

⁸ A "defeat device[]" is illegal under Section 203(a)(3)(B) of the Clean Air Act. 42 U.S.C. § 7401, *et seq.* Regulations implementing the Act define a "defeat device" as a prohibited form of "auxiliary emission control device" that "reduce[s] the effectiveness of the emission control system under conditions which may reasonably be expected to be encountered in normal vehicle operation and use." 40 C.F.R. § 86.094-2.

⁹ *VW Plea*, *supra* note 4, at Ex. 2-27.

¹⁰ See *infra* pp. 71-74.

¹¹ U.S. ENVTL. PROT. AGENCY, Press Release, *EPA, California Notify Volkswagen of Additional Clean Air Act Violations* (Nov. 2, 2015), <http://yosemite.epa.gov/opa/admpress.nsf/6424ac1caa800aab85257359003f5337/4a45a5661216e66c85257ef10061867b!OpenDocument>.

¹² Sarah Zhang, *New Study Links VW's Emissions Cheating to 60 Early Deaths*, WIRED MAGAZINE (Oct. 30, 2015), <http://www.wired.com/2015/10/new-study-links-vws-emissions-cheating-59-deaths>.

¹³ Sarah Knapton, *Volkswagen Scandal: Nearly 12,000 Deaths Could Be Avoided If Industry Met Emissions Targets*, THE TELEGRAPH (Sept. 22, 2015), <http://www.telegraph.co.uk/news/health/news/11883416/vw-scandal-emission-target-death-rate.html> (noting that 500,000 people die each year from air pollution, 23,500 deaths each year are directly attributable to pollution from diesel cars, and that nearly 12,000 of those people a year may be dying because the car industry did not meet emissions promises).

¹⁴ Shannon Hall, *VW Scandal Causes Small but Irreversible Environmental Damage*, SCIENTIFIC AMERICAN (Sept. 29, 2015), <https://www.scientificamerican.com/article/vw-scandal-causes-small-but-irreversible-environmental-damage>.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* (quoting a Northwestern University engineering professor).

¹⁸ Karl Mathiesen & Arthur Neslen, *VW Scandal Caused Nearly 1m Tonnes of Extra Pollution, Analysis Shows*, THE GUARDIAN (Sept. 23, 2015), <https://www.theguardian.com/business/2015/sep/22/vw-scandal-caused-nearly-1m-tonnes-of-extra-pollution-analysis-shows>.

¹⁹ Stephen R. H. Barrett, et al., *Impact of the Volkswagen Emissions Control Defeat Device on US Public Health*, 10 ENVTL. RES. LETTERS 11 (Oct. 29, 2015), <http://iopscience.iop.org/article/10.1088/1748-9326/10/11/114005#erl521037s4>.

²⁰ GmbH is a German abbreviation for Gesellschaft mit beschränkter Haftung, a limited liability company. Investopedia.com.

Bosch's role in helping VW develop and install the defeat-device software across VW AG models.²¹ Bosch "is one of the world's largest privately held companies, with [2016 sales] of... \$78.5 billion."²² The company supplies integral components to virtually every automaker in the world.²³ In sum, "it would be tough to find a car that does not have some Bosch parts."²⁴

Although Bosch has not formally admitted wrongdoing, Bosch not only understood that the software it was helping VW develop was an illegal defeat device and detailed its concerns in a letter to VW,²⁵ but it demanded that VW indemnify Bosch for its anticipated liability.²⁶ Even without indemnification, Bosch continued to work closely with VW on the software for seven more years, marketing VW vehicles as "clean diesel" in the U.S., and lying to U.S. regulators on VW's behalf.²⁷

The VW criminal settlement describes the involvement of a second supplier, identified by outsiders as IAV GmbH,²⁸ that also helped VW to evade U.S. emissions standards, and to destroy evidence in violation of a legal hold when authorities started closing in on the companies.²⁹

This 2015-17 VW scandal is representative of modern large-scale corporate wrongdoing. Within industries, the methods of large-scale crimes are echoing and repeating. Some intra-industry pattern may be the result of competitive pressure, but it may also signal cross-company communication. Within the auto industry, for example, VW and its two suppliers are not alone in being suspected of large-scale emissions cheating.³⁰ As one analyst summed up, when "[t]here's intense pressure to reach [emissions] standards... [companies] are doing it by not actually having the performance to back it up."³¹ In June 2014, Ford had to lower the fuel-economy ratings on six of its cars, mostly hybrids, sold in the U.S.³² In April 2016, Mitsubishi admitted cheating on fuel-economy tests in 620,000 cars in the Japanese market, affecting cars sold by Nissan as well.³³ Later that month, Daimler, at the prompting of the U.S. Department of Justice (DOJ), agreed to conduct a review of its Mercedes-Benz vehicle emissions ratings.³⁴ In May 2016, General Motors admitted that it had overstated the fuel economy of Chevy Traverse, GMC

²¹ Jack Ewing, *Supplier's Role Shows Breadth of VW's Deceit*, N.Y. Times (Feb. 1, 2017), <https://mobile.nytimes.com/2017/02/01/business/bosch-vw-diesel-settlement.html>.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ Andreas Cremer & Steve Scherer, *VW Staff, Supplier Warned of Emissions Test Cheating Years Ago: Reports*, REUTERS (Sept. 27, 2015), <http://www.reuters.com/article/us-volkswagen-emissions-idUSKCNORP14U20150927> (citing *Bild am Sonntag*); *Consol. Compl.*, *supra* note 4, at 154.

²⁶ *Consol. Compl.*, *supra* note 4, at 145; *id.* at 154-55.

²⁷ Order Granting Prelim. Approval of The Bosch Class Action Settlement, at 2, Doc. No. 2920, In re: Volkswagen "Clean Diesel" Litigation, 3:15-md-02672-CRB (N.D. Calif., filed Feb. 16, 2017).

²⁸ *VW Plea*, *supra* note 4, at Ex. 2-3; Tom Schoenberg & Alan Katz, *U.S. Is Investigating Bosch in Widening VW Diesel-Cheat Scandal*, BLOOMBERG (Sept. 16, 2016), <https://www.bloomberg.com/news/articles/2016-09-16/vw-diesel-cheat-probe-widens-as-u-s-said-to-investigate-bosch>.

²⁹ *VW Plea*, *supra* note 4, at Ex. 2-27.

³⁰ Joanna Walters, Graham Ruddick, & Sean Farrell, *VW Emissions Scandal Could Snare Other Firms, Whistleblower Claims*, THE GUARDIAN (Sept. 21, 2015), <https://www.theguardian.com/business/2015/sep/21/volkswagen-emissions-scandal-sends-shares-in-global-carmakers-reeling>.

³¹ Jonathan Soble, *Mitsubishi Admits Cheating on Fuel-Economy Tests*, N.Y. TIMES (Apr. 20, 2016), <https://www.nytimes.com/2016/04/21/business/mitsubishi-fuel-economy-tests.html>.

³² Danielle Ivory, *Ford Lowers Gas Mileage on 6 Models, All 2013-14s*, N.Y. TIMES (June 12, 2014), <https://www.nytimes.com/2014/06/13/business/ford-lowers-fuel-economy-ratings-on-some-of-its-cars.html>.

³³ Soble, *supra* note 31.

³⁴ Natascha Divac, *Daimler Shares Tumble on Diesel Emissions Review*, WALL ST. J. (Apr. 22, 2016), <https://www.wsj.com/articles/daimler-profit-drops-but-sticks-to-full-year-forecasts-1461307252>.

Acadia, and Buick Enclave cars by 12 percent.³⁵ In January 2017, the U.S. Environmental Protection Agency (EPA) accused Fiat Chrysler of installing defeat-device software on 100,000 Jeep Grand Cherokee and Dodge Ram diesel-powered cars and trucks.³⁶ The next day, French prosecutors announced an investigation of Renault.³⁷

Coordination of wrongdoing appears to be spreading across companies, borders, and partners. Outside of the auto industry, the 2013 horsemeat contamination scandal reached all the way to Nestlé, the world's largest food company, and implicated the British and French arms of a Swedish food company, as well as Romanian, German, and other subcontractors.³⁸ In 2015, a settlement with New York regulators for foreign currency exchange rate manipulation revealed direct communications among traders for three of the top four investment bank European currency trading desks "on the planet."³⁹ In 2015, major technology companies including Apple, Google, Intel, and Adobe paid \$415 million to nearly 65,000 affected workers following coordinated anti-poaching, that echoed the 2013 \$20 million settlement paid by Intuit, Lucasfilm, and Pixar.⁴⁰ The 2016-17 Wells Fargo scandal involving the opening of two million fraudulent customer accounts now implicates Prudential, the bank's retail partner in the insurance industry.⁴¹

One of the reasons why these scandals can be so well coordinated and widespread is that that they are incubating for increasing lengths of time without public knowledge. VW's fraud was an "open secret" inside the company and Bosch for over ten years.⁴² Other reports trace the history of VW's device back to Audi in 1999, over seventeen years ago.⁴³ The Wells Fargo fraudulent-accounts scandal grew to 2 million accounts over a minimum of eleven years.⁴⁴ The Takata exploding airbag scandal affecting hundreds of millions of defective airbags has been traced back to seven automakers that may have been complicit for nearly 20 years.⁴⁵ General

³⁵ Mike Colias, *GM Can't Expect Benefit of the Doubt*, AUTO. NEWS (May 21, 2016), <http://www.autonews.com/article/20160521/OEM11/305239956>; Bob Sorokanich, *The Facts Behind Every Major Automaker Emissions Cheating Scandal Since VW*, ROAD & TRACK (May 25, 2016), <http://www.roadandtrack.com/new-cars/car-technology/a29293/vehicle-emissions-testing-scandal-cheating>.

³⁶ Chris Isidore, *Fiat Chrysler Cheated on Diesel Emissions, EPA Says*, CNN MONEY (Jan. 13, 2017), <http://money.cnn.com/2017/01/12/news/companies/epa-emissions-cheating-fiat-chrysler>.

³⁷ Agence France-Presse, *Renault to be Investigated Over Diesel Emissions 'Cheating'*, THE GUARDIAN (Jan. 13, 2017), <https://www.theguardian.com/business/2017/jan/13/renault-diesel-emissions-cheating-france-us-fiat-chrysler>.

³⁸ Euractiv.com with Reuters, *Nestlé Roped into Horsemeat Scandal*, (Feb. 20, 2013), <https://www.euractiv.com/section/health-consumers/news/nestle-roped-into-horsemeat-scandal>; Laura Smith-Spark & Per Nyberg, *Meat Industry Under Scrutiny As Horsemeat Scandal Spreads*, CNN (Feb. 15, 2013), <http://www.cnn.com/2013/02/09/world/europe/uk-horsemeat-probe>.

³⁹ Consent Order Under New York Banking Law §§ 44 and 44-a, at 5-6, In re Barclays Bank PLC (N.Y. State Dep't of Fin. Servs. May 19, 2015), <http://www.dfs.ny.gov/about/ea/ea150520.pdf>.

⁴⁰ Jeff John Roberts, *Tech Workers Will Get Average of \$5,770 Under Final Anti-Poaching Settlement*, FORTUNE (Sept. 3, 2015), <http://fortune.com/2015/09/03/koh-anti-poach-order>.

⁴¹ Stacy Cowley & Matthew Goldstein, *Accusations of Fraud at Wells Fargo Spread to Sham Insurance Policies*, N.Y. TIMES (Dec. 9, 2016), <https://www.nytimes.com/2016/12/09/business/dealbook/wells-fargo-accusations-sham-insurance-policies.html>.

⁴² Georgina Prodhon, *Volkswagen Probe Finds Manipulation Was Open Secret In Department*, REUTERS (Jan. 23, 2016), <http://www.reuters.com/article/us-volkswagen-emissions-investigation-idUSKCN0V02E7>; *accord Consol. Compl.*, *supra* note 4, at 151.

⁴³ *Consol. Compl.*, *supra* note 4, at 140. It was this Audi version that spread across the rest of VW. *Id.* at 135-36; *accord VW Plea*, *supra* note 4, at Ex. 2-13.

⁴⁴ Stacy Cowley, *At Wells Fargo, Complaints About Fraudulent Accounts Since 2005*, N.Y. TIMES (Oct. 11, 2016), <http://www.nytimes.com/2016/10/12/business/dealbook/at-wells-fargo-complaints-about-fraudulent-accounts-since-2005.html>.

⁴⁵ Hiroko Tabuchi & Neal E. Boudette, *Automakers Knew of Takata Airbag Hazard for Years, Suit Says*, N.Y. TIMES (Feb. 27, 2017), <https://www.nytimes.com/2017/02/27/business/takata-airbags-automakers-class-action.html>

Motors admits that it knew for more than a decade about the ignition switch malfunction that killed at least 124 people and maimed many more.⁴⁶ As will be discussed, an irony of our current disclosure system is that we are not finding out what we really need to know for increasingly long periods of time.⁴⁷

In sum, it should command our attention that these scandals are enormous in size, occur within diverse industries, and increasingly pull across companies and borders. To provide a sense of scale for the damages involved in white collar crimes, the FBI estimates that the total cost of all property crime in 2014 from burglary, larceny-theft, and motor vehicle theft was \$14.3 billion.⁴⁸ This total is a mere 0.06 percent of what the financial crisis cost the U.S. economy,⁴⁹ and sixteen percent of the potential cost of the 2015-17 emissions-controls scandal at the single company of VW.⁵⁰

In the VW case, there were likely hundreds of people coordinating across at least three companies and five different name brands who made the cheating scheme possible.⁵¹ As the *New York Times* reports, “[t]he sheer amount of work required to install the software in Volkswagen vehicles suggests that a large number of people were involved.”⁵² The defeat-device “software had to be altered for each model and option package.”⁵³ And these changes had to be made in “11 million tainted diesel engines in more than 30 Volkswagen, Audi, Porsche, Seat and Skoda models, which were available around the world in dozens of variations.”⁵⁴ In another indication of how widespread VW’s fraud must have been, despite a company culture described as “North Korea without labor camps,” at least fifty whistleblowers have come forward inside VW after the fraud was publically revealed who had not been comfortable previously reporting information to authorities.⁵⁵

Yet when VW pled guilty, it was merely to failing to tell the truth about its deception. For perpetuating a more-than-ten-year scheme that has cost tens of thousands of deaths from air pollution, the criminal charges against VW and seven of its executives are for covering up the organization’s crime in disclosures to regulators—not for the crime itself.⁵⁶ From the beginning of the case, the charges against VW and variously against its executives have been (1) conspiracy to defraud the government, (2) obstruction of justice, and (3) entering goods into the country by

(describing evidence against Ford, Honda, Nissan, and Toyota going back in part to 1999); *id.* (mentioning evidence against BMW); Hiroko Tabuchi, *A Cheaper Airbag, and Takata’s Road to a Deadly Crisis*, N.Y. TIMES (Aug. 26, 2016), <https://www.nytimes.com/2016/08/27/business/takata-airbag-recall-crisis.html> (documenting the involvement of General Motors going back to the late 1990s).

⁴⁶ CBS News/AP, *General Motors Announces 30th Recall of Year*, CBSNEWS (May 23, 2014), <http://www.cbsnews.com/news/general-motors-announces-30th-recall-of-year>; Chris Isidore & Evan Perez, *GM CEO: ‘People Died in Our Cars,’* CNN MONEY (Sept. 17, 2015), <http://money.cnn.com/2015/09/17/news/companies/gm-recall-ignition-switch>.

⁴⁷ See *infra* pp. 29–57, 71–76.

⁴⁸ U.S. Dep’t of Justice, *FBI Releases 2014 Crime Statistics* (last visited Oct. 14, 2015), <https://www.fbi.gov/about-us/cjis/ucr/crime-in-the-u.s/2014/crime-in-the-u.s.-2014/resource-pages/fbi-releases-2014-crime-statistics>.

⁴⁹ Eleazar David Melendez, *Financial Crisis Cost Tops \$22 Trillion, GAO Says*, HUFF. POST (Feb. 14, 2013), http://www.huffingtonpost.com/2013/02/14/financial-crisis-cost-gao_n_2687553.html.

⁵⁰ Alanna Petroff, *Volkswagen Scandal May Cost Up To \$87 Billion*, CNN MONEY (Oct. 2, 2015), <http://money.cnn.com/2015/10/02/news/companies/volkswagen-scandal-bp-credit-suisse>.

⁵¹ See, e.g., *Consol. Compl.*, *supra* note 4, at 149 (citing VW-MDL2672-02559780, a spreadsheet detailing 8,565 entries and hundreds of individuals).

⁵² Ewing, *supra* note 21.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Jack Ewing & Graham Bowley, *The Engineering of Volkswagen’s Aggressive Ambition*, N.Y. TIMES (Dec. 13, 2015), <http://www.nytimes.com/2015/12/14/business/the-engineering-of-volkswagens-aggressive-ambition.html>.

⁵⁶ See *infra* pp. 28–33.

false statement.⁵⁷ VW AG has pleaded guilty to all three charges.⁵⁸ One of its executives has pleaded guilty to conspiracy to defraud the government.⁵⁹ Versions of the same disclosure-based charges are pending against six remaining VW executives.⁶⁰ In 2017, one of those six executives was arrested in Miami while attempting to return to Germany, has pled not guilty, and claims he is a scapegoat for the company's misrepresentations to regulators because he "merely did what Volkswagen lawyers told him to do."⁶¹ The other five executives remain abroad, and Germany is unlikely to extradite them to the United States.⁶² This result is thus the practical end of VW's high-profile U.S. criminal case.⁶³

The more we scratch the surface of the VW scandal, the more problematic issues emerge. First, the sheer scale, length, and coordination involved in the scandal provide a window into modern international large-scale corporate wrongdoing.⁶⁴ Second, it strains credibility that the company's C-suite officers and directors have no liability because they claim they did not know what was happening before being confronted by regulators.⁶⁵ Their assertions of blindness, largely backed up by independent evidence with debates over a few months' difference, force us to ask how that could be possible.⁶⁶ Third, even though VW's settlement resulted from one of the highest-profile and best-resourced prosecutions in the world, the actual charges that the company and its accomplices have pled to have little to do with the substance of their crimes.⁶⁷

This Article explores these problems and asserts that they are connected. We have created a 'don't ask, don't tell' system for corporate crime that enables the growth and coordination of crimes by middle management across corporate forms.⁶⁸ In putting the pieces of this puzzle together and proposing a solution, this Article breaks important new ground. No academic work before has identified middle management as key to these large-scale corporate crimes; demonstrated how 'don't ask, don't tell' incentives drive internal and external behavior; and proposed reforms to free reporting from within the business organizational form. If we fix our

⁵⁷ Indictment, U.S. v. Liang, No. 2:16-cr-20394 (E.D. Mich., filed under seal June 6, 2016; unsealed with Rule 11 Plea Agreement, Sept. 9, 2016); Second Superseding Indictment, U.S. v. Dorenkamp et al., No. 2:16-cr-20394 (E.D. Mich., Jan. 11, 2017) [hereinafter *Executives Indictment*]; Third Superseding Information, U.S. v. Volkswagen AG, No. 2:16-cr-20394 (E.D. Mich., Jan. 11, 2017).

⁵⁸ *VW Plea*, *supra* note 4, at 1.

⁵⁹ Rule 11 Plea Agreement, U.S. v. Liang, No. 16-cr-20394 (E.D. Mich., Sept. 9, 2016).

⁶⁰ *Executives Indictment*, *supra* note 57, at 11 (charges of conspiracy to defraud the government against all six defendants); *id.* at 32 (charges of making false statements in violation of the Clean Air Act against four defendants); *id.* at 35 (charges of wire fraud against four defendants).

⁶¹ Jack Ewing, *VW Executive Charged in Emissions Case Says He Was a Bit Player*, N.Y. TIMES (Feb. 25, 2017), <https://mobile.nytimes.com/2017/02/25/business/volkswagen-diesel-scandal-emissions-oliver-schmidt.html>.

⁶² Karin Matussek, Bloomberg, *VW Executives Safe from U.S. Extradition in Home Country*, AUTO. NEWS (Jan. 12, 2017), <http://www.autonews.com/article/20170112/OEM02/170119907/vw-executives-safe-from-u.s.-extradition-in-home-country>.

⁶³ The Trump government does not seem particularly interested in pursuing corporate crime. *See, e.g.*, Charlie Savage & Maggie Haberman, *Trump Abruptly Orders 46 Obama-Era Prosecutors to Resign*, N.Y. TIMES (Mar. 10, 2017), <https://www.nytimes.com/2017/03/10/us/politics/us-attorney-justice-department-trump.html>.

⁶⁴ *See infra* pp. 8–12.

⁶⁵ *See infra* pp. 13–17, 63–72.

⁶⁶ *See infra* pp. 23–26.

⁶⁷ *See infra* pp. 17–20, 38–60.

⁶⁸ "Don't ask, don't tell" was a description coined in the 1990s originally to describe President Clinton's policy of ignoring the sexual orientation of troops serving in the U.S. military. Mary Kate Cannistra, Kat Downs, & Cristina Rivero, *A History of 'Don't Ask, Don't Tell'*, WASH. POST (Nov. 30, 2010), <http://www.washingtonpost.com/wp-srv/special/politics/dont-ask-dont-tell-timeline>. It was repealed because it failed to address the substantive issue whether the U.S. military was open to people of all sexual orientations who wanted to serve, and, in the meantime, was destructive of thousands of soldiers' lives. *Id.*; Ben Ilany, *Don't Ask, Don't Tell—Don't Live*, MORNINGSIDE REV. (last visited Feb. 10, 2017), <http://morningsidereview.org/essay/dont-ask-dont-tell-dont-live>.

‘don’t ask, don’t tell’ system, we may be able to curtail the increasing scale, length, and coordination of corporate wrongdoing that is causing enormous harm to the public.

The Organization of this Article

The Article makes its argument in an Introduction, five Parts, and a Conclusion. Part I presents the new concept of a ‘don’t ask, don’t tell’ system driving corporate crime, and academic developments feeding into the idea. Part II identifies VW’s largest liabilities, outlines the structure of U.S. disclosure laws, and explains how they have set patterns for the rest of the world. Part III explores the internal effects of ‘don’t ask, don’t tell’ incentives to explain how scandals reach such size and scale. Part IV illustrates how ‘don’t ask, don’t tell’ incentives fuel VW’s external behavior toward regulators and the public. Part V presents a proposal for reforming flaws in our ‘don’t ask, don’t tell’ system. Individuals should have a duty to come forward within organizations without the current burdens imposed on whistleblowers. This ‘easier ask, let individuals tell’ approach would reduce the administrative burden of the current system on businesses, and allow regulators to better compile information across corporate forms, industries, and borders.

The Conclusion calls for rethinking the protections that we have built into the law to immunize individuals within middle management from scrutiny and consequences for their actions. By providing a representative case study of VW, this Article spotlights the role of ‘don’t ask, don’t tell’ incentives in driving large-scale wrongdoing, spurs a challenge to the insulation of middle management to coordinate it, and seeks to reform our ‘don’t ask, don’t tell’ system of corporate crime.

I. The ‘Don’t Ask, Don’t Tell’ System and Academic Background

Our ‘don’t ask, don’t tell’ system fuels corporate crime. The system’s disclosure-based enforcement places burdens on business organizations to collect information for regulators on the assumption that making the information public will mobilize market pressure to achieve morally desirable results. This Article argues that the foundations of this system are broken. First, this collection of information places a costly and ineffective burden on business organizations and is improperly housed inside the organizations where both the collection of and choice to report the information can be—and are—manipulated.⁶⁹ Second, when the information is released to the market, it is not having the effect of enforcing morally desirable results.⁷⁰ Third, because we presume that the morally desirable results we seek will arrive through market pressure, we hide the underlying moral judgments—the actual standards we seek to hold corporations to—in procedural disclosure requirements instead of in substantive criminal or civil law.⁷¹ Even as judged by data on outcome, disclosure alone is an ineffective way to achieve underlying morally desirable results.

Other academics have written on flaws in our disclosure-based system without putting these parts together and documenting its impacts on the overall shape of corporate crime and the growth of untouchable middle management. Most other academic work in this area has been in close studies of the SEC and its role in creating disclosure rules. This Article expands these critiques to the entire landscape of white collar crime enforcement, and it connects our

⁶⁹ See *infra* pp. 39–41.

⁷⁰ See *infra* pp. 10–16.

⁷¹ See *id.*

overreliance on disclosure-based regulation to the role of middle management in corporate crimes.

In 2013, Professors Langevoort and Thompson describe for the first time how U.S. disclosure rules—largely driven by activity in the field of securities regulation—are actually a poor proxy for substantive regulation of large corporations in the era of limited government resources and public interest in supervising their substantive behavior.⁷² Examining Facebook’s gyrations to avoid registering as a public company because that distinction would trigger “rigorous disclosure, governance, and accountability consequences,” they note how “going public” in effect means submitting to what rules we do have about corporate behavior.⁷³

Langevoort and Thompson “suspect that some portion of what we call securities regulation follows from an effort to create more accountability of large, economically powerful business institutions that is only loosely coupled with orthodox (and arguably more measurable) notions of investor protection.”⁷⁴ Excellent examples of disclosure as a substitute for outright statements of substantive compliance include Dodd-Frank’s requirement that companies disclose conflict minerals in their supply chains,⁷⁵ and the ratio of the CEO’s pay to the median worker’s.⁷⁶

Professors Cox and Thomas in 2003 foreshadow Langevoort and Thompson’s insight into the link between the expansion of the SEC’s responsibilities and a doubling-down on disclosure-based regulation in response to scandal and complexity.⁷⁷ By 2016, Langevoort and Thompson trace the history of securities regulation to conclude that, despite corporate-law orthodoxy that the only interest the law should have is in the marketplace of information, the fact that “securities regulation is about social, political, and economic interests, in addition to investor protection and capital formation, has been seriously underestimated.”⁷⁸

Especially relevant to this Article’s VW discussion, Langevoort and Thompson describe how Congressional findings that environmental damage should be prevented have become the subtext of U.S. disclosure regulations.⁷⁹ Environmental disclosure is a “slightly more textured example” of any justification that the information to be disclosed is merely for investor judgment.⁸⁰ True, “[e]nvironmental compliance costs and climate change impacts can affect issuers in a material way, making this fair game for mandatory disclosure.”⁸¹ Nonetheless, “environmental disclosure can be designed to produce societal benefits, and we strongly suspect that the motivation for action in this area cannot be explained by investor needs alone.”⁸²

⁷² Donald C. Langevoort & Robert B. Thompson, “Publicness” in *Contemporary Securities Regulation After The JOBS Act*, 101 GEO. L.J. 337 (2013); accord Barnali Choudhury, *Social Disclosure*, 13 BERKELEY BUS. L.J. 183, 185 (2016) (surveying global trends and noting that “[t]hese practices are indicative of a growing trend by governments to use corporate and securities disclosure rules to achieve social aims”).

⁷³ Langevoort & Thompson, *supra* note 72, at 338.

⁷⁴ *Id.* at 340.

⁷⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502, 124 Stat. 1376, 2213 (2010) (codified at 15 U.S.C. § 78m(p)).

⁷⁶ *Id.*, codified at 15 U.S.C. §§ 78n-1, 78j-3, 78j-4.

⁷⁷ James D. Cox & Randall S. Thomas, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 759 (2003).

⁷⁸ Langevoort & Thompson, *supra* note 72, at 372-73.

⁷⁹ *Id.* at 373.

⁸⁰ *Id.*

⁸¹ *Id.* (citing Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6,290 (Feb. 8, 2010)).

⁸² *Id.*; accord U.S. SEC. AND EXCH. COMM’N, STRATEGIC PLAN: FISCAL YEARS 2014–2018, at 7, <https://www.sec.gov/about/sec-strategic-plan-2014-2018.pdf>.

Meanwhile, classical law-and-economics theory postulates that markets will provide the most efficient solution to enforcement problems,⁸³ but a growing body of academic work now demonstrates that disclosure alone does not impact corporate behavior the way that law-and-economics theorists speculated.⁸⁴

Initially, there are the practical problems of information overload, in which companies may hide negative disclosures in floods of documents to overwhelm the attention of investors and analysts.⁸⁵ A 2012 accounting study finds that the average number of pages devoted to management discussion, analysis, and footnotes in the previous twenty years has quadrupled; these sections are on track by the year 2032 to be over 500 pages.⁸⁶ As one company's audit committee member confidentially reports, because "[t]he volume [of disclosures] is increasing much faster than the rate of [meaningful] information provided.... [w]e are not accomplishing transparency. In fact, we are creating obfuscation."⁸⁷ By 2013, the SEC Chairman herself questioned the impact of "detailed and lengthy disclosures about all of the topics that companies currently provide in the reports they are required to prepare."⁸⁸

By 2016 Professor Rauterberg, however, describes even more basic components of the market's failure to achieve morally desirable results through disclosure alone. There is a fundamental incentive problem for investors that no amount of disclosure will ultimately address. As Rauterberg notes, "It seems to be a curious myopia of business ethics... that it has largely sought to reimagine the ethics of managers without revisiting the ethics of owners or consumers."⁸⁹ As he correctly identifies, owners and consumers do not have the right incentives to enforce business ethics unless reforms are more systemic because ethical actions may result in short-term reductions in profit.⁹⁰ "[E]thical managers" are "soon... weeded out by less ethical owners, unless the latter [are] also converted. If profits [begin] to decline at a firm or even across an entire industry, shareholders... quickly assemble at the next board of directors meeting and select a new board."⁹¹ Competitive optimization encourages this board to "promptly fire the ethical officers and replace them with less scrupulous successors."⁹² Well-meaning managers may be "able to extract some private benefits—and create some public benefits—without repercussions," but without systemic changes, unchecked competitive product markets and competition for corporate control "impose important limits" on ethical behavior.⁹³

⁸³ Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 1-15 (1960); RICHARD POSNER, ECONOMIC ANALYSIS OF LAW at i (9th ed., 2014); see also Paul H. Rubin, *Law and Economics* in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (2008) (describing the history and development of law-and-economics).

⁸⁴ Cox and Thomas list, for example, quite a number of reasons why private suits fail to adequately enforce disclosure-based rules. Cox & Thomas, *supra* note 77, at 744-45.

⁸⁵ KPMG & Fin. Execs. Res. Found., *Disclosure Overload and Complexity: Hidden in Plain Sight* 2-3 (2011), <http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/disclosure-overload-complexity.pdf>.

⁸⁶ ERNST & YOUNG, NOW IS THE TIME TO ADDRESS DISCLOSURE OVERLOAD 1 (2012), [http://www.ey.com/Publication/vwLUAssets/ToThePoint_BB2367_DisclosureOverload_21June2012/\\$FILE/ToThePoint_BB2367_DisclosureOverload_21June2012.pdf](http://www.ey.com/Publication/vwLUAssets/ToThePoint_BB2367_DisclosureOverload_21June2012/$FILE/ToThePoint_BB2367_DisclosureOverload_21June2012.pdf).

⁸⁷ EY, DISCLOSURE EFFECTIVENESS at 2 (Nov. 2014), [http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-november-2014/\\$FILE/EY-disclosure-effectiveness-november-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-november-2014/$FILE/EY-disclosure-effectiveness-november-2014.pdf).

⁸⁸ Mary Jo White, Chair, Sec. & Exch. Comm'n, *The Path Forward on Disclosure* (Oct. 15, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539878806#_ftnref7.

⁸⁹ Gabriel Rauterberg, *The Corporation's Place in Society*, 114 MICH. L. REV. 913, 925 (2016).

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* This is also a reverse implication of Professor Coffee's famous argument in favor of disclosure that it "improve[s] the allocative efficiency of the capital market," and therefore the productiveness of the economy as a

If the release of information on the ratio of CEO pay to average worker pay, for example, was supposed to create pressure from the marketplace to make the discrepancy smaller, empirical evidence demonstrates that the system is not working. In 2017, news reports lead with “American corporate bosses continue to get bigger raises than their workers.”⁹⁴ In fiscal year 2016, “pay for chief executives at 42 public U.S. companies rose 5.5% ... from the prior year, widening the gap with average earnings of employees, which rose 2.8%.”⁹⁵

More disturbingly, not only is the market failing to hold companies accountable, U.S. regulatory agencies are even worse at taking action on violations. Even under administrations that appeared interested in punishing corporate misbehavior, “[w]hile the number of [company] filings increased by sixty percent between 1991 and 2000, the proportion of filings receiving review declined from twenty-one percent to eight percent. In 2001, the SEC completed full review of only sixteen percent of issuers, missing its stated goal by half.”⁹⁶

Even more of a problem for law-and-economics theory, imposing fines on a corporate entity may disgorge profits and provide compensation to the victims of large-scale wrongdoing, but it does not change business behavior.⁹⁷ These management literature findings need to come into the law. In direct contrast to law-and-economics expectations, empirical management studies establish that the net impact of corporate fines on shareholders is effectively zero.⁹⁸ In addition, with the growth of institutional shareholders—even by 2009, 78 percent of the shares of the top 1,000 companies on U.S. markets were owned by institutional shareholders⁹⁹—investors are less interested in corporate reputation and tend to measure value in terms of profit, regardless of its sources.¹⁰⁰

Corporate recidivism studies conclude that, because wrongdoing tends to be a culture-based phenomenon within organizations, without the imposition of individual liability within the

whole. John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 722 (1984).

⁹⁴ Anders Melin, *CEOs Widen Income Gap Over Staff as Survey Shows 5.5% Pay Jump*, BLOOMBERG (Mar. 8, 2017), <https://www.bloomberg.com/news/articles/2017-03-08/ceos-widen-income-gap-over-staff-as-survey-shows-5-5-pay-jump>.

⁹⁵ *CEO Pay Gap Widens*, Risk and Compliance, WALL ST. J. (Mar. 8, 2017).

⁹⁶ Natalya Shnitser, *A Free Pass For Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638, 1658 (2010).

⁹⁷ See, e.g., David C. Weiss, *The Foreign Corrupt Practices Act, SEC Disgorgement of Profits, and the Evolving International Bribery Regime: Weighing Proportionality, Retribution, and Deterrence*, 30 MICH. J. INT’L L. 471, 506 (2009) (“The justification for [corporate] criminal punishment, in general, rests on either utilitarian or retributivist grounds.”); *id.* at 506-07 (“[D]eterrence can be particularly ineffective for punishing corporations.”); Uri Gneezy, Stephan Meier, & Pedro Rey-Biel, *When and Why Incentives (Don’t) Work to Modify Behavior*, 25 J. ECON. PERSPECTIVES 4, 201-02 (2011) (providing examples of when and why structural incentives fail to have their intended effects, including in the “Wall Street Game” and other behavioral experiments with money).

⁹⁸ See, e.g., Jason R. Pierce, *Reexamining the Cost of Corporate Criminal Prosecutions*, J. MGMT. (July 24, 2015), <http://jom.sagepub.com/content/early/2015/07/23/0149206315594845.abstract> (“Scholars of management and related disciplines have consistently found that criminal convictions have negligible impacts on shareholder wealth despite theoretical expectations to the contrary.”).

⁹⁹ Comm’r Luis A. Aguilar, U.S. Sec. and Exch. Comm’n, Speech, *Institutional Investors: Power and Responsibility* (Apr. 19, 2013), <https://www.sec.gov/news/speech/2013-spch041913la.htm>.

¹⁰⁰ See, e.g., Stephen Choi & Marcel Kahan, *The Market Penalty For Mutual Fund Scandals*, 87 BOSTON UNIV. L. REV. 1021, 1025 (2007) (“[W]e find significant withdrawals only when a scandal portends that continued wrongdoing will likely result in future harm to the fund investors. For scandals where the risk of future harm to the fund investors is low, however, we find no statistically or economically significant withdrawals.”); *but see* V. Sampath, N. Gardberg, & N. Rahman, *Corporate Reputation’s Invisible Hand: Bribery, Rational Choice, and Market Penalties*, J. BUS. ETHICS 1, 27 (July 2016) (finding that, of losses observed, “reputational penalties account for 81.8¢ of every dollar of share value loss,” meaning that penalties for market firms may originate from consumers if not investors).

organization, a strong predictor of repeat wrongdoing ironically is previous sanction of the entity for wrongdoing.¹⁰¹ Over time, corporate wrongdoing without individual sanctions grows from small acts to worse ones.¹⁰² Disclosure-based ‘don’t ask, don’t tell’ incentives effectively operate to shield individuals, especially in middle management, from liability.¹⁰³ Only imposing liability on individuals significantly under the level of the corporate form changes business behavior.¹⁰⁴

Thus, the following description of resource-extraction under our ‘don’t ask, don’t tell’ system of disclosure-based regulation speaks only to what the board of directors and top executives may consider in terms of liability, but fails to impose individual liability below them on middle management. Methods for imposing such substantive individual liability become the focus of the end of this Article.¹⁰⁵

II. The Shape of Disclosure-Based Regulation

At the VW guilty plea press conference, Andrew McCabe, the deputy director of the FBI proudly boasted, “[t]his case is a great example of the fact that no corporation is too big, no corporation is too global, and no person is beyond the law.”¹⁰⁶ But what is that law? What are the standards to which corporations are being held? How are we actually incentivizing their behavior? The DOJ and FBI may be bringing cases under the law, but U.S. law—and by extension the law of other countries that replicate its disclosure-based regulatory approach—creates a ‘don’t ask, don’t tell’ system for corporate crime.

This Part surveys VW’s largest liabilities, the structure of U.S. disclosure laws, and briefly describes how similar disclosure-based approaches are taken by the other major jurisdictions where VW faces liability. While this survey is primarily concerned with sovereign national governmental actions against VW, many of these jurisdictions provide for echoing state subdivision and private actions.¹⁰⁷ The sovereign national cases have moved first in the United States and then in South Korea, which like the U.S. is focused on the company’s lies to government officials.¹⁰⁸ In August 2016, the Australian government filed against VW for misrepresentation.¹⁰⁹ At the end of 2016, U.S. and Canadian consumers announced

¹⁰¹ See, e.g., Q. Zheng & R. Chun, *Testing Corporate Immoral Recidivism*, ACAD. MGMT. PROC. 1, 5 (Jan. 2011) (finding with Chinese data that “past immoral conducts were significantly correlated with immediately following ones”); *id.* at 6 (“[W]hen a company does not learn a lesson from its past immoral conduct, it is likely to repeat the same behavior.”); accord A.J. Daboub, A.M. Rasheed, R.L. Priem, & D.A. Gray, D.A., *Top Management Team Characteristics and Corporate Illegal Activity*, 20 ACAD. OF MGMT. REV. 138, 161 (1995) (“[T]he very fact that an organization has engaged in an illegal behavior predisposes it for further illegalities.”).

¹⁰² L. Geriessh, *Organizational Culture and Fraudulent Financial Reporting*, 73 CPA J. 3, 28 (2003).

¹⁰³ [***Redacted**], *The Corporate Conspiracy Vacuum*, 37 CARDOZO L. REV. 1, 289, 290 (2015); [***Redacted**], *The Intracorporate Conspiracy Trap*, 36 CARDOZO L. REV. 969, 1019–23 (2015); LYNN A. STOUT & [***Redacted**], *BUSINESS ETHICS: WHAT EVERYONE SHOULD KNOW* (Oxford Univ. Press, forthcoming 2018).

¹⁰⁴ Accord Timothy P. Glynn, *Beyond ‘Unlimiting’ Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VANDERBILT L. REV. 2, 401-02, 410-11 (2004).

¹⁰⁵ See *infra* pp. 83-85.

¹⁰⁶ Hiroko Tabuchi, Jack Ewing, & Matt Apuzzo, *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>.

¹⁰⁷ See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 225-56 (2007) (describing forms of disclosure-based regulation internationally).

¹⁰⁸ In-Soo Nam, *South Korea Questions Volkswagen Unit Chief as Emissions Probe Widens*, WALL ST. J. (Aug. 18, 2016), <https://www.wsj.com/articles/south-korea-questions-volkswagen-unit-chief-as-emissions-probe-widens-1471507807>.

¹⁰⁹ Robb M. Stewart, *Australia Sues Volkswagen Over Emissions Claims*, WALL ST. J. (Aug. 31, 2016), <https://www.wsj.com/articles/australia-sues-volkswagen-over-emissions-claims-1472700347>.

misrepresentation settlements.¹¹⁰ There are similar groups of private actions based on misrepresentation to consumers proceeding in Britain, Australia, Germany, France, Italy, and Ireland.¹¹¹ Among the above jurisdictions, only the United States, Canada, and Britain have class-action consolidation systems.¹¹² The private German suits, for example, may use similar cases as precedent, but must technically be tried individually.¹¹³

A. VW's Largest Liability

The biggest driver of VW's liability around the world outside the U.S. is a set of cases in Germany alleging that investors lost money on VW shares because the company was too slow to disclose its emissions-cheating problems.¹¹⁴ VW faces a record \$9.2 billion in liability if it admits that its top executives or board knew more about the cheating than what and when they told the public.¹¹⁵ The value of these cases could rise to \$12 billion—and almost \$34 million of that total are U.S. government claims as an investor.¹¹⁶ A second set of German civil cases against VW and its holding company demands another \$614 million on the same basis.¹¹⁷

In November 2016, German prosecutors reversed a previous non-prosecution decision, and announced their own investigation into “whether VW's top management violated German disclosure laws by not informing shareholders as soon as they became aware of the affair.”¹¹⁸ The renewed investigation targets “Martin Winterkorn, the VW chief executive who resigned shortly after the scandal broke, and Hans Dieter Pötsch, chairman of the supervisory board.”¹¹⁹ Prosecutors would mimic the disclosure-based civil cases' theory to hold the executives responsible for VW's drop in stock price.¹²⁰

The German liability debate—as elsewhere—has thus become a game of who among VW's top executives and board knew what and when; not an investigation into how the fraud itself started within the company, spread, and grew to cause so much harm. The German parliament has called VW ex-CEO Winterkorn to testify about when he knew of the emissions-defeat

¹¹⁰ See U.S. settlements *infra* pp. 51–54; Sean O'Shea, *Canadian Volkswagen Diesel Owners Displeased With Deal*, GLOBAL NEWS (Mar. 31, 2017), <http://globalnews.ca/news/3349791/volkswagen-diesel-owners-displeased-with-deal>.

¹¹¹ Jack Ewing & Neal E. Boudette, *As VW Pleads Guilty in U.S. Over Diesel Scandal, Trouble Looms in Europe*, N.Y. TIMES (Mar. 10, 2017), <https://www.nytimes.com/2017/03/10/business/volkswagen-europe-diesel-car-owners.html>; Maria Juul, Briefing, EUR. PARL. RES. SERV., LAWSUITS TRIGGERED BY THE VOLKSWAGEN EMISSIONS CASE at 3-4 (May 2016), [http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/583793/EPRS_BRI\(2016\)583793_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/583793/EPRS_BRI(2016)583793_EN.pdf).

¹¹² Ewing & Boudette, *supra* note 111.

¹¹³ *Id.*

¹¹⁴ Karin Matussek, *VW Sued for Record \$9.2 Billion in German Investor Lawsuits*, BLOOMBERG (Sept. 21, 2016), <https://www.bloomberg.com/news/articles/2016-09-21/vw-investors-sue-for-8-2-billion-euros-in-germany-over-diesel>.

¹¹⁵ *Id.*

¹¹⁶ *Id.* (€10.7 billion & €30 million).

¹¹⁷ *Id.* (€547 million).

¹¹⁸ Patrick McGee, *US Authorities Pursuing More VW Personnel Over Diesel Scandal*, FIN. TIMES (Jan. 12, 2017), <https://www.ft.com/content/36ab8aec-d8e5-11e6-944b-e7eb37a6aa8e>; Jack Ewing, *Volkswagen Emissions Scandal Inquiry Widens to Top Levels*, N.Y. TIMES (Nov. 6, 2016), <http://www.nytimes.com/2016/11/07/business/inquiry-in-emissions-scandal-widens-to-volkswagens-top-levels.html>.

¹¹⁹ McGee, *supra* note 118.

¹²⁰ Ewing, *supra* note 118.

devices.¹²¹ German prosecutors have interrogated VW board members about when they learned of the cheating,¹²² and they have raided VW's Audi-brand executives' homes and offices in an attempt to gain more evidence of executives' cover-up.¹²³

By 2017, VW perceives such a threat to its welfare from disclosure-based timing issues that it has threatened to sue its former chairman, Mr. Ferdinand Piëch, grandson of Ferdinand Porsche who designed the VW Beetle.¹²⁴ According to reports, Mr. Piëch admitted to Braunschweig prosecutors that "members of the supervisory board... were briefed on the diesel scandal in about February or March 2015" instead of when the company asserts that they were informed in September 2015.¹²⁵ VW's 20-member supervisory board has issued a statement that it "emphatically repudiates" Mr. Piëch's testimony.¹²⁶ One of the biggest issues of contention will be Mr. Piëch's assertion that Mr. Winterkorn "knew of the diesel fraud as early as February 2015"¹²⁷ instead of when Mr. Winterkorn asserted to the German parliament that "he did not know what a 'defeat device' was until September 2015."¹²⁸

The focus of these cases on a few months' difference in disclosure timing is bizarre, however, for a fraud that affected eleven million vehicles and was planned over more than ten years. Ex-CEO Winterkorn, for example, is a highly-trained technical engineer who earned a reputation over his thirty-five-years at VW as being "[a] fastidious perfectionist with the nickname 'Mr Quality.'"¹²⁹ He once jokingly boasted "I know every screw in our cars."¹³⁰ If he did not know about the more-than-ten-year deception, it is because he did not want to know.¹³¹

Ironically, in Germany as in the United States, recent disclosure-based prosecution cases that seek to impose liability even on top executives who do communicate with investors have been failing.¹³² This author has written separately about this phenomenon in the United States.¹³³ The failure of these cases at trial makes prosecutors understandably reluctant to charge individuals going forward. In March 2016, for example, a regional court in Germany found two former VW executives not guilty of alleged stock manipulation connected to the Porsche family's 2008

¹²¹ Alison Smale & Jack Ewing, *Ex-Chief of VW Holds Firm During Grilling on Emissions Deception*, N.Y. TIMES (Jan. 19, 2017), <https://www.nytimes.com/2017/01/19/business/germany-investigation-volkswagen-winterkorn-diesel-emissions.html>.

¹²² Patrick McGee, *Volkswagen Threatens Legal Action Against Former Chairman*, FIN. TIMES (Feb. 8, 2017), <https://www.ft.com/content/17a1284e-ee3b-11e6-ba01-119a44939bb6>

¹²³ Jack Ewing, *German Police Raid Audi Offices, Escalating Volkswagen Diesel Inquiry*, N.Y. TIMES (Mar. 15, 2017), <https://www.nytimes.com/2017/03/15/business/audi-vw-diesel-emissions.html>.

¹²⁴ McGee, *supra* note 122.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ Smale & Ewing, *supra* note 121.

¹²⁹ Christina Neuhaus, AFP, *VW Ex-Boss Denies Prior Knowledge of Pollution Cheating*, YAHOO! NEWS (Jan. 19, 2017), <https://www.yahoo.com/news/vw-ex-boss-denies-prior-knowledge-pollution-cheating-000512056.html>; Smale & Ewing, *supra* note 121.

¹³⁰ Neuhaus, *supra* note 129.

¹³¹ By 1999, Audi had developed the basic form of the defeat device that would spread across the other brands. *Consol. Compl.*, *supra* note 4, at 140. In July 2005, emails were being sent back and forth between VW AG and Bosch executives about the defeat device and its problems with U.S. emissions compliance. *Id.* at 152. In 2006, an internal PowerPoint circulated briefing executives on the details of the defeat device with warnings about the need not to be caught by U.S. regulators. *Id.* at 152-53. In 2007, Bosch sent VW AG its detailed warning letter about the illegality of the defeat devices. *Id.* at 154. In 2008, Bosch demanded indemnification from VW—literally using the words "defeat device" in English. *Id.* at 145.

¹³² [***Redacted**], *Paper Dragon Thieves*, 105 GEO. L.J. 4, 908-26 (2017).

¹³³ *Id.* at 926-41; accord Brandon L. Garrett, *The Corporate Criminal as Scapegoat*, 101 VA. L. REV. 1789, 1805-15 (2015).

takeover of VW.¹³⁴ Even before those executives' acquittal, German prosecutors had initially announced that they would not prosecute former CEO Winterkorn for his involvement in the 2015-17 VW scandal, but were forced to backtrack and re-open their investigation in the face of public outrage.¹³⁵

1. The Danger of Precedent

Given the worldwide scale of VW's fraud, the company is particularly sensitive to precedent being set with every suit. Litigation in Australia, for example, is explicitly a test for how EU regulations, which are very similar, may apply to VW's actions.¹³⁶ Customers across Europe are vocally unhappy with VW's payment of compensation to affected customers in the U.S. and Canada, but not in Europe.¹³⁷ German prosecutors in particular are in a political quandary: the health consequences of VW's air pollution will be felt more strongly in Germany than in the U.S. because of the country's population density and higher percentage of diesel cars on the road.¹³⁸ But VW employs 300,000 people in the country,¹³⁹ and the regional government of Lower Saxony owns twenty percent of VW AG.¹⁴⁰ California state officials accuse German prime minister Angela Merkel of improperly pressuring them not to investigate VW's defeat devices.¹⁴¹ The EU itself has not filed criminal charges against VW, and objects that its member states have not granted it the authority to investigate charges against other car manufacturers such as Fiat Chrysler, which the U.S. government has also accused of defeat-device violations.¹⁴²

B. The Impact of U.S. Disclosure Laws

Driving even VW's international liabilities, however, remains the U.S. system of disclosure laws. Not only is the U.S. a plaintiff in the German civil suits that have the potential to cost VW the most money, but across the world, the U.S. tends to move first in its own courts and to

¹³⁴ Ilka Kopplin & Eyk Henning, *Ex-Porsche Executives Acquitted of Market Manipulation in Volkswagen Bid*, WALL ST. J. (Mar. 18, 2016), <http://www.wsj.com/articles/porsche-executives-acquitted-of-market-manipulation-in-volkswagen-bid-1458293491>.

¹³⁵ Danny Hakim & Jack Ewing, *VW Refuses to Give American States Documents in Emissions Inquiries*, N.Y. TIMES (Jan. 8, 2016), <http://www.nytimes.com/2016/01/09/business/vw-refuses-to-give-us-states-documents-in-emissions-inquiries.html>.

¹³⁶ Steward, *supra* note 109.

¹³⁷ In January 2017, British drivers filed a class action against VW, citing disparity of treatment with U.S. consumers. Ray Massey, *Give Us £3,000 Each, British Drivers Tell Volkswagen*, THE DAILY MAIL (Jan. 8, 2017), <http://www.dailymail.co.uk/news/article-4100220/Class-action-launched-against-Volkswagen-ten-thousand-owners-Dieselgate-scandal.html>. A representative of the European Consumer Organisation explains "[t]he fact that VW refuses to pay compensation in Europe but is ready to pay in the US adds insult to injury." *Id.* (quoting Monique Goyens).

¹³⁸ Diesel cars are three percent of U.S. cars on the road, but fifty percent of European cars. Jessica Lussenhop, *Why do American Car Buyers Shy Away from Diesel?*, BBC NEWS (Sept. 23, 2015), <http://www.bbc.com/news/world-us-canada-34329596>.

¹³⁹ Kapadia, *supra* note 3.

¹⁴⁰ Christoph Rauwald, *Germany's Lower Saxony Defends its Role as VW Anchor Shareholder*, BLOOMBERG (June 23, 2016), <https://www.bloomberg.com/news/articles/2016-06-23/germany-s-lower-saxony-defends-its-role-as-vw-anchor-shareholder>.

¹⁴¹ Friedrich Geiger, *Merkel Complained in 2010 About California Emissions Rules*, WALL ST. J. (Nov. 12, 2015), <https://www.wsj.com/articles/merkel-complained-in-2010-about-california-emissions-rules-1447349303>.

¹⁴² Nick Kostov, *Renault Under Investigation in France Over Emissions*, WALL ST. J. (Jan. 13, 2017), <https://www.wsj.com/articles/renault-under-investigation-in-france-over-emissions-1484303906>.

receive the largest settlements.¹⁴³ The evidence produced in U.S. courts and the U.S.’s approach to large-scale corporate crimes echo in jurisdictions around the world.

It is thus important that there is boiling frustration with the over-emphasis of form over substance in U.S. law on white collar crime.¹⁴⁴ As will be seen, not only is the U.S.’s technical, rule-based enforcement system not producing the results that best protect the public from large-scale fraud, but its emphasis on disclosure alone is designed for the easy extraction of resources from companies for technical violations.¹⁴⁵ The system imposes unreasonable burdens on businesses to allocate their resources to comply with disclosure rules at the price of more substantive changes in accountability and reduction of harm to the public.¹⁴⁶

1. The Sources of ‘Don’t Ask, Don’t Tell’ Liability

The primary U.S. legal tools for regulating white collar crime outside of tax and industry-specific rules¹⁴⁷ are (1) anti-bribery laws including the FCPA,¹⁴⁸ (2) securities disclosure laws discussed *infra*,¹⁴⁹ and (3) wire and other prosecutions for fraudulent misrepresentation.¹⁵⁰ These federal laws often have corollaries at the state and local levels.

i. The FCPA

There is no allegation in the 2015-17 scandal that VW has bribed officials, but VW did bribe German officials as recently as a scandal in 2005.¹⁵¹ In 2016, companies paid a record \$3.85 billion to settle FCPA claims with the U.S. government.¹⁵² Interestingly, the U.S.’s rationale for enforcing the FCPA is very similar to its rationale for enforcing the securities laws—right down to the use of the phrase “level[ing] the playing field.”¹⁵³ In fact, as of 2016, it is the SEC that

¹⁴³ See *infra* pp. 36–38.

¹⁴⁴ *Id.*

¹⁴⁵ See *infra* pp. 24–30.

¹⁴⁶ See, e.g., Robert C. Bird & Stephen Kim Park, *Turning Corporate Compliance Into Competitive Advantage*, 19 U. PA. J. BUS. L. ___, 18-29 (forthcoming 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2763348 (describing a balance of regulation and costs for optimal compliance).

¹⁴⁷ The author discusses anti-money laundering statutes later in this Article, but those are an example of rules that primarily govern the financial industry. See *infra* pp. 62–67.

¹⁴⁸ The Foreign Corrupt Practices Act of 1977, *codified at* 15 U.S.C. §§ 78dd-1 to -3 (2012).

¹⁴⁹ See *infra* pp. 38–42.

¹⁵⁰ See *infra* pp. 47–51.

¹⁵¹ Dietmar Hawranek, Padma Rao, & Sven Röbel, *Scandal at Volkswagen: With Prostitutes and Shady Executives, There’s No Love Left in this Bug*, DER SPIEGEL (July 18, 2005), <http://www.spiegel.de/international/spiegel/scandal-at-volkswagen-with-prostitutes-and-shady-executives-there-s-no-love-left-in-this-bug-a-365752-2.html>.

¹⁵² Author’s calculation from SEC and DOJ websites. See also Richard L. Cassin, *The 2016 FCPA Enforcement Index*, FCPABLOG.COM (Jan. 3, 2017), <http://www.fcpablog.com/blog/2017/1/3/the-2016-fcpa-enforcement-index.html>. The Author’s numbers include Braskem S.A.’s \$957 million agreed to on Dec. 21, 2016 as well as other monies listed by the SEC as settled that year. The Author did not include the Rolls Royce case listed under 2016 on the DOJ’s website because the settlement was announced in January 2017. DOJ, *Related Enforcement Actions: 2016* (last visited April 29, 2017), <https://www.justice.gov/criminal-fraud/case/related-enforcement-actions/2016>.

¹⁵³ *Compare* Press Release and Text of Speech, Dep’t of Justice, Acting Principal Deputy Asst. Att’y Gen. Trevor N. McFadden Speaks at Anti-Corruption, Export Controls & Sanctions 10th Compliance Summit (Apr. 18, 2017), <https://www.justice.gov/opa/speech/acting-principal-deputy-assistant-attorney-general-trevor-n-mcfadden-speaks-anti>, with Chairman Mary Schapiro, U.S. Sec. & Exch. Comm’n, Speech, Opening Statement at SEC Open Meeting (June 29, 2011), <https://www.sec.gov/news/speech/2011/spch062911mls.htm>.

garners nearly 90 percent of FCPA enforcement dollars.¹⁵⁴ The agency exercises jurisdiction on the basis that companies—even foreign companies such as VW AG—issue stock in the U.S.¹⁵⁵

ii. Securities Laws

Even though the SEC is not one of the agencies currently prosecuting VW, securities fraud has become the catch-all category under which to prosecute most corporate crime. Other broad corporate conspiracies such as the tobacco industry's lies about the cancer risks associated with smoking and, in 2015, Exxon Mobil's alleged attempts to suppress information about its product's impacts on climate change, have been first investigated as the companies' failure to have adequately warned investors about potential financial risks.¹⁵⁶ One of the largest payments in the Deepwater Horizon oil spill case, for example, was the \$525 million that BP paid to settle SEC charges of securities fraud related to public statements describing the spill.¹⁵⁷

Most importantly, disclosure-based regulation as shaped by the SEC drives white collar liabilities in the U.S. and increasingly, internationally as well. In the VW case, the company's largest liabilities are for securities fraud in Germany, and it has appointed a securities lawyer to be its new top attorney for North America.¹⁵⁸ In Jan. 2017, a U.S. federal judge agreed to let private U.S. VW securities cases proceed, and damages from those cases may soon dwarf other settlements.¹⁵⁹

U.S. disclosure statutes and regulations require public companies to disclose all “material” information to investors.¹⁶⁰ At the federal level, although there are five other major securities laws, most securities fraud is charged under the Securities Act of 1933¹⁶¹ (1933 Act) and the Securities Exchange Act of 1934¹⁶² (1934 Act).¹⁶³ The well-known reform efforts of the Sarbanes-Oxley Act of 2002¹⁶⁴ (SOX) and the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act¹⁶⁵ (Dodd-Frank), for example, amended these basic securities laws. The 1933 Act controls the issuance of securities, and the 1934 Act controls the trading of securities after they are issued.¹⁶⁶ The 1934 Act applies to all publicly traded companies with

¹⁵⁴ Author's calculation using U.S. Sec. & Exch. Comm'n, *SEC Enforcement Actions: FCPA Cases* (last visited Apr. 29, 2017), <https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml>. Jurisdictional basis as described by the SEC. *Id.*

¹⁵⁵ *Id.*; see also discussion *infra* pp. 43–45.

¹⁵⁶ Justin Gillis & Clifford Krauss, *Exxon Mobil Investigated for Possible Climate Change Lies by New York Attorney General*, N.Y. TIMES (Nov. 5, 2015), <http://www.nytimes.com/2015/11/06/science/exxon-mobil-under-investigation-in-new-york-over-climate-statements.html>.

¹⁵⁷ Press Release, SEC, BP to Pay \$525 Million Penalty to Settle SEC Charges of Securities Fraud During Deepwater Horizon Oil Spill (Nov. 15, 2012), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171485962>.

¹⁵⁸ David Shepardson, *VW Replaces Top U.S. Lawyer As Seeks To Win Approval On Emissions Fix*, REUTERS (Feb. 4, 2016), <http://uk.reuters.com/article/uk-volkswagen-emissions-fix-idUKKCN0VD284>.

¹⁵⁹ Order Re: Mots. to Dismiss the Consol. Sec. Class Action Compl., Doc. No. 2636, at 2, In re: Volkswagen “Clean Diesel” Litigation, 3:15-md-02672-CRB (N.D. Calif., Jan. 4, 2017); William Boston, *Volkswagen Must Face U.S. Investor Suit Over Emissions, Judge Rules*, WALL ST. J. (Jan. 6, 2017), <https://www.wsj.com/articles/volkswagen-must-face-u-s-investor-suit-over-emissions-judge-rules-1483638864>.

¹⁶⁰ See, e.g., 17 C.F.R. § 240.10b-5 (2015) (prohibiting any person from making false statements or omissions of a material fact in connection with the purchase or sale of securities).

¹⁶¹ 15 U.S.C. §§ 77a–77aa (2012).

¹⁶² 15 U.S.C. §§ 78a–78nn (2012).

¹⁶³ See, e.g., Brian Lewis et al., *Securities Fraud*, 52 AM. CRIM. L. REV. 1567, 1568–69 (2015).

¹⁶⁴ Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C.).

¹⁶⁵ Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of 5 U.S.C. & 12 U.S.C.).

¹⁶⁶ Lewis et al., *supra* note 163, at 1569.

more than 500 shareholders and ten million dollars in assets.¹⁶⁷ Most securities prosecutions are brought under Rule 10b-5¹⁶⁸ and Section 32(a) of the 1934 Act,¹⁶⁹ which prohibit insider trading, as well as other types of fraud based on material misrepresentations, omissions, or both.¹⁷⁰

According to the U.S. Supreme Court, information is “material” when there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”¹⁷¹ The SEC requires the regular disclosure of material information in Form 10-K, Form 20-F, and other filings.¹⁷²

In practice, insider trading, which prohibits the non-public dissemination of material information for trading purposes, has become a strict liability crime for disclosure personnel prosecuted under the SEC’s theory of “control person” liability.¹⁷³ “Control person” liability also applies under Section 20 of the Securities Exchange Act of 1934¹⁷⁴ and the FCPA.¹⁷⁵

The remaining securities fraud standards effectively collapse into a single inquiry into whether the defendant mishandled, omitted, or misrepresented material information, either knowingly or with reckless disregard for the truth.¹⁷⁶ Civil securities fraud, which includes the misrepresentation of material information to investors, requires an “intent to deceive, manipulate, or defraud.”¹⁷⁷ The Seventh Circuit and many other appellate courts allow the intent for civil securities fraud to be satisfied by a defendant’s reckless action.¹⁷⁸ The classic case involves the reckless omission of material facts.¹⁷⁹ Criminal securities fraud, which contains almost the same elements as civil securities fraud but must be proven beyond a reasonable doubt, requires “willfulness” on the part of a defendant.¹⁸⁰ And, similar to civil cases, criminal securities fraud “willfulness” can be satisfied by a “defendant’s reckless disregard for the truth.”¹⁸¹

These disclosure-based standards, however, are both overly broad and overly narrow as a method of enforcement.¹⁸² Companies and compliance officers live in fear of how many

¹⁶⁷ 15 U.S.C. § 78l(g).

¹⁶⁸ 17 C.F.R. § 240.10b-5 (2015).

¹⁶⁹ 15 U.S.C. § 78ff(a).

¹⁷⁰ Lewis et al., *supra* note 163, at 1570, 1579.

¹⁷¹ TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

¹⁷² Specifically, SEC Regulation S-K, which prescribes the disclosure requirements for Form 10-K and other filings, requires that companies describe factors in transactions such as “the relationships among the parties, the structure of the securities offered (including, for example, the flow of funds or any subordination features) and any other material features.” 17 C.F.R. § 229.1103(a).

¹⁷³ See, e.g., Christopher L. Garcia & Boyd M. Johnson III, *Defending Clients in Insider Trading Investigations and Enforcement Actions*, in DEFENDING CORPORATIONS AND INDIVIDUALS IN GOVERNMENT INVESTIGATIONS 633, 642–43 (Daniel J. Fetterman & Mark P. Goodman eds., 2012–13).

¹⁷⁴ 15 U.S.C. § 78t (2012).

¹⁷⁵ 15 U.S.C. §§ 78dd-1 to -3 (2012).

¹⁷⁶ Lewis et al., *supra* note 163, at 1580.

¹⁷⁷ *Id.* at 1577–78 (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976)).

¹⁷⁸ *Id.* at 1578.

¹⁷⁹ Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977).

¹⁸⁰ United States v. Dearing, 504 F.3d 897, 902 (9th Cir. 2007); Lewis et al., *supra* note 163, at 1579.

¹⁸¹ *Dearing*, 504 F.3d at 903; Lewis et al., *supra* note 163, at 1579.

¹⁸² See, e.g., Coffee, *supra* note 107, at 305 (“At present, we have both too little private enforcement and too much—too little in that the outside professionals are rarely sued and corporate officers often pay nothing, and too much in that the corporation itself is regularly sued and settles at the shareholders’ expense.”); Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1303 (2008) (“Rule 10b-5 class actions may both overdeter some actors (e.g., issuers, who face essentially strict enterprise liability for the frauds of their agents) and underdeter others (e.g., individual wrongdoers, who are rarely forced to contribute to settlements . . .).”).

statements can be swept up in the overly broad concept of “material risk.”¹⁸³ As Professors Jolls, Sunstein, and Thaler have explained the conundrum, “[d]ecisionmakers in such a case are required to make an after-the-fact determination of whether a reasonable ex ante decisionmaker would have thought the prospective issue or problem ‘material’ to the average shareholder based on the information available at the time.”¹⁸⁴ Hence, in practical terms, there is a large measure of uncontrollability and/or inevitability in the outcome. Indeed, “the main predictor of whether a securities fraud action is brought seems to be whether there has been a large change in the company’s stock market value, not whether the company’s behavior was reasonable from an ex ante perspective.”¹⁸⁵ Meanwhile, because most of a company’s agents have no personal duty of disclosure, they remain unaffected by the overly narrow impact of disclosure-based regulations.¹⁸⁶

Top officials who personally sign SEC filings or who communicate with investors may be liable for material misrepresentations, omissions, or both, but this leaves out the vast majority of agents under the corporate forms of most companies.¹⁸⁷ Businesses have thus started appointing specific people with disclosure duties who will take the organizational fall, regardless of whether they had any involvement in—or even knowledge of—the wrongdoing within the organization. Appointing these ‘Vice Presidents of Going to Jail’ may satisfy the public’s need for vengeance, but structuring the law this way has limited ability to prevent or even restrain the size of corporate scandals.¹⁸⁸

After SOX, the SEC does impose a duty on attorneys “to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof).”¹⁸⁹ If these specific company officers do not act on the information, the attorney must then report to members of the board.¹⁹⁰ But the SEC still does not require an attorney to report a violation outside of the company.¹⁹¹ Most company agents who are not attorneys, audit professionals, the CEO, or the board, have nothing to worry about from disclosure-based regulations.

iii. Wire and Other Forms of Fraudulent Misrepresentation

VW and its executives also focus on disclosure to the exclusion of substance because their guilty pleas have not been to the immediate harm they caused the public, but only to having been caught lying. Blindness to this distinction pervades not only the charges, discussed in more detail below, but even the press conference language government officials used to describe the

¹⁸³ See, e.g., description of public reaction to rulemaking, Sec. & Exch Comm’n, *Final Rule: Selective Disclosure and Insider Trading*, 17 CFR Parts 240, 243, and 249, Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99, RIN 3235-AH82, <https://www.sec.gov/rules/final/33-7881.htm>.

¹⁸⁴ Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1532-33 (1998).

¹⁸⁵ *Id.* at 1533.

¹⁸⁶ See Coffee, *supra* note 107, at 305; Rose, *supra* note 183, at 1303.

¹⁸⁷ Coffee, *supra* note 107, at 305; Rose, *supra* note 183, at 1303.

¹⁸⁸ Matt Apuzzo & Ben Protess, *Justice Department Sets Sights on Wall Street Executives*, N.Y. TIMES (Sept. 9, 2015), <http://www.nytimes.com/2015/09/10/us/politics/new-justice-dept-rules-aimed-at-prosecuting-corporate-executives.html>.

¹⁸⁹ Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6296 n.1 (Feb. 6, 2003) (codified at 17 C.F.R. pt. 205).

¹⁹⁰ *Id.*

¹⁹¹ Lewis et al., *supra* note 163, at 1647.

settlement. Rather than focusing on the first-order danger to the public from VW's fraud, the officials instead repeatedly objected to being lied to.¹⁹²

VW's federal criminal and civil settlements

The main statutes through which federal prosecutors charge a company with lying are wire and other forms of propagating fraudulent statements. In fact, by 2016, 75.6 percent of all federal white collar cases charge a version of fraud.¹⁹³ This statistic is particularly significant because, as a whole, the U.S. is prosecuting fewer white collar crime cases than at any point over the last twenty years.¹⁹⁴ By February 2017, white collar prosecutions have fallen 40.4 percent from five years ago.¹⁹⁵ There is an argument this Article addresses *infra* that lying is a form of the lowest-hanging fruit for prosecutors reluctant to build or charge more substantive cases, and this may be the reason why prosecutions for fraud dominate the declining numbers.¹⁹⁶ Regardless, companies such as VW understand that fraudulent statements are for what they are liable.

In its January 2017 federal settlements, VW pled guilty to violating three criminal statutes, and it resolved its civil claims with three federal agencies.¹⁹⁷

The criminal settlement covers emissions-control defeat devices on over 500,000 cars in the United States including seven 2.0-liter diesel engine VW-brand models, six 3.0-liter diesel VW and Audi models, and the diesel Porsche-brand Cayenne.¹⁹⁸

The three criminal statutes to which VW AG pled guilty are 18 U.S.C. §371, 18 U.S.C. §1512, and 18 U.S.C. §542.¹⁹⁹

Under 18 U.S.C. §371, the company admits to conspiring to defraud the United States, committing wire fraud, and violating the Clean Air Act.²⁰⁰ Although presented in multiple parts, this charge boils down to misrepresentation. The three parts of the charge are (i) conspiracy, (ii) to violate the wire fraud statute; and (iii) the Clean Air Act.²⁰¹ First, the law requires that “two or more persons conspired... to defraud the United States or one of its agencies... in this case, the Environmental Protection Agency... by dishonest means.”²⁰² Second, there was “a violation of the wire fraud statute (18 U.S.C. § 1343)” requiring that the “defendant knowingly participated

¹⁹² See, e.g., Aruna Viswanatha, William Boston, & Mike Spector, *U.S. Indicts Six Volkswagen Executives in Emission Scandal*, WALL ST. J. (Jan. 11, 2017), <https://www.wsj.com/articles/volkswagen-pleads-guilty-in-u-s-emissions-scand-1484159603> (“Volkswagen knew of these problems, and when regulators expressed concerns, [executives] obfuscated... and they ultimately lied.”) (quoting U.S. Attn’y Gen. Loretta Lynch); *id.* (“It’s now clear that Volkswagen’s top executives knew about this illegal activity,” but they purposefully “kept stakeholders ‘in the dark.’”) (quoting FBI Deputy Dir. Andrew McCabe).

¹⁹³ Author’s calculations from data supplied by the DOJ and grouped by TRAC reports. TRAC Reports, *White Collar Crime Convictions Continue To Decline* (last visited Apr. 30, 2017), <http://trac.syr.edu/tracreports/crim/421>.

¹⁹⁴ *Id.*

¹⁹⁵ TRAC Reports, *White Collar Crime Prosecutions for February 2017* (last visited Apr. 30, 2017), http://trac.syr.edu/tracreports/bulletins/white_collar_crime/monthlyfeb17/fil.

¹⁹⁶ See *infra* pp. 55–56, 88.

¹⁹⁷ DOJ, *supra* note 2.

¹⁹⁸ *VW Plea*, *supra* note 4, at Exh. 2-8 & 2-9. The seven types of 2.0-liter engine vehicles covered are model years: 2009-15 VW Jetta; 2009-14 VW Jetta Sportwagen; 2010-15 VW Golf; 2015 VW Golf Sportwagen; 2010-13 & 2015 Audi A3; 2013-15 VW Beetle and VW Beetle Convertible; and 2012-15 VW Passat. *Id.* at Exh. 2-8. The six types of 3.0-liter engine vehicles covered are model years: 2009-16 VW Touareg; 2009-15 Audi Q7; 2014-16 Audi A6 Quattro; 2014-16 Audi A7 Quattro; 2014-16 Audi A8L; and 2014-16 Audi Q5. *Id.* at Exh. 2-8 & 2-9. The Porsche cars are 2013-16 Porsche Cayenne diesel vehicles. *Id.* at Exh. 2-9.

¹⁹⁹ *VW Plea*, *supra* note 4, at 2-3.

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² *Id.* at 3.

in, devised, or intended to devise a scheme to defraud in order to obtain money or property;” that the “scheme included a material misrepresentation or concealment of a material fact;” that the “defendant had the intent to defraud;” and the “defendant used (or caused another to use) wire, radio or television communication in interstate or foreign commerce in furtherance of the scheme.”²⁰³ And third, the “defendant knowingly made (or caused to be made) a false material statement, representation, or certification, or omission of material information;” that “was in a notice, application, record, report, plan or other document required to be filed or maintained under the Clean Air Act [42 U.S.C. §7413(c)(2)(A)];” and the “statement, representation, certification, or omission of information, was material.”²⁰⁴

Under 18 U.S.C. §1512, VW obstructed justice by concealing or destroying evidence—in essence, lying.²⁰⁵ And under 18 U.S.C. §541, it entered goods by false statement.²⁰⁶

The three federal agencies with which VW reached civil resolutions were the EPA, the U.S. Customs and Border Protection (CBP), and the DOJ Civil Division. All three agencies’ charges establish deficiencies only in VW’s disclosures. The EPA settlement establishes liability on the basis that the emissions-defeat device software was “not disclosed in the Certificate of Conformity applications” under the Clean Air Act.²⁰⁷ The CBP settlement is based on “alleged misrepresentations, omissions, or submission of inaccurate information on importation and entry pertaining to compliance with environmental laws and emissions requirements.”²⁰⁸ The DOJ Civil Division settlement is for manipulation of the financial system²⁰⁹ under a theory that “VW represented to its United States customers, United States dealers, and others in the United States that the Subject vehicles met applicable United States emissions standards and designed a specific marketing campaign to market these vehicle to United States customers as ‘clean diesel’ vehicles....”²¹⁰ Based on VW’s misrepresentations, the “loans, leases, and floorplan financing of Volkswagen vehicles” contaminated pools of asset-backed securities that federally-insured financial institutions purchased and for which they served as trustees.²¹¹

On the same day that VW’s federal settlement was announced, the DOJ filed an indictment against six VW executives.²¹² The executives’ indictment is similarly flawed and dependent on the same disclosure-based charges.

The six named executives served as public faces of the company in its interactions with regulators rather than deeper-level engineers who also coordinated the code.²¹³ The facts of the

²⁰³ *Id.* at 4-5.

²⁰⁴ *Id.* at 5.

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 6.

²⁰⁷ Third Partial Consent Decree, at 2, In re: Volkswagen “Clean Diesel” Litigation, 3:15-md-02672-CRB (N.D. Calif., Jan. 11, 2017). The EPA had alleged violations of 42 U.S.C. §§ 203(a)(1), (2), (3)(A), and (3)(B) of the Clean Air Act. *Id.* at 1.

²⁰⁸ Settlement Agreement, U.S. Customs and Border Protection v. Volkswagen, at 2 (Jan. 11, 2017), available as “VW AG CPB Settlement” at <https://www.justice.gov/opa/pr/volkswagen-ag-agrees-plead-guilty-and-pay-43-billion-criminal-and-civil-penalties-six>.

²⁰⁹ The civil monetary penalty was collected under FIRREA, the Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 U.S.C. § 1833a. Settlement Agreement, Dept. of Justice v. Volkswagen, at 6 (Jan. 11, 2017), available as “Firrea Settlement Agreement” at <https://www.justice.gov/opa/pr/volkswagen-ag-agrees-plead-guilty-and-pay-43-billion-criminal-and-civil-penalties-six>.

²¹⁰ *Id.* at 3.

²¹¹ *Id.*

²¹² *Executives Indictment, supra* note 57, at 1.

²¹³ The six executives are Oliver Schmidt—the only one of the six to be arrested—VW’s head of U.S. compliance who allegedly lied repeatedly to government regulators; Heinz-Jacob Neusser, an executive who represented the company at new car shows; Jürgen Peter, who worked in Germany to invent the excuses that VW AG would use with American regulators and pleaded with colleagues for them to “Come up with a story please;” Richard

filings would establish that the individuals ordered, pressured their subordinates, and explicitly facilitated large-scale coordinated wrongdoing.²¹⁴ Meanwhile, the charges in the indictments merely assert that the individuals, like VW itself, misrepresented or omitted facts to regulators or the public—in other words, liability for covering up the fraud, not for orchestrating and perpetuating it.²¹⁵

Count One against all individual defendants alleges violation of 18 U.S.C. §371, the charge of defrauding the government to which VW AG pled guilty—with the same flaws as described above. Counts Two through Ten against four of the six defendants allege violations of the Clean Air Act on the same misrepresentation basis that the defendants “did knowingly make and cause to be made, false material statements, representations, and certifications in, and omit and cause to be omitted material information from, notices, applications, records, reports, plans, and other documents required pursuant to the... Act.”²¹⁶ Counts Eleven through Eighteen against four of the six defendants allege misrepresentation through wire fraud.²¹⁷

The only other individual charged in the VW scandal thus far has been the company’s U.S. Leader of Diesel Competence, an engineer named James Liang.²¹⁸ On Sept. 9, 2016, he pled guilty to one count under 18 U.S.C. §371, the same charge of defrauding the government to which VW AG would plead.²¹⁹ Lang has cooperated extensively with the federal government, and he is expected to receive credit for his cooperation at sentencing.²²⁰

Meanwhile, strangely missing from the U.S. individual indictments are several people described in the VW settlement as committing internal wrongdoing without making outside statements on behalf of the company. Prosecutors know the identity, for example, of “Supervisor B,” “senior executives [who] rebuffed a group of Volkswagen engineers who had discovered the illegal software,” and “Attorney A.”²²¹ According to the VW plea statement of facts, in 2006, “Supervisor B” specifically overruled engineers who had “raised objection to the propriety of the defeat device,” ordered them to continue, and “instructed those in attendance...not to get caught.”²²² In 2012, a group of senior executives who had received a presentation on the illegal software from nervous engineers “encouraged the further concealment of the software” and “instructed the engineers...to destroy the document they had used to illustrate the operation of

Dorenkamp, who spoke often at industry gatherings; Bernd Gottweis, VW’s internal “fireman” who warned ex-CEO Winterkorn that U.S. regulators were investigating VW’s defeat devices; and Jen Hadler, who had a doctorate in engineering but pushed VW’s fraudulent “clean diesel” strategy. Jack Ewing, *Volkswagen’s Diesel Scandal: Who Has Been Charged?*, N.Y. TIMES (Jan. 13, 2017), <https://www.nytimes.com/2017/01/13/business/volkswagen-diesel-emissions-executives.html>.

²¹⁴ *Executives Indictment*, *supra* note 57.

²¹⁵ *Id.*

²¹⁶ *Id.* at 32.

²¹⁷ *Id.* at 35–36 (citing 18 U.S.C. §§ 1343 and 2). Defendants allegedly “did knowingly, willfully, and with the intent to defraud, having devised and intending to devise a scheme and artifice to defraud, and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, knowing such pretenses, representations, and promises were false and fraudulent when made, transmit and cause to be transmitted, by means of wire, radio, and television communication, writings, signals, pictures, and sounds in interstate and foreign commerce for the purposes of executing such scheme and artifice.” *Id.*

²¹⁸ Indictment, *supra* note 57, at 8.

²¹⁹ Plea, *supra* note 59.

²²⁰ Chris Isidore, *Volkswagen Engineer Pleads Guilty To Criminal Charges In Emissions Cheating Case*, CNN MONEY (Sept. 9, 2016), <http://money.cnn.com/2016/09/09/news/companies/volkswagen-engineer-emissions-scandal-guilty-plea>.

²²¹ Jack Ewing, *More VW Executives Could Be Charged, Court Documents Suggest*, N.Y. TIMES (Jan. 13, 2017), <https://www.nytimes.com/2017/01/13/business/volkswagen-emissions-scandal-charges.html>.

²²² *VW Plea*, *supra* note 4, at Ex. 2-14.

the defeat device software.”²²³ In 2015, as regulators were closing in and had issued a litigation hold notice to VW, “Attorney A” urged engineers to destroy documents relevant to the defeat device, and at least two other VW AG employees contacted employees at another company to delete their documents as well.²²⁴ As a result of “Attorney A”’s instructions, at least 40 employees deleted thousands of documents,²²⁵ but many of those documents were later recovered through computer forensic examinations.²²⁶

Civil Fraud against Consumers

The last major form of VW’s liability is under consumer protection laws that rely on proof of misrepresentation. These liabilities are additionally based on disclosure—here to the public—and again litigation in the U.S. is leading cases around the world.

Private U.S. litigation against VW has been consolidated as multidistrict litigation (MDL) class actions in the Northern District of California.²²⁷ The MDL has been brought on behalf of U.S. consumers,²²⁸ reselling dealerships,²²⁹ competitor brand dealerships,²³⁰ securities litigants such as pension and investment funds that have been affected by changes in stock prices,²³¹ and a case from the Eastern District of Michigan in which the EPA sued for misrepresentation, offers for sale, tampering, and reporting violations under the Clean Air Act.²³² The State of California

²²³ *Id.* at Ex. 2-19.

²²⁴ *Id.* at Exs. 2-28–30.

²²⁵ Jack Ewing, *Inside VW’s Campaign of Trickery*, N.Y. TIMES (May 6, 2017), <https://mobile.nytimes.com/2017/05/06/business/inside-vws-campaign-of-trickery.html>.

²²⁶ *VW Plea*, *supra* note 4, at Ex. 2-30.

²²⁷ Coral Davenport & Danny Hakim, *U.S. Sues Volkswagen in Diesel Emissions Scandal*, N.Y. TIMES (Jan. 4, 2016), <http://www.nytimes.com/2016/01/05/business/vw-sued-justice-department-emissions-scandal.html>; Transfer Order from Judicial Panel on Multidistrict Litigation, Doc. No. 1, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Dec. 8, 2015).

²²⁸ These are individuals and business that have purchases or leased one of the affected cars in the U.S. Consol. Consumer Class Action Compl. at 3, 6-14, Doc. No. 1230, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Feb. 22, 2016); *accord Consol. Compl.*, *supra* note 4. See additional suit description *infra* text and notes 236-241.

²²⁹ The two named dealerships were independent businesses that bought affected vehicles. Consol. Am. Reseller Dealership Class Action Compl. at 5, Doc. No. 1231, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Feb. 22, 2016). The charges are the same RICO “mail and wire fraud” violation as in the consumer suit, see *infra*, as well as common law fraud, failure to recall/retrofit, and unjust enrichment from VW’s misrepresentations. *Id.* at 61-84; *accord* Second Am. Consol. Reseller Dealership Class Action Compl. (Redacted), Doc. No. 1805, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Sept. 2, 2016).

²³⁰ These cases included Carriage Chevrolet, Inc., Case No. 3:16-cv-00296; Brown Daub Chevrolet of Nazareth, Inc., Case No. 3:15-cv-06245; Eagle Auto Mall Corp., Case No. 3:15-cv-05923; Saturn SW Florida LLC et al., Case No. 3:15-cv-05959; Windham Motor Co. Inc., Case No. 3:16-cv-00310. Consol. Am. Competitor Dealership Class Action Compl., Doc. No. 1232, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Feb. 22, 2016). The charges are for “false statement and misrepresentations” in advertising under the Lanham Act, as well as unfair competition and deceptive acts under state laws. *Id.* at 57-68; *accord* Second Am. Consol. Competitor Dealership Class Action Compl. (Redacted), Doc. No. 1806, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Sept. 2, 2016).

²³¹ These cases included the City of St. Clair Shores, 15-1228 (E.D. Va.); Travalio, 15-7157 (D.N.J.); George Leon Family Trust, 15-7283 (D.N.J.); Charter Twp. of Clinton, 15-13999 (E.D. Mich.); and Wolfenbarger, 15-326 (E.D. Tenn.). Pretrial Order No. 4: Order Appointing Lead Pl. in Sec. Actions, Doc. No. 545, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Jan. 5, 2016).

²³² Pretrial Order No. 7: Order Appointing Pls.’ Lead Counsel, Pls.’ Steering Comm., and Gov’t Coordinating Counsel at 5, Doc. No. 1084, In re: Volkswagen “Clean Diesel” MDL, 3:15-md-02672-CRB (N.D. Calif., filed Jan.

claimed environmental damages based on false advertising and other misrepresentations.²³³ The Plaintiffs Steering Committee for the non-government cases alone is twenty-two attorneys.²³⁴ The MDL names VW AG; VW AG’s American Volkswagen, Audi, and Porsche brands; Bosch; and top executives of the companies.²³⁵

All of the MDL charges are disclosure-based even though, as in the agency cases above, the statements of alleged facts would seem to support charges for more complex underlying harms. For example, much of the consumer complaint describes emotional and physical harms to the plaintiffs from driving cars that created forty times the levels of air pollution than they had expected.²³⁶ The plaintiffs’ harm results from the defendants having “disregarded their rights, and used them as unwitting puppets in a scheme that jeopardized the safety of the American public.”²³⁷ Yet the consumer complaint asserts only disclosure-based liability such as a RICO violation based on “mail and wire fraud,”²³⁸ misleading advertising in violation of federal²³⁹ and state consumer protection laws,²⁴⁰ as well as common law fraud, breach of contract, and unjust enrichment from VW’s misrepresentations.²⁴¹

The MDL has produced three major settlements. In July 2016, VW settled with the parties regarding its 2.0-liter diesel engine vehicles.²⁴² In February 2017, VW settled over its 3.0-liter engine vehicles.²⁴³ Also in February 2017, Bosch settled over its involvement with both VW’s 2.0- and 3.0-liter engines.²⁴⁴ According to the settlements, U.S. consumers may sell their cars back to VW for \$7,500 over the value of the vehicle.²⁴⁵ In the alternative, VW will compensate consumers between \$5,100–\$10,000 for affected 2.0-liter cars, and \$7,000–\$16,000 per 3.0-liter vehicle.²⁴⁶ Bosch will pay \$350 to customers who bought affected 2.0-liter-engine cars and \$1,500 for larger 3.0-liter cars.²⁴⁷

21, 2016); Compl., at 20-26, U.S. v. Volkswagen AG, et al., 2:16-cv-10006 (E.D. Mich., filed Jan. 4, 2016) (consolidated into MDL).

²³³ Second Partial Consent Decree at 2, California v. Volkswagen, 3:16-CV-03620 (N.D. Calif., filed May 17, 2017) (part of MDL 3:15-md-02672-CRB at Doc. No. 3226).

²³⁴ Order No. 7, *supra* note 232, at 4.

²³⁵ *Id.*

²³⁶ Consumer Compl., *supra* note 228, at 2 (“Volkswagen secretly turned the most environmentally-conscious consumers into some of the biggest polluters on the road—and charged them a premium in the process.”); *id.* at 3 (describing human deaths and environmental damage from the scandal).

²³⁷ *Id.* at 4.

²³⁸ *Id.* at 193-215.

²³⁹ The second federal charge is alleged violation of 15 U.S.C. §§ 2301, et seq., The Magnuson-Moss Warranty Act (MMWA). *Id.* at 215-17.

²⁴⁰ *Id.* at 222-700.

²⁴¹ *Id.* at 217-22.

²⁴² Am. Order Granting Prelim. Approval of Settlement at 1, Doc. No. 1698, In re: Volkswagen “Clean Diesel” MDL; 3:15-md-02672-CRB (N.D. Calif, filed July 29, 2016); Consumer Compl., *supra* note 228, at 3 (listing 2-liter vehicles); *see* models *supra* note 198.

²⁴³ Order Granting Prelim. Approval of the Consumer and Reseller Dealership 3.0-Liter Class Action Settlement at 1, Doc. No. 2919, In re: Volkswagen “Clean Diesel” MDL; 3:15-md-02672-CRB (N.D. Calif., filed Feb. 16, 2017); Consumer Compl., *supra* note 228, at 3 (listing 3-liter vehicles); *see* models *supra* note 198.

²⁴⁴ Patrick McGee, *Bosch Reaches \$328m Settlement in VW Emissions Scandal*, FIN. TIMES (Feb. 1, 2017), <https://www.ft.com/content/964a2f72-e898-11e6-967b-c88452263daf>.

²⁴⁵ David Shepardson, *VW, Robert Bosch Agree to Pay \$1.55 Billion to Settle U.S. Diesel Claims*, REUTERS (Feb. 1, 2017), <http://www.reuters.com/article/us-volkswagen-emissions-idUSKBN15G3NX>.

²⁴⁶ Jack Ewing, *What Volkswagen Settlements Mean for Vehicle Owners*, N.Y. TIMES (Feb. 1, 2017), <https://mobile.nytimes.com/2017/02/01/business/volkswagen-compensation-settlement-bosch-audi-porsche.html>.

²⁴⁷ McGee, *supra* note 244.

In a minor MDL settlement, California and the EPA agreed to the recall of vehicles, a \$2 billion investment that VW was already going to make in zero-emission vehicles (such as its electric models already on display at auto shows), and a \$2.7 billion payment into an environmental mitigation trust fund that will come with significant tax write-offs for VW.²⁴⁸ This was a whimpering resolution to EPA claims alone that had started at \$19 billion.²⁴⁹ In addition, California will receive 74 percent of the mitigation funds when the harms outside of Los Angeles and San Francisco should be much larger based on population density and the size of cities on the East Coast, Chicago, Denver, Phoenix, Seattle, and elsewhere.²⁵⁰ Neither the EPA nor California participated in the Bosch litigation and they are not included in that settlement.²⁵¹

Meanwhile, state Attorneys General have been stymied in their pursuit of VW by the company's assertion of German privacy laws and its refusal to cooperate with U.S. investigators.²⁵² Even state-level investigations in the U.S. seemed to be focusing, however, on what VW top executives disclosed to regulators or investors and when.²⁵³ In June 2016, forty-three states' Attorneys General announced a \$570 million VW settlement for "unfair or deceptive trade practices" towards consumers.²⁵⁴ Finally in March 2017, ten state Attorneys General were able to extract \$157 million in civil environmental damages—closing the book on harms to the public without uncovering the depth of the fraud and costing VW 1.7 percent of its securities law liability in a single part of Germany.²⁵⁵ The settlement represents a mere 0.6 percent of the company's payments in the U.S.²⁵⁶ Surveying the landscape of VW's liabilities, disclosure-based litigation dominates in all forms.

2. Overdependence on Disclosure-based Regulation to Extract Resources

Not only has U.S. disclosure-based regulatory enforcement become the model for many other countries,²⁵⁷ but U.S. enforcement of its disclosure laws disproportionately impacts the international marketplace. The United States is unique in that "the prospect of criminal enforcement radically distinguishes securities enforcement in the United States from that of the rest of the world," but also in that the amount its regulatory agencies recover is significantly

²⁴⁸ Order Granting The United States' Mot. to Enter Proposed Am. Consent Decree, at 2–4, Doc. No. 2103, In re: Volkswagen "Clean Diesel" MDL, 3:15-md-02672-CRB (N.D. Calif., filed Oct. 25, 2016); *id.* at 3 (citing Doc. Nos. 1973 & 1974 for California attachment to EPA claim); *cf.* Matthew Goldstein, *How 'Consumer Relief' After Mortgage Crisis Can Enrich Big Banks*, N.Y. TIMES (Mar. 17, 2017), <https://mobile.nytimes.com/2017/03/17/business/dealbook/mortgage-crisis-consumer-relief.html>.

²⁴⁹ Compl., *supra* note 232, at 26–28 (consolidated into MDL).

²⁵⁰ Order, *supra* note 248, at 3.

²⁵¹ Pls.' Mot. for Prelim. Approval of The Bosch Class Action Settlement at 6, Doc. No. 2838, In re: Volkswagen "Clean Diesel" MDL, 3:15-md-02672-CRB (N.D. Calif. filed Jan. 31, 2017).

²⁵² Hakim & Ewing, *supra* note 135.

²⁵³ Jack Ewing, *Volkswagen Memos Suggest Company Misled U.S. Regulators*, N.Y. TIMES (Feb. 18, 2016), <http://www.nytimes.com/2016/02/19/business/volkswagen-memos-suggest-emissions-problem-was-known-earlier.html>.

²⁵⁴ Press Release, Mass. Attn'y Gen., AG Healey Announces Major Award For More Than 12,500 Massachusetts Consumers Under Settlements with Volkswagen Over Emissions Fraud (June 28, 2016), <http://www.mass.gov/ago/news-and-updates/press-releases/2016/2016-06-28-vw-settlement.html>.

²⁵⁵ Bill Vlasic, *Volkswagen to Pay 10 States Over Environmental Claims*, N.Y. TIMES (Mar. 30, 2017), <https://www.nytimes.com/2017/03/30/business/volkswagen-diesel-penalties.html>; Matussek, *supra* note 114.

²⁵⁶ Ed. Bd., *Europe's Sluggish Response to VW*, N.Y. TIMES (Mar. 10, 2017), <https://www.nytimes.com/2017/03/10/opinion/europes-sluggish-response-to-vw.html> (calculating VW's U.S. liabilities before the settlement at \$25 billion).

²⁵⁷ See *supra* pp. 16–22.

higher than the rest of the world.²⁵⁸ For example, “between 2000 and 2004, the United States brought an average of 224 public enforcement actions per trillion dollars of 2004 market capitalization, while the United Kingdom brought twenty-five.”²⁵⁹

Using the SEC as an example, the United Kingdom’s Financial Services Authority (FSA) is typically considered the SEC’s “most closely comparable regulator.”²⁶⁰ In 2005, “the SEC initiated 629 enforcement actions and imposed \$1.8 billion in penalties (or \$108,959 per billion dollars of stock market capitalization), while the [FSA]... initiated 269 enforcement actions and imposed approximately \$30 million in penalties (or \$9,916 per billion dollars of stock market capitalization).”²⁶¹ The SEC thus extracted nearly 11 times more compensation per billion dollars of stock market capitalization.

Interestingly, the U.S. government does not disproportionately fund the SEC to achieve these results.²⁶² The government does, however, calculate its return on investment (ROI) for the agency in part through the size of settlements.²⁶³

This bounty approach creates incentives for serious structural blindness. First, because so much of disclosure-based regulation is founded on strict liability,²⁶⁴ or nearly strict liability,²⁶⁵ the U.S. government’s cases are easy to prove and it is a simple matter for the penalty amounts to be ratcheted higher and higher. The stated goal of the SEC, for example, is to pursue cases that provide general benefit to investors and the market.²⁶⁶ Settlement data, however, show that the SEC tends to pursue weaker, smaller, and more financially troubled corporate targets that may fund less resistance to the agency.²⁶⁷ Another explanation for why the SEC “almost always targets companies with a market capitalization less than \$200 million,” rather than the companies that have caused the greatest losses to investors, may be the sloppiness of their audit procedures—another disclosure-based issue compounding what cases are easy for the agency to prove.²⁶⁸ Finally, the agency settles quickly and for lower amounts than it should even in the cases that it pursues. Thus, groups of individuals committing fraud, especially within large, well-funded corporation, have started to realize that “even when there is an enforcement action by the SEC, the case may still yield a low recovery relative to provable losses.”²⁶⁹

Second, the current disclosure-based method works well to extract company resources as measured by highly efficient ROI for inputs, but it does not curb wrongdoing.²⁷⁰ In the securities field—which is where large corporations such as VW and Wells Fargo are facing immediate liability—Professor Bainbridge expresses dissatisfaction with the rigid interpretation of form

²⁵⁸ Coffee, *supra* note 107, at 274.

²⁵⁹ Shnitser, *supra* note 96, at 1656.

²⁶⁰ John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 729 (2009).

²⁶¹ Shnitser, *supra* note 96, at 1656.

²⁶² Shnitser, *supra* note 259, at 1656.

²⁶³ Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 903–04 (2016).

²⁶⁴ See FCPA discussion *supra* pp. 37-38.

²⁶⁵ See material information disclosure standards *supra* pp. 38-50.

²⁶⁶ U.S. Sec. & Exch. Comm’n, *What We Do* (last visited May 4, 2017), <https://www.sec.gov/Article/whatwedo.html>.

²⁶⁷ Cox & Thomas, *supra* note 77, at 737, 777-78. There is a similar concern with the “private attorney general” function of investors specifically targeting “small vulnerable companies.” *Id.* at 742.

²⁶⁸ *Id.* at 766.

²⁶⁹ *Id.* at 778.

²⁷⁰ See *supra* pp. 28–30.

over function.²⁷¹ Evaluating the substance of shareholders proxy statement initiatives under SEC Rule 14a-8, for example, is “critical if the exclusion is to have real teeth.”²⁷²

C. Costly Growth of Compliance Departments and Attorney Gatekeepers

Compliance with current disclosure-based regulation not only fails to improve business behavior, but it is costing an enormous amount in business resources. Currently, compliance costs are estimated to run four percent of revenue in the financial sector.²⁷³ According to a 2016 report, “[c]ompliance officers are clearly... experiencing regulatory fatigue and overload in the face of ever-changing and growing regulations.”²⁷⁴ The increase in disclosure-based regulation is overwhelming. “Consistent with the previous year’s expectations, 69 percent of firms... are expecting regulators to publish even more information in the coming year, with 26 percent expecting significantly more.”²⁷⁵ Even with advances in computer technology, “[m]ore than a third of firms continue to spend at least a whole day every week tracking and analyzing regulatory change.”²⁷⁶

A 2017 survey of asset managers, brokers and banks predicts that compliance costs with disclosure-based regulation will more than double by 2022.²⁷⁷ Ironically, these calculations are being inflated in part by companies starting to include as costs of compliance not only “expenditure on compliance officers’ salary bills, [but also] fines imposed by regulators, and the personal liabilities of senior executives in cases of wrongdoing.”²⁷⁸ In other words, at the same time that compliance staff numbers are exploding, firms expect higher fines and greater wrongdoing on the part of their top executives.²⁷⁹

These changes are being driven in the United States and Canada, but echo strongly around the world.²⁸⁰ Disclosure-based regulations modeled on the U.S. Securities and Exchange Commission’s approach now specifically exist in corporate law around the world. A 2013 survey of 45 nations found 180 initiatives requiring social disclosure, 72 percent of which were mandatory.²⁸¹

III. How Disclosure-Based Regulation Drives Internal Behavior

In the ‘don’t ask, don’t tell’ system, large-scale coordinated wrongdoing spreads in size and sophistication through the insulation of middle management from liability while top executives maintain plausible deniability through willful blindness, and a culture of fear prevents whistleblowers from coming forward. Although this Part uses examples from VW, the case study

²⁷¹ Stephen M. Bainbridge, *Revitalizing SEC Rule 14a-8's Ordinary Business Exclusion: Preventing Shareholder Micromanagement By Proposal*, 85 *FORDHAM L. REV.* 705 (2016).

²⁷² *Id.* at 734.

²⁷³ Lucy McNulty, *Compliance Costs To More Than Double By 2022*, *FIN. NEWS* (Apr. 27, 2017), <https://www.fnlondon.com/articles/compliance-costs-to-more-than-double-by-2022-survey-finds-20170427>.

²⁷⁴ STACEY ENGLISH & SUSANNAH HAMMOND, THOMPSON REUTERS, *THE COST OF COMPLIANCE 2016* at 3, <https://risk.thomsonreuters.com/content/dam/openweb/documents/pdf/risk/report/cost-compliance-2016.pdf>.

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ McNulty, *supra* note 273.

²⁷⁸ *Id.*

²⁷⁹ *Id.*

²⁸⁰ ENGLISH & HAMMOND, *supra* note 274, at 7-8 (comparing charts of world impacts).

²⁸¹ UNITED NATIONS ENV'T PROGRAMME, *Graphic, CARROTS AND STICKS: SUSTAINABILITY REPORTING POLICIES WORLDWIDE—TODAY'S BEST PRACTICE, TOMORROW'S TRENDS* 9 (2013), <https://www.globalreporting.org/resource/library/Carrots-and-Sticks.pdf>.

is representative of similar issues at many corporations, including public discussions of culture at Walmart,²⁸² United Airlines,²⁸³ Wells Fargo,²⁸⁴ and Uber,²⁸⁵ among others.

A. ‘Don’t Ask, Don’t Tell’ Willful Blindness

Individuals with disclosure obligations under the ‘don’t ask, don’t tell’ system don’t ask about wrongdoing within the organization because they don’t want to have to tell. This system leads to willful blindness towards coordinated agent wrongdoing within the company.²⁸⁶

Disclosure-based prosecutions increasingly impose strict liability on individuals with disclosure obligations, but this merely leads to arbitrary executive turnover.²⁸⁷ Disclosure-based regulation shoots the messenger in charge of conveying information, and fails to provide incentives for the messenger to more deeply investigate the substance of his message.²⁸⁸ Taking a ‘don’t ask, don’t tell’ approach signals that we don’t want to hear what the message really is. Additionally, the high rate of executive turnover further discourages executives’ interest in uncovering fraud, and it shortens their tenure so that they are not able in practical terms to correct wrongdoing within the company even if they do know about it.²⁸⁹

Enabling the flaws in ‘don’t ask, don’t tell’ executive behavior, corporate boards fail to exert the pressure to investigate that they should.²⁹⁰ As senior counsel to many companies explains, “Every board of directors already knows that a major compliance failure can cause vast reputational damage.... At the board level, the problem isn’t a lack of deterrents. The problem is denial.”²⁹¹ Because individual jail time, if served at all, will typically be served only by executives with disclosure responsibilities, directors fail to probe the full scale of issues themselves.²⁹²

²⁸² Adam Hartung, *Walmart Investors Should Worry About Tracy Morgan Lawsuit—A Lot*, (July 15, 2014), <http://adamhartung.com/walmart-investors-should-worry-about-tracy-morgan-lawsuit-a-lot>.

²⁸³ Adam Hartung, *Why United Airlines Abuses Customers: The Risks of Operational Excellence*, FORBES (Apr. 10, 2017), <https://www.forbes.com/sites/adamhartung/2017/04/10/why-united-airlines-abuses-customers-the-risks-of-operational-excellence/#37f991c9bb10>.

²⁸⁴ Ed. Bd., *Plenty More Villains at Wells Fargo*, N.Y. TIMES (Apr. 12, 2017), <https://mobile.nytimes.com/2017/04/12/opinion/plenty-more-villains-at-wells-fargo.html>.

²⁸⁵ Cale Guthrie Weissman, *This is What Caused Uber’s Broken Culture Problem*, FAST CO. (Feb. 27, 2017), <https://www.fastcompany.com/3068475/this-is-what-caused-ubers-broken-company-culture>.

²⁸⁶ This phenomenon is related to the “ostrich problem” with corporate enforcement. *See, e.g.*, BRANDON GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS 280 (Harv. Univ. Press 2014) (noting, for example, how “[e]xecutives have insulated themselves” from SOX reporting liability “by requiring certificates from subordinates so they can defend themselves by showing how they relied on reviews by others”).

²⁸⁷ *Vacuum*, *supra* note 103, at 286-88; [***Redacted***], *supra* note 132, at 880.

²⁸⁸ Even the DOJ knows that this phenomenon is happening. Apuzzo & Protess, *supra* note 188.

²⁸⁹ [***Redacted***], *supra* note 103, at 287-88.

²⁹⁰ *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (establishing the basic duties of the board to monitor corporate acts); *Stone v. Ritter*, 911 A.2d 362 (Del. 2006) (finding monitoring duties consistent with the duty of good faith and loyalty). A separate work by this Author describes how corporate law on board duties permits the failure and abuse of internal compliance systems, largely a flaw in having to prove scienter to establish lack of good faith. [***Redacted***], *Abusive Internal Controls* (on file with author). This board incentive not to know about problems further feeds into the ‘don’t ask, don’t tell’ system.

²⁹¹ Ben DiPietro, *Is PG&E Sentence a Sign of Things to Come?*, WALL ST. J. (Jan. 30, 2017) (quoting Scott Killingsworth, senior counsel at law firm Bryan Cave).

²⁹² *Id.* Furthermore, U.S. law may be further diverging in the protection of directors more than a corporation’s officers. Deborah DeMott, *Corporate Officers as Agents*, 74 WASH. & LEE L. REV. 2, ___ (forthcoming 2017), http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6417&context=faculty_scholarship (draft at 3).

Directors also fail to push executives to investigate the full scale of wrongdoing.²⁹³ Using an example from outside of VW to show how pervasive these problems are, Wells Fargo's 2017 board investigation of the company's two million false accounts "depict[s] the board as hoodwinked by bank executives who withheld important facts."²⁹⁴ Yet, as the board's own report concludes, "[m]any things collectively should have raised suspicion..." from the fact that "[c]ustomers were failing to ...put money into, their new accounts at alarming rates" to the fact that "[r]egional managers were imploring their bosses to drop sales goals, saying they were unrealistic and bad for customers."²⁹⁵

Thus, for all of these reasons, high-level management often are allowed to have limited knowledge of what a company's agents are doing because they do not want to know and have a disincentive to ask.²⁹⁶

1. Plausible Deniability

VW top leaders' willful blindness to wrongdoing beneath them is a conscious choice. As the failure of recent prosecutions has proven, walling themselves off from negative information protects executives at trial even against strict liability because judges and juries are sympathetic to the defense of plausible deniability.²⁹⁷

The cultivation of plausible deniability across VW's directors and top executives is especially effective because they are an insular group led by the Porsche family.²⁹⁸ Individuals at the top of the company look out for each other, and VW is known for promoting executives from within its own ranks.²⁹⁹ VW also now seems to be trying to restore to power the few individuals who have been suspended in the course of its own investigation.³⁰⁰

Moreover, a key feature of VW's reorganization in response to the 2015-17 scandal will be the further removal of executives from reports about operations. This change continues to send the company in the wrong direction for the purpose of accountability for fraud. In February 2016, the company explains that those individuals "who continue to report to the CEO now have a more narrowly defined strategic role."³⁰¹ Thus, "[d]ecisions relegated to operations at the company's 12 brands are increasingly delegated to the brand management."³⁰² CEO Müller will

²⁹³ DiPietro, *supra* note 291.

²⁹⁴ Stacy Cowley & Jennifer A. Kingson, *Wells Fargo to Claw Back \$75 Million From 2 Former Executives*, N.Y. TIMES (Apr. 10, 2017), <https://mobile.nytimes.com/2017/04/10/business/wells-fargo-pay-executives-accounts-scandal.html>.

²⁹⁵ *Id.*

²⁹⁶ The 2016-17 Wells Fargo scandal involving 2 million fraudulent accounts is another excellent example of willful blindness on the part of top management. See Wells Fargo discussion in [***Redacted**], *supra* note 132, at 925-32, & notes 2, 7, 437, 439, 464, *passim*.

²⁹⁷ *Id.* at 928-41.

²⁹⁸ William Boston, *Institutional Investors Sue Volkswagen Over Fall in Share Price*, WALL ST. J. (Mar. 15, 2016), <http://www.wsj.com/articles/institutional-investors-sue-volkswagen-over-fall-in-share-price-1458038261>.

²⁹⁹ Danny Hakim, *VW's Crisis Strategy: Forward, Reverse, U-Turn*, N.Y. TIMES (Feb. 26, 2016), <http://www.nytimes.com/2016/02/28/business/international/vws-crisis-strategy-forward-reverse-u-turn.html>.

³⁰⁰ *Id.* VW also parted ways with its post-scandal head of compliance under suspicious circumstances within a year of hiring her. Patrick McGee, *VW Executive Brought in to Clean Up After Emissions Scandal Quits*, FIN. TIMES (Jan. 26, 2017), <https://www.ft.com/content/82368938-e3d2-11e6-8405-9e5580d6e5fb>.

³⁰¹ William Boston, *Volkswagen's Quality-Control Chief Frank Tuch Resigns*, WALL ST. J. (Feb. 8, 2016), <http://www.wsj.com/articles/volkswagens-quality-control-chief-frank-tuch-resigns-1454937362>.

³⁰² *Id.*

be freed loftily to “focus on larger strategic questions” and there will be “faster decision making at the individual brands” with even less top executive oversight of middle management.³⁰³

2. Pressure for Results Without Inquiry Into Methods

VW’s executives exploit their cloak of plausible deniability to put pressure on their subordinates to cheat. As VW’s chairman of the board has admitted about the background of the scandal at the company, “[t]here was a tolerance for breaking the rules.”³⁰⁴

VW’s top executives, as is true of executives in many multinational corporations, set high expectations for the company.³⁰⁵ As an executive inside the company who spoke anonymously for fear of losing his job explains, VW’s leaders know only “one way of management: ...Be aggressive at all times.”³⁰⁶ Inside VW “performance was driven by fear and intimidation,” and leadership was “a reign of terror” for employees.³⁰⁷ “Stories are legion in the industry about Volkswagen engineers and executives shaking in their boots prior to presentations” afraid of being “fired instantly.”³⁰⁸

As a result, fraud becomes the method through which agents under the top management choose to satisfy the executives’ expectations.³⁰⁹ In 2011, VW’s CEO told a distinguished gathering, “[b]y 2018, we want to take our group to the very top of the global car industry.”³¹⁰ As the media reports, “[o]ne way Volkswagen aimed to achieve its lofty goal was by betting on diesel-powered cars—instead of hybrid-electric vehicles like the Toyota Prius—promising high mileage and low emissions without sacrificing performance.”³¹¹ In 2007, VW “abandoned a pollution-control technology developed by Mercedes-Benz and Bosch and instead used internal technology.”³¹² Meanwhile, “the determination by Mr. Winterkorn, the company’s hard-charging chief executive, to surpass Toyota put enormous strain on his managers to deliver growth in America.”³¹³ Mr. Müller, the new CEO, admits that the current cheating began “after people inside Volkswagen realized that a new engine line could not comply with United States pollution limits.”³¹⁴

The fundamental engineering problem with VW’s advertised diesel efficiency is that “[m]easures that reduce output of nitrogen oxides, which can cause lung ailments, automatically

³⁰³ *Id.*

³⁰⁴ Jack Ewing, *VW Says Emissions Cheating Was Not a One-Time Error*, N.Y. TIMES (Dec. 10, 2015), <http://www.nytimes.com/2015/12/11/business/international/vw-emissions-scandal.html>.

³⁰⁵ Danny Hakim, Aaron M. Kessler & Jack Ewing, *As Volkswagen Pushed to Be No. 1, Ambitions Fueled a Scandal*, N.Y. TIMES (Sept. 26, 2015), <http://www.nytimes.com/2015/09/27/business/as-vw-pushed-to-be-no-1-ambitions-fueled-a-scandal.html>.

³⁰⁶ Ewing & Bowley, *supra* note 55.

³⁰⁷ Bob Lutz, *One Man Established the Culture That Led to VW’s Emissions Scandal*, ROAD & TRACK (Nov. 4, 2015), <http://www.roadandtrack.com/car-culture/a27197/bob-lutz-vw-diesel-fiasco>.

³⁰⁸ Doron Levin, *The Man Who Created VW’s Toxic Culture Still Looms Large*, FORTUNE (Oct. 16, 2015), <http://fortune.com/2015/10/16/vw-ferdinand-piech-culture>.

³⁰⁹ Ewing & Bowley, *supra* note 55.

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.*

³¹³ *Id.*

³¹⁴ Danielle Ivory & Jack Ewing, *Volkswagen U.S. Chief Knew of Potential Emissions Problems in 2014*, N.Y. TIMES (Oct. 7, 2015), <http://www.nytimes.com/2015/10/08/business/international/volkswagen-diesel-emissions-fix.html>.

increase production of soot particles, which can cause cancer.”³¹⁵ This mechanical trade-off between nitrogen oxides and soot cannot be solved by any existing diesel technology, especially in a cost-effective manner.³¹⁶ And VW’s engine technology was very similar to the engines of all the other manufacturers on the market.³¹⁷ Thus, the obvious question is “why Volkswagen’s top managers never asked themselves why their engineers succeeded where others had failed in producing relatively inexpensive diesel cars” that could meet the American emissions standards.³¹⁸

As leaders responsible for the culture of a \$227 billion-dollar company, VW’s top executives’ responses to the scandal provide a window into their ability to disconnect the pressure that they apply from above from the behavior of their agents beneath them.³¹⁹ Although VW’s leaders personally have strong technical engineering backgrounds and are selected for that application of their expertise,³²⁰ Mr. Müller protests, “Do you really think that a chief executive had time for the inner functioning of engine software?”³²¹ Given the magnitude of VW’s fraud, blaming the blindness of its ex-CEO on his busy schedule is an interesting choice. Similarly, ousted U.S. CEO Horn admits to having heard something about “a possible emissions noncompliance” as early as 2014, but he was quickly assured that engineers would work with the EPA to fix the issue.³²²

3. A Culture of Fear Suppresses Potential Whistleblowers

In understanding how the fraud inside VW happened, “[t]he failure of people inside the carmaker to sound warnings about illegal engine software has emerged as a crucial element of the scandal.”³²³

Shareholder advocates and former employees of VW criticize the construction of a culture inside the company that “discouraged open discussion of problems, creating a climate in which people may have been fearful of speaking up.”³²⁴ Even VW’s internal investigation into the fraud has been hampered “by an ingrained fear” in the company’s culture “of delivering bad news to superiors.”³²⁵

One mechanism of control over dissent within the organization is VW’s compliance reporting system, which, as is typical of many companies, sends employees’ reports of violations

³¹⁵ Jack Ewing, *Court Sets Deadline for a Volkswagen Diesel Fix, but Solution Could Prove Elusive*, N.Y. TIMES (Mar. 24, 2016), <http://www.nytimes.com/2016/03/25/business/international/volkswagen-emissions-scandal-fix-hearing.html>.

³¹⁶ *Id.*

³¹⁷ *Id.*

³¹⁸ *Id.*

³¹⁹ Kapadia, *supra* note 3.

³²⁰ Ewing, *supra* note 315.

³²¹ Ed. Bd., *VW Needs to Come Clean, Now*, N.Y. TIMES (Oct. 8, 2015), <http://www.nytimes.com/2015/10/09/opinion/vw-and-michael-horn-need-to-come-clean-now.html> (quoting CEO Matthias Müller about his predecessor Martin Winterkorn).

³²² Ivory & Ewing, *supra* note 314.

³²³ Jack Ewing, *Volkswagen Inquiry’s Focus to Include Managers Who Turned a Blind Eye*, N.Y. TIMES (Oct. 25, 2015), <http://mobile.nytimes.com/2015/10/26/business/international/volkswagen-investigation-focus-to-include-managers-who-turned-a-blind-eye.html>.

³²⁴ *Id.*

³²⁵ Jack Ewing, *Volkswagen Says Whistle-Blower Pushed It to Admit Broader Cheating*, N.Y. TIMES (Nov. 8, 2015), <http://mobile.nytimes.com/2015/11/09/business/international/volkswagen-says-whistle-blowers-pushed-it-to-admit-gas-car-cheating.html> (citing report in *Bild am Sonntag*).

right back to their direct supervisors who may have ordered the illegal behavior.³²⁶ Another mechanism is VW's anonymous complaint procedure, again typical of many large corporations.³²⁷ Experts now concede that, when a company's reporting mechanism is a mere hotline, protections for whistleblowers remain "woefully insufficient."³²⁸ This author describes at length the weaknesses of whistleblower law in a separate work.³²⁹

B. The Growing Power and Entrenchment of Middle Management to Commit Large-scale Wrongdoing

Removing and/or discouraging oversight at the top ranks of a company empowers middle management to expand the scope and coordination of wrongdoing under the corporate form. The middle management of a company has no interest in halting the wrongdoing committed by agents when managers only profit from this coordinated misbehavior and absorb no individual repercussions.

Three parts of VW's internal 'don't ask, don't tell'-driven behavior particularly implicate the coordination and control of middle management in the size, scope, and sophistication of the wrongdoing.

1. Coordination of Wrongdoing Under and Across Corporate Forms

Although VW has officially "blamed a small group of engineers for the misconduct," commentators allege that "the scale of the problem suggests the involvement of separate engineering teams."³³⁰ Software of the kind used to cheat the emissions controls "is heavily documented."³³¹ Especially in a command-and-control culture like VW's, it is "very unlikely" that even a "group of engineers could have taken the risk of modifying the software without approval at a high level of management."³³² As a former regulator concludes, blaming fraud of this magnitude merely on a few engineers "just doesn't pass the laugh test."³³³ The company's middle management had to be involved on a broad scale.

Coordinated agent wrongdoing in the VW case extends in sophisticated ways across corporate forms. The MDL against Bosch reveals, for example, a redacted spreadsheet on defeat-devices with 8,565 task entries representing hundreds of individuals.³³⁴ Additional redacted documents from the same litigation show "special access" to the joint VW-Bosch project given in 2006 by Bosch to 35 VW and IAV employees before the project massively expanded.³³⁵

In order to reach across corporate forms, the employees coordinating the behavior had to have the degree of seniority and length of tenure to have formed the required personal networks not only within VW, but also across to employees in other companies to support and conceal

³²⁶ Stephen Dockery, *VW Whistleblower Appeal May Be Too Late*, WALL ST. J. (Nov. 13, 2015); *see also* [***Redacted**], *supra* note 290.

³²⁷ Dockery, *supra* note 326.

³²⁸ *Id.* (quoting Gregory Keating, a whistleblower expert at the firm Choate).

³²⁹ [***Redacted**], *supra* note 290; *see also* STOUT & [***Redacted**], *supra* note 103 (describing whistleblowing limitations).

³³⁰ Ewing & Bowley, *supra* note 55.

³³¹ *Id.*

³³² Ewing, *supra* note 315.

³³³ *Id.*

³³⁴ *Consol. Compl.*, *supra* note 4, at 149 (citing VW-MDL2672-02559780).

³³⁵ *Id.* at 150.

frauds over more than ten years of engine re-designs.³³⁶ These attributes of longevity further point to the significant involvement of middle management.

2. Middle Management's Ability to Suppress Dissent

Not only does the insulation of middle management from prosecution permit middle management to coordinate large-scale wrongdoing, but it also incentivizes and enables them to suppress dissent.

VW middle management has put direct pressure on subordinates to commit wrongdoing before. As far back as 2004, a low-level American employee in VW's compliance department objected that the company should disclose increasing reports of broken emissions-control parts to California air-quality regulators.³³⁷ It was a mid-level manager in Germany who ordered the American compliance personnel not to report the defect and to start hiding the item from future reports to regulators.³³⁸

Showing that mid-level management at VW is not alone in its incentives to suppress dissent, in 2015 reports surfaced that, for a decade, U.S. employees of the Japanese air-bag maker Takata had "raised concerns internally about misleading testing reports on air bags that later became prone to explosions."³³⁹ As early as 2005, Takata's middle management had insisted on "prettifying up" the data, which included "removing unflattering test results."³⁴⁰ By 2016, air-bag explosions had been linked to the deaths of eleven people, and had prompted the recall of 70 million air bags in the U.S.³⁴¹ Takata has been fined \$70 million for these safety violations; three top executives were charged, but no middle managers, even though documents reveal exactly who the middle managers are.³⁴²

3. Repeating the Same Patterns of Fraud Even After Top Officers Leave

Even more disturbingly, scandals tend to repeat themselves when middle management becomes entrenched and heads roll only at the top of the corporate ladder. Consider VW's own history in this regard. In the 1970s, when the EPA began testing cars for tail-pipe emissions standards, VW was one of the first brands to be caught cheating.³⁴³ In 2005, VW was embroiled in a three-part German scandal involving private land deals, prostitutes, and the bribing of government officials.³⁴⁴

The top individuals in power during these scandals had been removed long before VW's 2015-17 scandal, but the pressure on middle management to produce results without scrutiny of

³³⁶ See [***Redacted***], *supra* note 132, at 888–96.

³³⁷ Justin Scheck, Mike Spector & Mark Maremont, *VW Kept Earlier Emissions Issue From Regulator*, WALL ST. J. (Dec. 8, 2015), <http://www.wsj.com/articles/vw-kept-earlier-emissions-issue-from-regulator-1449612215>.

³³⁸ *Id.*

³³⁹ Mike Spector, *Takata U.S. Employees Saw Problems in Air-Bag Tests*, WALL ST. J. (Nov. 24, 2015), <http://www.wsj.com/articles/takatas-u-s-employees-flagged-reporting-issues-over-air-bags-1448411043>.

³⁴⁰ *Id.*

³⁴¹ Mike Spector, *New Vehicles Found to Have Faulty Takata Air Bags*, WALL ST. J. (Jun. 2, 2016), <https://www.wsj.com/articles/new-vehicles-found-to-have-faulty-takata-air-bags-1464796600>.

³⁴² Spector, *supra* note 339.

³⁴³ Hakim, Kessler, & Ewing, *supra* note 305.

³⁴⁴ Hawranek, Rao, & Röbel, *supra* note 151.

methods has remained unchanged.³⁴⁵ The inference for middle management is to continue to cheat for results until they personally absorb repercussions.³⁴⁶

IV. How Disclosure-based Regulation Drives External Behavior

‘Don’t ask, don’t tell’ incentives also fuel the external behavior of VW and other large companies with regulators and the public. VW has learnt that the game is only about disclosure, and its lesson from the scandal has been to disguise its wrongdoing more effectively.

A. The Cat-And-Mouse Game With U.S. Regulators

Because VW understands that its liability is based on what it says when, the company has played a cat-and-mouse game of denial with regulators. What was happening both inside and outside the company show a pattern of consistent deception and cover-up.

In 2007, during a conversation documented in the VW executives’ indictment, defendants exchange slides detailing the defeat device, after which one writes in German “we shall please never present this anywhere and will also not distribute it.”³⁴⁷

In 2012, VW executives order engineers who have identified a defeat device as the source of hardware failures in the company’s cars to “destroy the document used to illustrate the operation of the cheating software.”³⁴⁸

In April 2014, several VW executives forward each other a copy of the non-profit ICCT’s presentation in which they acknowledge that “[s]ome presenters indicated that they suspected cheating... We will have to be careful with going forward.”³⁴⁹ In a cover email, the head of U.S. compliance writes that “[w]ithin [Volkswagen Group of America, Inc.], the study is known only to [the Engineering and Environmental Office], and we want to keep it that way for the time being.”³⁵⁰

In May 2014, the testing group sponsored by ICCT informs the EPA and California regulators that “two Volkswagen diesels—a 2012 Jetta and a 2013 Passat—emit far more nitrogen oxide on the road than expected.”³⁵¹ A VW employee sends the head of U.S. compliance an email that reads “[a]s mentioned orally, VW [North America]... has the problem of high off cycle emissions.... [T]he EPA has now found out about and we must respond.”³⁵² The employee’s email further names several top executives coordinating a response.³⁵³ The head of compliance replies “Are you crazy? Recall the email.”³⁵⁴

From May to December 2014, while the EPA confronts VW and continues to test cars, VW “denies there is a problem and offers explanations why the road tests don’t match expectations.”³⁵⁵ In December 2014, VW begins a “voluntary” recall of select cars.³⁵⁶ From May

³⁴⁵ Catherine Boyle, *VW Scandal: \$7.3B Profit Warning But Damage Could Hit Germany*, CNBC (Sept. 23, 2015), <http://www.cnn.com/2015/09/22/vw-scandal-germanys-reputation-on-the-line.html>.

³⁴⁶ See agent incentives discussion in [***Redacted**], *supra* note 132, at 889–91.

³⁴⁷ *Executives Indictment*, *supra* note 57, at 27.

³⁴⁸ *Id.* at 20.

³⁴⁹ *Id.* at 29.

³⁵⁰ *Id.*

³⁵¹ *How VW’s Scandal Unfolded*, N.Y. TIMES (Oct. 23, 2015), <http://www.nytimes.com/interactive/2015/10/23/business/international/vw-scandal-timeline.html>.

³⁵² *Executives Indictment*, *supra* note 57, at 29.

³⁵³ *Id.*

³⁵⁴ *Id.*

³⁵⁵ *How*, *supra* note 351.

to July 2015, California regulators perform additional tests and find “limited benefits from the recall.”³⁵⁷

In June 2015, a VW liaison between the company and regulators pushes VW employees to come up with “‘good arguments’ to counter... questions from the U.S. regulators.”³⁵⁸

That summer, by changing tactics to examine VW’s computer code, regulators discover that “[a] subroutine, or parallel set of instructions, [is] secretly being sent by the computer to what seemed to be the emissions controls.”³⁵⁹ When regulators reset the parameters of laboratory tests to “cheat the cheat” by making the VW cars think that they are out on the road, the cars suddenly “beg[in] spewing nitrogen oxide far above the legal limit,”³⁶⁰ up to forty times previous emissions levels.³⁶¹ In August 2015, the EPA refuses to certify VW’s “2016 diesels until the company can explain the discrepancies.”³⁶² Later that month, at an academic conference organized by the University of California, Davis, “a Volkswagen official informally mention[s] to a senior EPA official that the company had been deceiving regulators.”³⁶³

In August 2015, the head of U.S. compliance explains that another VW employee “should not come along” to a future meeting with regulators “so he would not have to consciously lie.”³⁶⁴ Later that month, the head of VW brand development approves the specific script for employees to follow in meeting with regulators so as to continue concealing the defeat devices.³⁶⁵

In September 2015, local dealers and American VW executives begin to pressure VW to explain when its new cars will be certified by the EPA.³⁶⁶ According to the EPA, the pressure from local dealers is what ultimately makes VW confess.³⁶⁷ On September 3, 2015, one day after the company renews its chief executive’s contract, VW officials detail in a call with the EPA and California regulators “how its cars contain a defeat device that cuts emissions when the car is being tested in a lab.”³⁶⁸

On September 18, 2015, the EPA issues a public “Notice of Violation” regarding VW’s admissions,³⁶⁹ and the news makes headlines worldwide.³⁷⁰ The U.S. orders VW to recall 500,000 cars.³⁷¹

³⁵⁶ *Id.*

³⁵⁷ *Id.*

³⁵⁸ *Executives Indictment*, *supra* note 57, at 31.

³⁵⁹ Hakim, Kessler, & Ewing, *supra* note 305.

³⁶⁰ *Id.*

³⁶¹ U.S. ENVTL. PROT. AGENCY, Press Release, *EPA, California Notify Volkswagen of Clean Air Act Violations* (Sept. 18, 2015), <http://yosemite.epa.gov/opa/admpress.nsf/6424ac1caa800aab85257359003f5337/dfc8e33b5ab162b985257ec40057813b!OpenDocument>.

³⁶² Jack Ewing & Jad Mouawad, *Directors Say Volkswagen Delayed Informing Them of Trickery*, N.Y. TIMES (Oct. 23, 2015), <http://www.nytimes.com/2015/10/24/business/international/directors-say-volkswagen-delayed-informing-them-of-trickery.html>.

³⁶³ *Id.*

³⁶⁴ *Executives Indictment*, *supra* note 57, at 31.

³⁶⁵ *Id.* at 31-31.

³⁶⁶ Hakim, Kessler, & Ewing, *supra* note 305.

³⁶⁷ *Id.*

³⁶⁸ Ewing & Mouawad, *supra* note 362.

³⁶⁹ U.S. ENVTL PROT. AGENCY, VW NOTICE OF VIOLATION, CLEAN AIR ACT (Sept. 18, 2015), <http://www3.epa.gov/otaq/cert/documents/vw-nov-caa-09-18-15.pdf>.

³⁷⁰ Ewing & Mouawad, *supra* note 362.

³⁷¹ Coral Davenport & Jack Ewing, *VW Is Said to Cheat on Diesel Emissions; U.S. to Order Big Recall*, N.Y. TIMES (Sept. 18, 2015), <http://www.nytimes.com/2015/09/19/business/volkswagen-is-ordered-to-recall-nearly-500000-vehicles-over-emissions-software.html>.

On September 23, VW German CEO Winterkorn resigns.³⁷² Winterkorn's pension on separation is estimated to be thirty-two million dollars.³⁷³ On September 24, VW admits rigging emissions tests to German regulators.³⁷⁴ On September 30, the company admits rigging tests to U.K. regulators.³⁷⁵ Eleven million cars are affected starting with models from 2009.³⁷⁶

In October 2015, the EPA and California officials discover a second emissions testing defeat mechanism.³⁷⁷ The second type of emissions fraud does not expand the U.S. recall, but may have broader repercussions in Europe, where more EA 288 vehicles have been sold.³⁷⁸ Germany orders a recall of 8.5 million VW cars.³⁷⁹ In November 2015, the EPA and private testing groups discover emissions-controls defeat devices on another 10,000 cars, including Porsche and Audi models.³⁸⁰

On November 3, 2015, finally driven by a whistle-blower inside the company,³⁸¹ VW admits that it misled the public in a third fraud about a new subject: carbon dioxide non-compliance, affecting 800,000 vehicles across Europe.³⁸² That same month, the EPA finds a fourth type of cheating in Audis, and for the first time, in Porsche vehicles.³⁸³ A year later, in November 2016, VW is forced to admit to a German newspaper a fifth type of emissions fraud, under the term of a "cycle-optimized shifting program" in Audis.³⁸⁴ Given VW's history of being less-than-forthcoming, the revelations may continue.

B. Net Impact of VW's Behavior

³⁷² William Boston, *Volkswagen CEO Resigns as Car Maker Races to Stem Emissions Scandal*, WALL ST. J. (Sept. 23, 2015), <http://www.wsj.com/articles/volkswagen-ceo-winterkorn-resigns-1443007423>.

³⁷³ Alex Davies, *VW's Ousted CEO Is Probably Getting a \$32 Million Pension*, WIRED MAGAZINE (Sept. 23, 2015), <http://www.wired.com/2015/09/ousted-vw-ceo-32-million-pension>.

³⁷⁴ *VW Manipulated Diesel Emissions Tests In Europe, Says German Minister*, BBC NEWS (Sept. 24, 2015), <http://www.bbc.com/news/business-34345210>.

³⁷⁵ Graham Ruddick, *VW Emissions Scandal: 1.2m UK Cars Affected*, THE GUARDIAN (Sept. 30, 2015), <http://www.theguardian.com/business/2015/sep/30/vw-emissions-scandal-12m-uk-cars-affected>.

³⁷⁶ Danielle Ivory & Keith Bradsher, *Regulators Investigating 2nd VW Computer Program on Emissions*, N.Y. TIMES (Oct. 8, 2015), <http://www.nytimes.com/2015/10/09/business/international/vw-diesel-emissions-scandal-congressional-hearing.html>.

³⁷⁷ *Id.*

³⁷⁸ Jack Ewing, *Volkswagen Investigating if Diesel Emissions Deception Was More Extensive*, N.Y. TIMES (Oct. 22, 2015), <http://www.nytimes.com/2015/10/23/business/international/volkswagen-diesel-investigation.html>.

³⁷⁹ *Id.*

³⁸⁰ Jad Mouawad, *E.P.A. Finds More VW Cheating Software, Including in a Porsche*, N.Y. TIMES (Nov. 2, 2015), <http://www.nytimes.com/2015/11/03/business/some-porsche-models-found-to-have-emissions-cheating-software.html>; U.S. EPA, *supra* note 11.

³⁸¹ Ewing, *supra* note 325 (citing report in *Bild am Sonntag*).

³⁸² Jack Ewing & Graham Bowley, *VW Reveals It Misstated Emissions of Gas Cars*, N.Y. TIMES (Nov. 3, 2015), <http://mobile.nytimes.com/2015/11/04/business/vw-discloses-new-emissions-problem-involving-carbon-dioxide.html>.

³⁸³ Jad Mouawad, *Cheating Software Found on Porsches, More VWs*, BOSTON GLOBE (Nov. 2, 2015), <https://www.bostonglobe.com/business/2015/11/02/some-porsche-models-found-have-emissions-cheating-software/pK9LqZ1TVgMQ52rmUoCDTM/story.html>.

³⁸⁴ Jack Ewing, *New Type of Emissions Cheating Software May Lurk in Audis*, N.Y. TIMES (Nov. 12, 2016), <https://mobile.nytimes.com/2016/11/13/business/volkswagen-audi-new-emissions-cheating.html> (confirming report in *Süddeutsche Zeitung*). In 2017, Audi would also settle additional misrepresentation charges with the Federal Trade Commission. Jack Ewing, *German Police Raid Audi Offices, Escalating Volkswagen Diesel Inquiry*, N.Y. TIMES (Mar. 15, 2017), <https://mobile.nytimes.com/2017/03/15/business/audi-vw-diesel-emissions.html>.

Nonetheless, VW's gamble to conceal its fraud from regulators and focus solely on its disclosure language has paid off. It is true that VW has been hurt by the scale of the scandal, but ultimately the company is coming out ahead. As of March 2017, VW has agreed to pay \$25 billion in fines and other penalties, but early estimates had been \$87 billion.³⁸⁵

Most commentators agree that VW can survive its fines; in fact, they are well within easy net liquidity for a company VW's size—and VW can pay its entire federal settlement penalty out of free cash flow.³⁸⁶ After a single 2015 loss of €1.4 billion, VW made a 2016 net profit of €5.4 billion (\$5.76 billion U.S.).³⁸⁷

In the end, VW's board and top management have achieved what they wanted. VW's driving ambition has been to become the world's number-one automaker.³⁸⁸ In 2016, despite the scandal, the company became the world's #1 automaker over Toyota.³⁸⁹ Apparently, consumers simply do not care enough about the scandal, and VW was particularly buoyed by the Chinese market where sales for the year increased 12 percent.³⁹⁰

Even U.S. consumers seem to have forgotten this is the same company that staked its reputation on “clean diesel,” and sponsored advertisements during the 2015 Superbowl of its engineers sprouting angels' wings.³⁹¹ By May 2017, VW brags that it has “almost returned to precrisis levels within just 1½ years.... And this is all without the diesel model, which we have completely withdrawn from the U.S. market.”³⁹²

Additionally, many settlement terms have had silver linings for the company.³⁹³ Under its terms with the States Attorneys General and MDL litigants, VW has to put \$2 billion into electric vehicles.³⁹⁴ Conveniently, VW had started unveiling its electric vehicles in 2013 auto shows.³⁹⁵ Now the company will be rewarded for putting money into them.³⁹⁶

No attorneys for the company have been charged despite the fact that they destroyed evidence, possibly multiple times, and allegedly fired a whistleblower who questioned company

³⁸⁵ Ed. Bd., *supra* note 256; Petroff, *supra* note 50.

³⁸⁶ Tom Schoenberg & Alan Katz, Bloomberg, *How Hefty a Penalty Can VW Withstand?*, INDUS. WEEK (Sept. 27, 2016), <http://www.industryweek.com/treasury-cash-management/how-hefty-penalty-can-vw-withstand>.

³⁸⁷ Dealbook, *Looking Ahead*, N.Y. TIMES (Mar. 13, 2017).

³⁸⁸ Hakim, Kessler, & Ewing, *supra* note 305.

³⁸⁹ Kana Inagaki, *VW Overtakes Toyota as World's Biggest Automaker in 2016*, FIN. TIMES (Jan. 30, 2017), <https://www.ft.com/content/8c3471f8-e6b5-11e6-893c-082c54a7f539>.

³⁹⁰ Emel Akan, *How China Made Volkswagen the World's Biggest Carmaker*, EPOCH TIMES (Feb. 16, 2017), <http://www.theepochtimes.com/n3/2223264-how-china-made-volkswagen-the-worlds-biggest-carmaker-2>.

³⁹¹ Hakim, Kessler, & Ewing, *supra* note 305.

³⁹² William Boston, *Volkswagen Brand Plots U.S. Turnaround—Again*, WALL ST. J. (May 7, 2017), <https://www.wsj.com/articles/volkswagen-brand-plots-u-s-turnaroundagain-1494155562> (quoting Herbert Diess, head of VW brand).

³⁹³ VW will also be able to wait out its federal monitor. As commentators have noted about monitors in the financial sector: “That's been the tendency of multinational banks of late: Wait out the monitor or the [timing] of the enforcement action, and then go back to what they were doing before.” Samuel Rubinfeld, *New HSBC Probe Puts Culture in Question*, WALL ST. J. (Risk Report, Feb. 22, 2017) (quoting anti-money-laundering expert Ross Delston). This form of compliance is not “the kind of change in course that's long-lasting or penetrates the organization as a whole.” *Id.*

³⁹⁴ Order, *supra* note 248, at 2-4.

³⁹⁵ Press Release, New Golf Sportsvan Takes Golf Plus Concept Into The Future (Sept. 8, 2013), <http://media.vw.com/release/484>.

³⁹⁶ See, e.g., Alex Davies, *VW's \$15B Diesel Settlement Might Actually Hurt Electric Cars*, WIRED (Oct. 17, 2016), <https://www.wired.com/2016/10/vws-15b-diesel-settlement-might-actually-hurt-electric-cars> (describing competitors' letter to the DOJ).

orders to destroy evidence.³⁹⁷ In March 2017, German authorities raided the offices of VW’s law firm Jones Day, in an indication that VW may still be withholding evidence.³⁹⁸

If VW has learned a lesson from its cat-and-mouse game, it has learned to be more cozy with regulators, even if it does not tell them the truth. In 2016, VW announced the opening of offices in downtown Washington, DC and other world capitals, as well as a new Audi government relations office in Sacramento.³⁹⁹

v. Fixing ‘Don’t Ask, Don’t Tell’ Incentives

This Part proposes ways to reform our ‘don’t ask, don’t tell’ system. It looks to the structure of successful international and federal anti-money-laundering laws as well as state statutes for the direct reporting of child abuse by teachers. Along these lines, individuals should have a duty to come forward within organizations without the current burdens imposed on whistleblowers.⁴⁰⁰ An ‘easier ask, let individuals tell’ approach would also reduce the burden of the current system on businesses, and allow regulators to better compile information across corporate forms.

A. The Need for Substantive Individual Liability for Coordinated Corporate Crimes

Before she left office in 2016, SEC Chairman Mary-Jo White called for the creation of new legal tools to combat the “seemingly intractable persistence of serious corporate wrongdoing” and to impose greater accountability “by expanding the reach of our laws.”⁴⁰¹ In particular, “[r]egulators and prosecutors world-wide are struggling with how best to deter what seems to be a persistent, post-financial crisis pattern of corporate wrongdoing at our major financial institutions.”⁴⁰² Chairman White expressed frustration that “senior executives” continue to evade responsibility for their organizations’ wrongdoing “either because they do not have their fingerprints directly on the conduct or indeed are not involved in it.”⁴⁰³

Chairman White suggested looking to models like a British rule that would require “executives to take steps to prevent misconduct.”⁴⁰⁴ Meanwhile, the inspector general for the U.S. government’s post-financial crisis Troubled Asset Relief Program would request that Congress require “chief executives to certify annually that they found no fraud within their organizations.”⁴⁰⁵

This Article agrees that the U.S. needs to re-think its enforcement tools. But doubling down on personal certification would only lead to greater blindness. There is stronger potential in

³⁹⁷ Sue Reisinger, *How VW's In-House Lawyers Screwed Up a Litigation Hold*, LAW.COM (Jan. 12, 2017), <http://www.law.com/sites/almstaff/2017/01/12/how-vws-in-house-lawyers-screwed-up-a-litigation-hold>; Aruna Viswanatha, *Lawsuit Accuses Volkswagen's U.S. Unit of Deleting Emissions-Related Document*, WALL ST. J. (Mar. 14, 2016), <http://www.wsj.com/articles/lawsuit-accuses-volkswagens-u-s-unit-of-deleting-emissions-related-documents-1457978876>.

³⁹⁸ Jack Ewing & Bill Vlasic, *German Authorities Raid U.S. Law Firm Leading Volkswagen's Emissions Inquiry*, N.Y. TIMES (Mar. 16, 2017), <https://www.nytimes.com/2017/03/16/business/volkswagen-diesel-emissions-investigation-germany.html>.

³⁹⁹ Shepardson, *supra* note 158.

⁴⁰⁰ [***Redacted**], *supra* note 290; *see also* STOUT & [***Redacted**], *supra* note 103.

⁴⁰¹ Aruna Viswanatha, *Head of SEC Calls for New Laws to Help Police Wall Street*, WALL ST. J. (Nov. 18, 2016), <https://www.wsj.com/articles/head-of-sec-calls-for-new-laws-to-help-police-wall-street-1479486766>.

⁴⁰² *Id.*

⁴⁰³ *Id.*

⁴⁰⁴ *Id.*

⁴⁰⁵ *Id.*

rethinking executives' and others' duty to investigate, prevent, and report corporate wrongdoing before it becomes widespread.

Social science research suggests simplifying ethical rules and making them less technical.⁴⁰⁶ In 2017, a survey of 556 ethics, compliance, and legal professionals worldwide reveals that the most effective ethics programs are not focused on technicalities, as is our system of disclosure-based regulation, but on promoting values that the organization and individuals buy into.⁴⁰⁷ As the survey concludes, “values-based workplace cultures are significantly more effective at influencing employee behavior than those solely oriented toward rules or procedures.”⁴⁰⁸ The survey’s numbers are startling: “97% of these values-based entities demonstrate better performance than their competitors in all of the 17 countries represented in the study.”⁴⁰⁹

In summary, “[v]alues-based organizations produce superior financial performance, generate more innovation and have higher levels of employee engagement and customer satisfaction.”⁴¹⁰ Additionally, “[c]ompanies that foster cultures of compliance through values-based systems of ethics reliant on trust and respect are less likely to experience employee misconduct but also more likely to outperform competitors that base their compliance programs on a check-the-box adherence to rules.”⁴¹¹ Paradoxically, the take-away for effective programs is that “[w]hen it comes to ethics and compliance, less is often more.”⁴¹²

Similarly, investors describe how an overly-legalistic ‘checklist’ mentality towards disclosure is permeating business behavior.⁴¹³ Disclosures are driven by the need to play legal defense.⁴¹⁴ According to one survey it is “the threat of litigation” and hence “‘defensive disclosure’ that overloads SEC reports without communicating meaningful information.”⁴¹⁵

For a recent illustration, the 2017 board investigation of Wells Fargo’s two-million fraudulent accounting scheme concludes that one of the major reasons why the company’s internal mechanisms failed to catch more than thirteen years of systemic misconduct was that they “often adopted a narrow ‘transactional’ approach to issues as they arose.”⁴¹⁶ Instead of searching for patterns as an outside regulator would, “[t]hey focused on the specific employee complaint or individual lawsuit that was before them, missing opportunities to put them together in a way that might have revealed sales practice problems to be more significant and systemic than was appreciated.”⁴¹⁷

How do we reform our ‘don’t ask, don’t tell’ system to be more flexible, values-based, and to incentivize individuals to actively investigate and report corporate wrongdoing before it grows?⁴¹⁸ The keys from successful models are (1) preventing the defense of plausible deniability through willful blindness instructions; (2) prompting individuals to ask their own reasonable questions about what is happening around them, and protecting their reports; (3)

⁴⁰⁶ See, e.g., Bird & Park, *supra* note 146, at 18-29 (demonstrating that theoretically optimal levels of compliance indicate that less may indeed be more).

⁴⁰⁷ Ben DiPietro, *Values-Based Culture Pays Off for Companies*, WALL. ST. J. (Mar. 8, 2017).

⁴⁰⁸ *Id.* (quoting LRN report).

⁴⁰⁹ *Id.* (same).

⁴¹⁰ *Id.*

⁴¹¹ *Id.*

⁴¹² *Id.* (quoting Mike Eichenwald, leader of the advisory practice at LRN).

⁴¹³ EY, *supra* note 87, at 2.

⁴¹⁴ Accord Todd Haugh, *The Criminalization of Compliance*, 92 NOTRE DAME L. REV. 1215, 1218 (2017).

⁴¹⁵ EY, *supra* note 87, at 7.

⁴¹⁶ *Independent Directors of the Board of Wells Fargo & Company Sales Practices Investigation Report*, 16 (Apr. 10, 2017), <https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf>.

⁴¹⁷ *Id.*

⁴¹⁸ Andrew F. Tuch, *The Limits of Gatekeeper Liability*, 73 WASH. & LEE L. REV. ONLINE 619 (2017).

aggregating reports anonymously with a regulator who can see patterns in the meta-data and coordinate law-enforcement responses accordingly; and (4) removing the collection and massaging of reports from within business organizations—thereby freeing them of those financial burdens and freeing individuals in middle management and elsewhere from reporting constraints.

1. Anti-money Laundering Regulations

In a 2016 article, Professor Gadinis and Mr. Mangels note an interesting development in financial crimes law. They describe how “[a]nti-money-laundering laws [AMLs] have played a central part in four out of the eight biggest fines in the wake of the financial crisis.”⁴¹⁹ An innovation that enables AML to be more effective than other forms of disclosure-based regulation is that it requires “private industry to share with authorities *suspicions* of misconduct, even when these pieces fall far short of proving illegality.”⁴²⁰ This difference in approach overcomes the “perverse” effect of other frameworks that permit “[m]arket players... [to] very careful[ly]... ensure that they never reach... [*mens rea* thresholds of] knowledge or negligence.”⁴²¹ Gadinis and Mangels review the legal “gatekeeping” literature, which places special reporting burdens on organizations and compliance officers, to conclude that gatekeepers would welcome an expansion of AML techniques to other areas of financial regulation.⁴²²

This author disagrees with Gadinis and Mangels’s reading of AML *mens rea* and their embrace of gatekeeping at all, but appreciates their observation of AML’s effectiveness and would keep three AML components in shaping reforms. First, the reason why AML has become so powerful in pushing organizations to report their suspicions when other frameworks fail is not the law’s *mens rea* language but how courts enforce it through willful blindness instructions. Second, AML regulations permitting reports based on suspicions lesser than the threshold of full illegal actions encourage more reporting, and create safe harbors for institutions that do report. Third, AML reports are aggregated within a single agency that is able to observe meta-patterns across reports from organizations and coordinate law-enforcement responses accordingly. These are features that we could import into other areas of white collar law.

i. Willful Blindness Instructions

Contrary to Gadinis and Mangels’s description, many AML statutes do contain the same *mens rea* as in white collar law *supra* of “knowingly” committing acts.⁴²³ In fact, Sections 1956 and 1957 require an “actual knowledge” standard, “which is more stringent than ‘should have known’ or ‘reckless disregard.’”⁴²⁴

⁴¹⁹ Stavros Gadinis & Colby Mangels, *Collaborative Gatekeepers*, 73 WASH. & LEE L. REV. 797, 800-01 (2016).

⁴²⁰ *Id.* at 802 (italics in original).

⁴²¹ *Id.*

⁴²² *Id.* at 910-14.

⁴²³ Laundering of Monetary Instruments, 18 U.S.C. §1957(a)(1), et passim (2017) (“Whoever, knowing that the property involved in a financial transaction...”); Engaging in Monetary Transactions in Property Derived from Specified Unlawful Activity, 18 U.S.C. §1957(a), et passim (2017) (“Whoever... knowingly engages or attempts to engage in a monetary transaction...”); Prohibition of Illegal Money Transmitting Businesses, 18 U.S.C. §1960(a), et passim (2017) (“Whoever knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business...”); *supra* pp. 37–54.

⁴²⁴ Alexander Egbert & Lizet Steele, *Money Laundering* 53 Am. Crim. L. Rev. 1525, 1533 (2016).

What is important, however, is the way that courts have used the willful blindness doctrine to fill in the weaknesses of how “knowingly” is interpreted in AML statutes.⁴²⁵ Willful blindness doctrine is not the same as the strict liability standards that are sweeping other areas of white collar law.⁴²⁶ As the U.S. Supreme Court describes, willful blindness instructions counter plausible deniability defenses because “defendants cannot escape the reach of... statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances.”⁴²⁷ The Court explains that “[t]he traditional rationale for this doctrine is that defendants who behave in this manner are just as culpable as those who have actual knowledge.”⁴²⁸

In its 2011 *Global-Tech Appliances, Inc v. SEB S.A.* decision, the Supreme Court easily extended willful blindness instructions to civil induced patent infringement cases.⁴²⁹ Had the Court granted cert on the petition’s second question, it might also have extended willful blindness to insider trading cases in its 2016 *Salman* decision.⁴³⁰ Many U.S. Courts of Appeals approve willful blindness instructions in AML cases, including those courts for the First,⁴³¹ Second,⁴³² Third,⁴³³ Fourth,⁴³⁴ Fifth,⁴³⁵ Eighth,⁴³⁶ and Eleventh⁴³⁷ Circuits.

Willful blindness instructions would help prosecutors counter executives’ plausible deniability defense, especially after that defense has proven so successful at trial.⁴³⁸ Willful blindness instructions would also prompt individuals to ask more questions about transactions and report more to authorities.⁴³⁹ Applying these instructions in additional parts of white collar law would not require new legislation, and existing Supreme Court language could support their adoption.⁴⁴⁰

But solely introducing willful blindness instructions into other parts of white collar crime law will not fix the larger issue of how the current ‘don’t ask, don’t tell’ system cabins reporting within organizations where it can be controlled and information suppressed.⁴⁴¹ This Article *infra* proposes additional fixes for these elements of the problem.⁴⁴²

ii. Reasonable Investigation

⁴²⁵ See *Gadinis & Mangels*, *supra* note 419, at 873 (mentioning “willful blindness” merely in passing).

⁴²⁶ See *supra* pp. 37–54.

⁴²⁷ *Global-Tech Appliances, Inc v. SEB S.A.*, Slip Op. at 10 (U.S., May 31, 2011).

⁴²⁸ *Id.*

⁴²⁹ *Id.* at 12 (“Given the long history of willful blindness and its wide acceptance in the Federal Judiciary, we can see no reason why the doctrine should not apply in civil lawsuits for induced patent infringement under 35 U.S.C. §271(b).”).

⁴³⁰ *Petition for Writ of Certiorari at i, Salmon v. United States*, 137 S. Ct. 420 (No. 15-628) (2016).

⁴³¹ *United States v. Adorno-Molina*, 774 F.3d 116, 125 (1st Cir. 2014); *United States v. Epstein*, 426 F.3d 431, 440 (1st Cir. 2005).

⁴³² *United States v. Finkelstein*, 229 F.3d 90, 97 (2d Cir. 2000).

⁴³³ *United States v. Flores*, 454 F.3d 149, 155-56 (3d Cir. 2006); *United States v. Wert-Ruiz*, 228 F.3d 250, 255 n.3 (3d Cir. 2000).

⁴³⁴ *United States v. Logan*, 593 F. App’x 179, 185 (4th Cir. 2014).

⁴³⁵ *United States v. Freeman*, 434 F.3d 369, 378-79 (5th Cir. 2005).

⁴³⁶ *United States v. Clay*, 618 F.3d 946, 953-54 (8th Cir. 2010).

⁴³⁷ *United States v. Murray*, 154 F. App’x 740, 744 (11th Cir. 2005).

⁴³⁸ See *supra* at pp. 35, 60–67; [***Redacted**], *supra* note 132, at 926–41.

⁴³⁹ *Egbert & Steele*, *supra* note 424, at 1526.

⁴⁴⁰ See, e.g., *Global-Tech Appliances*, at 12 (“[E]very Court of Appeals—with the possible exception of the District of Columbia Circuit... has fully embraced willful blindness, applying the doctrine to a wide range of criminal statutes....”).

⁴⁴¹ See *supra* pp. 8–12, 67–71.

⁴⁴² See *infra* pp. 84–87.

AML regulations permit reporting based on suspicion lesser than the threshold of fully illegal actions, encouraging more reporting, and creating safe harbors for institutions that do report. Institutions file two types of AML reports.⁴⁴³ Customer Transaction Reports (CTRs) cover “currency transactions” over \$10,000.⁴⁴⁴ Suspicious Activity Reports (SARs) must be filed when there is suspected “(1) insider abuse involving any amount [of money]; (2) violations aggregating \$5,000 or more where a suspect can be identified; (3) violations aggregating \$25,000 or more regardless of potential suspects; and (4) transactions aggregating \$5,000 or more that involve potential money laundering or violate the [Bank Secrecy Act (BSA)].”⁴⁴⁵

Key, however, is that AML regulators have interpreted the statutes to require individuals at financial institutions to follow up when they observe “suspicious” behavior.⁴⁴⁶ The terms in AML compliance are an obligation for institutions to ‘know their customers,’⁴⁴⁷ and to inquire about transactions without “an apparent lawful purpose.”⁴⁴⁸ Once a report has been filed, regulators must keep it anonymous,⁴⁴⁹ institutions are not allowed to let the targets of reports know that reports have been filed,⁴⁵⁰ and there are well-designed safe harbors that prevent the reporting system from being abused.⁴⁵¹

iii. Aggregating Reports with Single Agency

AML reports are aggregated within a single agency that is able to observe meta-patterns across reports from many organizations and can coordinate law enforcement responses accordingly locally, nationally, and internationally. CTRs and SARs are filed with a bureau of the U.S. Treasury called the Financial Crimes Enforcement Network (FinCEN).⁴⁵² FinCEN is designed to be “a government-wide, multi-source intelligence and analytical network to support the detection, investigation, and prosecution of domestic and international money laundering and other financial crimes.”⁴⁵³ It collects the reports, pieces together information from multiple sources, provides analysis, and feeds cases to law enforcement agencies.⁴⁵⁴ As FinCEN describes, its approach “combin[es] information reported under the BSA with other government and public information” and “maximize[s] information sharing among law enforcement agencies.”⁴⁵⁵ Importantly, the bureau’s meta-approach enables law enforcement to adjust to new trends, build robust cases, and “plan new strategies to combat money laundering.”⁴⁵⁶ AML

⁴⁴³ Roy G. Dixon III, *The New York Department of Financial Service’s New Anti-Money Laundering Regulation: A Model for Improvement*, 21 N.C. BANKING INST. 383, 385 (2017).

⁴⁴⁴ 31 C.R.F. §1010.311 (2017).

⁴⁴⁵ Dixon, *supra* note 443, at 385.

⁴⁴⁶ 12 C.F.R. §21.11(a) (2017).

⁴⁴⁷ 31 C.R.F. §1010.312 (2017); accord Lara L. Kessler, *Is the Grass Really Greener? Profits from State-Legalized Marijuana Business vs. Federal Anti-Money Laundering Rules*, 23 J.L. BUS. & ETH. 45, 48 (2017) (describing the impact of Treasury regulations).

⁴⁴⁸ 12 C.F.R. §21.11(c)(4)(iii) (2017).

⁴⁴⁹ 31 U.S.C. §5318(g)(2) (2017).

⁴⁵⁰ *Id.*

⁴⁵¹ 12 U.S.C. §3403(c); 31 U.S.C. §5318(g)(3); 31 C.F.R. §103.21(e); accord JOHN K. VILLA, BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT, §9:30 (Jan. 2017 update).

⁴⁵² U.S. Dep’t of the Treasury, *Financial Crimes Enforcement Network* (last visited May 9, 2017), <https://www.treasury.gov/about/history/Pages/fincen.aspx>.

⁴⁵³ *Id.*

⁴⁵⁴ *Id.*

⁴⁵⁵ *Id.*

⁴⁵⁶ *Id.*

filings have also revealed unexpected information about elder abuse, mortgage fraud, insider fiduciary breaches, and virtual currency usage.⁴⁵⁷

ALM regulation is popular with industry as well as other stakeholders. According to a 2015 FinCEN budget report, 91 percent of stakeholders who interact with the bureau, including “industry, regulators, and law enforcement, both domestic and foreign” find its information-sharing approach helpful.⁴⁵⁸ FinCEN’s more comprehensive 2010 budget reports that 94 percent of industry contacts agree that the guidance they receive from the bureau is “understandable.”⁴⁵⁹ Eighty-three percent of law enforcement find the bureau’s “analytic products highly valuable.”⁴⁶⁰ Ninety-three percent of the financial industry filing reports agree that the bureau “efficient[ly] manage[s], safeguard[s], and use[s] BSA information.”⁴⁶¹

1. Gatekeeping Concept Harmful

A significant flaw in AML that restrains its effectiveness and opens its framework up to abuse, however, is the fact that reporting remains controlled inside corporations that have an interest in manipulating it.⁴⁶² Institutions’ AML programs include “(1) the development of internal policies, procedures, and controls; (2) the designation of a compliance officer; (3) an ongoing employee training program; and (3) an independent audit function to test programs.”⁴⁶³ The weak points of these systems are relying too much on “internal policies, procedures, and controls,” and overly penalizing the designated “compliance officer.” In 2017, New York State’s AML fix requires additional personal certification on the part of bank compliance officers⁴⁶⁴—doubling down on the same flaws, and fueling concern that the most ethical people may leave compliance as a profession.⁴⁶⁵

Even Gadinis and Mangels admit that FinCEN’s model has problems with “an institution’s failure to submit required reports [that] becomes apparent only after the underlying fraud is revealed, often to significant losses for victims.”⁴⁶⁶ Too much filtering of reports—read ‘selective editing’ for organizational position—happens within corporations. For example, one “small financial institution conducted 439 [internal] investigations in 2009 but decided to file in only thirty-nine cases.”⁴⁶⁷ Furthermore, when institutions do file reports, it is often at the end of a process after they have already decided to cut ties with the customer.⁴⁶⁸

⁴⁵⁷ Gadinis & Mangels, *supra* note 419, at 879-81.

⁴⁵⁸ Financial Crimes Enforcement Network, Description of Performance, *2017 Budget Performance* at 4 (last visited May 9, 2017), <https://www.treasury.gov/about/budget-performance/budget-in-brief/BIB17/10.%20FinCEN%20FY%202017%20BiB-1.pdf>

⁴⁵⁹ U.S. Dep’t of the Treasury, *Budget in Brief FY 2010*, at 39 (last visited May 9, 2017), <https://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/BIB-FinCEN.pdf> (reporting last available FY2008 numbers).

⁴⁶⁰ *Id.*

⁴⁶¹ *Id.*

⁴⁶² 12 U.S.C. §1892b(a)(2) (2017).

⁴⁶³ 31 U.S.C. §5318(h)(1) (2017).

⁴⁶⁴ Dixon, *supra* note 445, at 397.

⁴⁶⁵ ENGLISH & HAMMOND, *supra* note 274, at 9.

⁴⁶⁶ Gadinis & Mangels, *supra* note 419, at 891.

⁴⁶⁷ *Id.* at 886.

⁴⁶⁸ *See id.* at 888 (describing banks dropping clients after deciding to report).

In 2015, for example, Commerzbank agreed to pay \$1.45 billion for doing business with prohibited countries and for failing to enforce adequate AML controls.⁴⁶⁹ According to prosecutors, “Commerzbank committed these crimes even though managers inside the bank raised red flags about its sanctions-violating practices.”⁴⁷⁰ The bank’s management had specifically “designated a group of employees in the Frankfurt back office to review and amend Iranian payments so that the payments would not be stopped by U.S. sanctions filters.”⁴⁷¹ In echoes of the cover-up at VW, an email within Commerzbank to its employees instructed, “[i]f for whatever reason... New York inquires why our turnover has increase[d] so dramatically, under no circumstances may anyone mention that there is a connection to the clearing of Iranian banks!!!!!!!!!!!!!!”⁴⁷² All levels of the firm were involved in evading controls including “the head of Commerzbank’s internal audit division” who “stated in an email to a member of Commerzbank’s senior management that Iranian bank names in payment messages going to the United States were being ‘neutralized.’”⁴⁷³ The bank used the same techniques with banned Sudanese clients, and it perpetrated an elaborate transfer scheme for the Japanese manufacturer Olympus to conceal “hundreds of millions of dollars in losses.”⁴⁷⁴ Meanwhile, as within VW, there were employees within Commerzbank who did want to report to regulators and who are credited in the bank’s consent order with New York regulators.⁴⁷⁵

The problem with AML remains its dependence on gatekeepers—organizations and specific compliance personnel—to curate reports.⁴⁷⁶ Despite Gadinis and Mangels’s academic criticism survey of gatekeeping, they oddly embrace it as a central part of future financial regulation.⁴⁷⁷

Yet the current focus and dependence on gatekeepers in our ‘don’t ask, don’t tell’ system is ineffective, and even counter-productive. Corporate lawyers, often relied upon as gatekeepers in compliance systems, may in fact be some of the worst offenders.⁴⁷⁸

In an analysis of stock trading by general counsels before, during, and after the class period in firms involved in securities class action settlements, finance professor H. Nejat Seyhun and Mr. S. Burcu Avci empirically support their hypothesis that “in-house corporate counsels participate in planning, creation, execution or cover-up of the fraud alongside other top management.... Corporate counsels are typically not only present at the scene of the crime, but also they help create the crime and thus they are well aware of the crime and subsequent cover-

⁴⁶⁹ Dep’t of Justice, Press Release, *Commerzbank AG Admits to Sanctions and Bank Secrecy Violations, Agrees to Forfeit \$563 Million and Pay \$79 Million Fine* (Mar. 12, 2015), <https://www.justice.gov/opa/pr/commerzbank-ag-admits-sanctions-and-bank-secrecy-violations-agrees-forfeit-563-million-and>.

⁴⁷⁰ *Id.*

⁴⁷¹ *Id.*

⁴⁷² *Id.*

⁴⁷³ *Id.*

⁴⁷⁴ *Id.*

⁴⁷⁵ Consent Order Under New York Banking Law §§ 39 and 44, In the Matter of Commerzbank AG, Commerzbank AG New York Branch, at 4-5 (filed Mar. 12, 2015), <http://www.dfs.ny.gov/about/ea/ea150312.pdf>.

⁴⁷⁶ See, e.g., JOHN C. COFFEE, JR., *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* (2006) (describing problems, but advocating keeping the gatekeeper system).

⁴⁷⁷ Gadinis & Mangels, *supra* note 419, at 808-24, 910-14; COFFEE, *supra* note 476, at 5; Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1595 (2010); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L.REV. 301, 308 (2004); Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV. 53, 103-04 (2003).

⁴⁷⁸ See also Tim Cooper, “Full” Disclosure? 11 REPORTING at 3 (EY’s Newsletter, April 2016), [http://www.ey.com/Publication/vwLUAssets/EY-full-disclosure/\\$FILE/EY-full-disclosure.pdf](http://www.ey.com/Publication/vwLUAssets/EY-full-disclosure/$FILE/EY-full-disclosure.pdf) (quoting investor complaints that businesses “have to fight against the tendency to tick boxes because [many] reports today are supervised by legal people who are not concerned about the outcome or the use by shareholders”).

up.”⁴⁷⁹ Accordingly, counsel’s low level of reporting, even when legally required, makes sense because “corporate lawyers... have no incentive to report the fraud since they would be turning themselves in by reporting.”⁴⁸⁰ Seyhun and Avci recommend additional layers of gatekeeping reports, but this author argues that their data and additional studies suggest that our entire reliance on gatekeeping within organizations is flawed.⁴⁸¹

‘Don’t ask, don’t tell’'s fixation on gatekeepers at all is an odd one. It is key that individuals inside organizations at all levels have the ability to report outside the organization. Even after passage of SOX and the legal imposition of duties on corporate counsel to report wrongdoing, the majority of whistleblowing on corporate fraud comes from employees, non-financial market regulators, and the media.⁴⁸² We should want employees at all levels to be invested in the ethics of their jobs and be free of internal controls that may be designed, as in VW and countless other examples, to stifle independent thought and accountability.

Furthermore, as Seyhun and Avci note about the changing landscape of the law profession, strategic decisions are increasingly being brought in-house—where internal controls and pressure are most prevalent—and not even being revealed to outside professional gatekeepers.⁴⁸³ In these situations, only employees inside know enough to report.

This author more fully engages the gatekeeping literature in a separate work.⁴⁸⁴ As this Article describes, however, other good models are available.

2. Teacher Reporting Language

One of many models of direct reporting comes from mandates for teachers and other professionals to report child abuse to authorities without funneling it through organizations’ control.

The frustration with school officials hiding abuse echoes frustrations with organizational cover-ups of other institutional wrongdoing. As a Texas legislator involved in the strengthening the state’s law in 2013 describes its purpose “[t]he objective is to go after those individuals that have knowledge of severe, ongoing abuse, and they’re not reporting it.”⁴⁸⁵ Child advocates agree: the problem with previous statutes was that “[m]any of the schools were skirting the law.”⁴⁸⁶ An example cited in shaping Texas’s law is Pennsylvania State University’s systematic

⁴⁷⁹ S. Burcu Avci & H. Nejat Seyhun, *Why Don’t General Counsels Stop Corporate Crime?*, AM. ECON. ASSOC. (2017 papers) at 4 (Nov. 13, 2016). The paper was also featured by the Harv. L. Sch. Forum on Corp. Governance and Fin. Reg. (Sept. 19, 2016), <https://corpgov.law.harvard.edu/2016/09/19/why-dont-general-counsels-stop-corporate-crime>.

⁴⁸⁰ *Id.*

⁴⁸¹ *Id.* at 5.

⁴⁸² These numbers are 17 percent, 13 percent, and 13 percent. Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle of Corporate Fraud?*, 65 J. FIN. 2213, 2226 (2010).

⁴⁸³ Avci & Seyhun, *supra* note 479, at 10; accord Robert C. Bird, Paul Borochin, & John D. Knopf, *The Role of the Chief Legal Officer in Corporate Governance*, J. CORP. FIN. (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2379612. (finding that CLOs do not turn over after scandals like even CEOs and CFOs).

⁴⁸⁴ [***Redacted***], *supra* note 290 (describing interaction with abusive internal corporate control).

⁴⁸⁵ Ericka Mellon, *Few Charged With Failure To Report Abuse*, HOUSTON CHRONICLE (Dec. 8, 2013), <http://www.houstonchronicle.com/news/education/article/Few-charged-with-failure-to-report-abuse-5047094.php> (quoting State Representative Tan Parker).

⁴⁸⁶ *Id.* (quoting Madeline McClure, Exec. Dir. of TexProtects).

1970s-to-2011 cover-up of campus sexual abuse to protect its profitable football program and the school's image.⁴⁸⁷

Texas no longer permits an individual to delegate his or her responsibility to report in any way, and puts a 48-hour clock on reports to keep them from being interfered with by anyone within an organization's administration.⁴⁸⁸ As the Texas Attorney General describes, "[t]he law does not require the person reporting to be certain that a child is being abused or neglected before reporting, only to have reason for believing it.... [T]he disclosure should be reported so that appropriate authorities can judge the need for investigation."⁴⁸⁹ Penalties for not reporting suspected abuse may include "imprisonment for up to 180 days and/or a fine of up to \$2000;" there are also "good faith" safe harbors and anonymity.⁴⁹⁰

The Texas child-abuse reporting statute is particularly strict, but its premise is not unusual. All fifty states and the District of Columbia mandate direct reporting of child abuse for teachers as well as school administrators.⁴⁹¹ Fifteen states mandate anyone at all who suspects abuse to report it.⁴⁹² Five additional states explicitly permit anyone to report child abuse and extend safe harbors for such reports.⁴⁹³ The standards are generally reasonable suspicion—not proof of a completed crime.⁴⁹⁴

Eleven states make it the personal responsibility of a teacher or other individuals to report abuse directly to authorities.⁴⁹⁵ Illinois mandates that, if an institution discovers that one of its employees is reporting, "[u]nder no circumstances shall any person in charge of such institution... exercise any control, restraint, modification or other change in the report or the forwarding of such report."⁴⁹⁶

Five states permit an institution to make reports on behalf of its employees, but explicitly warn that reporting is the obligation of the employee and that the institution may not interfere

⁴⁸⁷ *Id.*; Hannah Rappleye, Tom Winter & Corky Siemaszko, *Two Penn State Admins Plead Guilty to Sandusky Scandal Charges*, NBC NEWS (Mar. 13, 2017), <http://www.nbcnews.com/news/us-news/two-more-penn-state-admins-plead-guilty-sandusky-scandal-charges-n732801>.

⁴⁸⁸ TEXAS FAM. CODE ANN. §261.101(b) (West 2017); *see also* ATTN'Y GEN. OF TEXAS, WHAT WE CAN DO ABOUT CHILD ABUSE, at Professionals Who Work with Children (last visited May 15, 2017), <https://www.texasattorneygeneral.gov/cvs/what-we-can-do-about-child-abuse-2#responsible> ("Local school district policy cannot conflict with or supersede the state law requiring a teacher to report child abuse to a law enforcement agency or TDFPS.").

⁴⁸⁹ ATTN'Y GEN., *supra* note 488, at "B. The Responsibility to Report Child Abuse."

⁴⁹⁰ *Id.* at "B. The Responsibility to Report Child Abuse" & "The Person Reporting is Protected Under Law."

⁴⁹¹ See mandatory language of reporting statutes as compiled by the School Counselor Association (last visited May 15, 2017), <https://www.schoolcounselor.org/asca/media/asca/home/childabusebystate.pdf>.

⁴⁹² IDAHO CODE §15-1605, §16-1605 (2017); 325 ILL. COMP. STAT. 5/4 (2017); IND. CODE §31-33-5-1 (2017); KY. REV. ST. ANN. §620.030 (West 2017); MD. CODE ANN. FAM. LAW §5-706 (West 2017); MISS. CODE ANN. §43-21-353 (2017); NEB. REV. STAT. §28-711 (2017); N.J. STAT. ANN. §9:6-8.10 (West 2017); N.M. STAT. ANN. §32A-4-3 (2017); N.C. GEN. STAT. §7B-301 (2017); OKLA. STAT. tit. 10A, §1-2-101 (2017); 40 R.I. GEN. LAWS §40-11-3(a) (2017); TENN. CODE ANN. §§ 37-1-403, 37-1-605 (2017); TEXAS FAM. CODE ANN. §261.101 (West 2017); UTAH CODE ANN. §62A-4a-403 (West 2017); WYO. STAT. ANN. §14-3-205 (2017).

⁴⁹³ CAL. PENAL CODE §11166 (West 2017); MINN. STAT. §626.556, Subd. 3 (2017); OHIO REV. CODE ANN. §2151.421 (West 2017); WASH. REV. CODE §26.44.030 (2017); W. VA. CODE §49-6A-2 (2017).

⁴⁹⁴ See blanket statutes, *supra* notes 492-493.

⁴⁹⁵ ALASKA STAT. §47.17.020(g) (2017); CAL. PENAL CODE §11166(f), (h) & (i)(1) (West 2017); D.C. CODE §4.1321.02(b) (2017); HAW. REV. STAT. §350-1.1(b) (2017); 325 ILL. COMP. STAT. 5/4 (2017); KAN. STAT. ANN. §38-2223 (2017); KY. REV. ST. ANN. §620.030(1) (West 2017); TENN. CODE ANN. §37-1-403(h) (2017); TEXAS FAM. CODE ANN. §261.101(b) (West 2017); W. VA. CODE §49-6A-2 (2017); WYO. STAT. ANN. §14-3-205 (2017).

⁴⁹⁶ 325 ILL. COMP. STAT. 5/4 (2017).

with it.⁴⁹⁷ Tennessee, for example, includes language in its statute that an organization's procedures "may not inhibit, interfere with, or otherwise affect the duty of a person to make a report."⁴⁹⁸ Nine states permit employees to delegate reporting to institutions, but place an obligation on the institution to submit reports immediately without interference.⁴⁹⁹

B. Proposal: 'Easier Ask, and Let Individuals Tell'

Combining elements from AML and teacher reporting statutes would enable an 'easier ask, let individuals tell' system. The system would use willful blindness instructions; the reasonable investigation of behavior and reporting protections; the aggregation of reports within a single agency that can coordinate with a broad range of law enforcement; and individual reporting freed from corporate restraints. This proposal keeps the best parts of these other systems and empowers better information collection and responses.

Another example of direct reporting to consider is the Consumer Financial Protection Bureau (CFPB). The CFPB has pioneered direct reporting on consumer subjects, demonstrating that technology enables regulators even with restricted resources to be responsive to a large volume of reports, and it has successfully used meta-data collection techniques to shine the light on abuses at Wells Fargo, Navient, and other high-profile corporations.⁵⁰⁰ Other regulators of white collar crime could take the same approach.

Attorneys should also be included in reporting reform.⁵⁰¹ Instructively, in 2017 Canada is adopting many other countries' approach to require lawyers to report suspicious money-laundering transactions the way bankers and real-estate agents already do.⁵⁰² The Canadian Supreme Court had originally permitted attorneys to be exempted from reporting because of attorney-client privilege, but the more tailored regulations should hold attorneys to "higher standards of due diligence and anti-money laundering compliance" without implicating attorney-client privilege.⁵⁰³

C. Benefits

Among others benefits, 'easier ask, let individuals tell' reforms would be less expensive than the current system.⁵⁰⁴ Paradoxically, recognizing that we do not always know the right questions to ask and allowing individuals to tell us what is happening around them will more efficiently supply regulators with information relevant to prevent corporate wrongdoing. Simplifying our

⁴⁹⁷ KY. REV. ST. ANN, §620.030(1) (West 2017) (belt-and-suspenders approach); MO. REV. STAT. §210.115(3) (2017); TENN. CODE ANN. §37-1-403(h) (2017); W. VA. CODE §49-6A-2 (2017); WYO. STAT. ANN. §14-3-205 (2017).

⁴⁹⁸ TENN. CODE ANN. §37-1-403(h) (2017).

⁴⁹⁹ KY. REV. ST. ANN, §620.030(1) (West 2017); CAL. PENAL CODE §11166(f) (West 2017); MASS. GEN. LAWS ch. 119, §21 (2017); MO. REV. STAT. §210.115(3) (2017); N.Y. SOC. SERV. LAW §413(b) (McKinney 2017); 23 PA. CONS. STAT. §6311(c) (2017); S.D. CODIFIED LAWS §26-8A-3 (2017); W. VA. CODE §49-6A-2 (2017); WYO. STAT. ANN. §14-3-205 (2017).

⁵⁰⁰ Andrew Kreighbaum, *Small Agency, Big Impact*, INSIDE HIGHER ED. (Sept. 28, 2016), <https://www.insidehighered.com/news/2016/09/28/consumer-financial-protection-bureau-plays-outsize-role-regulator-profits-and-loan>.

⁵⁰¹ See attorneys discussion *supra* pp. 48-49, 62, 76, 87-88.

⁵⁰² Sam Cooper, *Battle Over Lawyers' Money-Laundering Loophole Shapes Up in B.C.*, VANCOUVER SUN (Feb. 26, 2017), <http://vancouversun.com/news/national/b-c-a-battleground-for-lawyer-loophole-cases>.

⁵⁰³ *Id.* (quoting Transparency International author Adam Ross).

⁵⁰⁴ See *supra* pp. 56-58; accord Reinier H. Kraakman, *Corporate Liability Strategies and Costs of Legal Controls*, 93 YALE L.J. 857, 878 (1984) (discussing costs of liability regimes).

overly technical ‘check-the-box’ approach gives us both more information about problems and brings our system in line with successful values-based initiatives.⁵⁰⁵ Relaxing regulations to reasonable suspicion and importing willful blindness instructions would prompt investigation and thoughtfulness. These changes would allow individuals to contribute to the ethical health of their organizations instead of being constrained by suppressive thresholds and mechanisms of control.⁵⁰⁶

Aggregating reports permits regulators to adapt to new patterns and find crimes that reach across organizational forms.⁵⁰⁷ There is also an advantage in separating reports from their organizational sources in reducing regulatory capture, and in responding to what is happening in the marketplace with real-time input.⁵⁰⁸ An agency following meta-patterns is more likely to discover how wrongdoing may take multiple forms. To quote Warren Buffet, “In the world of business, bad news often surfaces serially: you see a cockroach in your kitchen; as the days go by, you meet his relatives.”⁵⁰⁹ This pattern has been true in widespread cases of corporate wrongdoing from VW, to Wells Fargo,⁵¹⁰ Navient,⁵¹¹ and Uber’s scandals including Greyball.⁵¹² We should be finding that first cockroach before his relatives take over the kitchen.

The FinCEN and CFPB models have shown that consolidating reports with a single agency is not only successful, but easy to administer with websites and technology.⁵¹³ Additionally, when patterns are published, news coverage encourages more reports and the crowdsourcing of information.⁵¹⁴ As in AML and Texas, reports can be anonymized for individuals to be comfortable reporting from inside organizations.⁵¹⁵

D. Counterarguments

Counterarguments against ‘easier ask, let individuals tell’ reforms include the value of asking specific questions to shine light on problems. As the father of modern management, Peter Drucker, is famous for saying, “[i]f you can’t measure it, you can’t improve it.”⁵¹⁶ We measure things to manage them.

⁵⁰⁵ See *supra* pp. 77–80.

⁵⁰⁶ See *supra* pp. 12–17, 21–28, 37–44.

⁵⁰⁷ See *supra* pp. 7–12, 66–70, 84–85.

⁵⁰⁸ See Gretchen Morgenson, Fair Game, *The Watchdog Protecting Consumers May Be Too Effective*, N.Y. TIMES (Feb. 10, 2017), <https://www.nytimes.com/2017/02/10/business/consumer-financial-protection-bureau-gretchen-morgenson.html> (“Perhaps more important, the bureau monitors the complaints to help determine its enforcement priorities. This is a far more efficient approach than that taken by other financial regulators, who often become part of the culture at entities they are supposed to police.”).

⁵⁰⁹ Catherine Boyle, *Warren Buffett Compares Tesco Problems to...Cockroaches*, CNBC (Mar. 2, 2015), <http://www.cnbc.com/2015/03/02/warren-buffett-compares-tesco-tocockroaches.html>.

⁵¹⁰ Cowley & Goldstein, *supra* note 41.

⁵¹¹ Gretchen Morgenson, Fair Game, *At Student Loan Giant Navient, Troubled Past Was Prologue*, N.Y. TIMES (Jan. 21, 2017), <https://www.nytimes.com/2017/01/21/business/navient-sallie-mae-student-loans.html>.

⁵¹² Eric Newcomer, *Uber’s Latest Executive Exit Adds to String of Controversies*, BLOOMBERG (Mar. 19, 2017), <https://www.bloomberg.com/news/articles/2017-03-19/uber-president-jones-said-to-quit-amid-turmoil-recode-reports>.

⁵¹³ Morgenson, *supra* note 508 (“Complaints can really tell us about business practices that pose risks to consumers... all this information together [helps us] to understand the problems consumers are experiencing and... enable the bureau to improve the marketplace.”) (quoting Darian Dorsey in the CFPB office of consumer response).

⁵¹⁴ See *id.* (“Monthly reports analyzing the grievances received by the bureau are available on its website, providing a real-time snapshot of problems consumers are experiencing in their financial lives.”).

⁵¹⁵ See AML discussion *supra* p. 83; child-abuse reporting *supra* p. 90.

⁵¹⁶ Dave Lavinsky, *The Two Most Important Quotes in Business*, GROWTHINK (Feb. 25, 2017), <http://www.growthink.com/content/two-most-important-quotes-business>.

Unfortunately, however, we are not receiving helpful answers in our attempt to measure these problems.⁵¹⁷ And even when companies provide answers, the marketplace and regulators are not responding to provide helpful ethical feedback.⁵¹⁸

Drucker also understood more nuance—the famous quote is inaccurate.⁵¹⁹ As Drucker explains “[w]ork implies not only that somebody is supposed to do the job, but also accountability, a deadline and, finally, the measurement of results—that is, feedback from results on the work and on the planning process itself.”⁵²⁰ In the case of disclosure-based regulation, our feedback mechanisms are not working, and we have a flawed ‘don’t ask, don’t tell’ system instead. We need to change our management technique.

Along the lines of ‘easier ask, let individuals tell’ reforms, Drucker explains “[y]our first role [in effective management]... is the personal one... It is the relationship with people, the development of mutual confidence, the identification of people, the creation of a community.”⁵²¹ More effective holistic management “cannot be measured or easily defined. But it is not only a key function. It is one only you can perform.”⁵²² Drucker calls for larger cultural changes, values-based ethics, and the creation of improved community norms that can be found through ‘easier ask, let individuals tell’ reforms.⁵²³

Another objection to ‘easier ask, let individuals tell’ reforms may be that they are not sweeping enough, and that, in order to achieve more substantive liability in white collar law, we must pass new legislation to define additional crimes and civil actions.

There are several responses to this objection. First, there is currently little political will or legislative opportunity to broadly redefine white collar crimes and civil actions.⁵²⁴ ‘Easier ask, let individuals tell’ reforms are practical steps to improve the system that we have now, with the end goal of reducing our emphasis on ‘don’t ask, don’t tell’ liability. As suggested *supra*, prosecutors with restricted resources may gravitate to disclosure-based charges because they are the low-hanging fruit.⁵²⁵ It is easier to try someone for making false statements than to investigate and explain a more detailed conspiracy to a jury. But evidence from FinCEN and the CFPB suggests that, when the agency coordinating the law-enforcement response has a more comprehensive understanding of scope of the wrongdoing, prosecutions can be more sophisticated. The FBI is a natural candidate for housing this centralized law-enforcement contact, but so would be a bureau within the Treasury Department like FinCEN, or an independent agency like the CFPB.

Second, we could begin increasing substantive individual liability if we were to implement both ‘easier ask, let individuals tell’ reforms and use our current laws differently. This author has written previously about RICO, for example, as a tool against coordinated wrongdoing within business organizations, but the statute has been defanged by judicial interpretation.⁵²⁶ If courts and prosecutors re-think their choice of charges and their interpretations of existing statutes, the landscape of current prosecutions could contain more substantive individual liability.

⁵¹⁷ See *supra* pp. 12–17, 59–66, 85–89.

⁵¹⁸ See *supra* pp. 21–28, 70–74.

⁵¹⁹ Paul Zak, *Measurement Myopia*, DRUCKER INST. (July 4, 2013), <http://www.druckerinstitute.com/2013/07/measurement-myopia> (quoting Drucker).

⁵²⁰ PETER F. DRUCKER, *MANAGEMENT: TASKS, RESPONSIBILITIES, PRACTICES* 94 (1986).

⁵²¹ Zak, *supra* note 519 (quoting Drucker).

⁵²² *Id.* (same).

⁵²³ [***Redacted***], *The Corruption Norm*, forthcoming in the J. OF MGMT. INQUIRY (2017) (on file with author); STOUT & [***Redacted***]N, *supra* note 103.

⁵²⁴ See *supra* note 63.

⁵²⁵ See *supra* pp. 44, 53–56.

⁵²⁶ *Trap*, *supra* note 103; *Vacuum*, *supra* note 103; [***Redacted***], *supra* note 132.

Third, honest middle managers often feel trapped by the ‘don’t ask, don’t tell’ system and, as in VW and Commerzbank, would report if ‘easier ask, let individuals tell’ reforms were in place. For those middle managers who do not respond to the opportunity to relieve this pressure, there still needs to be the threat of greater substantive individual liability, but the need for it may be less after ‘easier ask, let individuals tell’ reforms.⁵²⁷

Fourth, along these lines, new legislation on substantive individual liability for coordinated corporate wrongdoing should be passed in coordination with reforms of our whistleblower system. These details are beyond the scope of this Article, and are addressed in a sister work on abusive internal controls.⁵²⁸

Another set of objections to ‘easier ask, let individuals tell’ reforms concerns circumventing the domination of attorneys and trained gatekeepers. In Professor Coffee’s view, gatekeepers should be “some form of outside or independent watchdog or monitor—someone who screens out flaws or defects or who verifies compliance with standards or procedures.”⁵²⁹ We should focus on gatekeepers for optimal corporate governance because “[a]ll boards of directors are prisoners of their gatekeepers.”⁵³⁰

First, after ‘easier ask, let individuals tell’ reforms attorneys and other compliance personnel will still have roles and be available to help guide corporations. But we should not allow boards of directors and top executives use these personnel as a defensive wall against all forms of liability. Boards of directors and top executives have become “prisoners of their gatekeepers” by current ‘don’t ask, don’t tell’ design.

Second, the judgment of trained human gatekeepers is already disappearing with automation, and increasing computer automation amplifies ‘don’t ask, don’t tell’ check-the-box dangers. Algorithmic bias also introduces new layers of issues: as a 2017 RAND Corporation report explains, “[a]lgorithmic decisions are not automatically equitable just by virtue of being the products of complex processes, and the procedural consistency of algorithms is not equivalent to objectivity.”⁵³¹ In fact, “[w]hile human decision-making is... rife with comparable biases that artificial agents might exhibit, the question of accountability is murkier when artificial agents are involved.”⁵³² These are further reasons to enact ‘easier ask, let individuals tell’ reforms, and resisting these reforms will not save attorneys’ jobs.⁵³³

Businesses may protest that enacting ‘easier ask, let individuals tell’ reforms sets up tension with internal corporate controls. But there does not need to be conflict with positive internal controls, such as strong values-based cultures on display at Southwest Airlines and other

⁵²⁷ Cf., e.g., Jeyup S. Kwaak, *Hyundai Whistle-Blower*, in *Rarity for South Korea, Prompts Recall*, N.Y. TIMES (May 16, 2017), <https://www.nytimes.com/2017/05/16/business/hyundai-south-korea-whistle-blower-recall.html> (describing cultural changes towards whistleblowing).

⁵²⁸ [***Redacted**], *supra* note 290.

⁵²⁹ COFFEE, *supra* note 476, at 2

⁵³⁰ *Id.* at 1.

⁵³¹ Ben DiPietro, Morning Risk Report, *Beware Bias Risks Associated With Algorithms*, WALL ST. J. (Apr. 14, 2017).

⁵³² *Id.* (quoting report).

⁵³³ By 2017, the Royal Bank of Scotland announced that it would cut 2,000 compliance staff to be replaced by computer automation. Richard Partington, *Banks Trimming Compliance Staff as \$321 Billion in Fines Abate*, BLOOMBERG (Mar. 22, 2017), <https://www.bloomberg.com/news/articles/2017-03-23/banks-trimming-compliance-staff-as-321-billion-in-fines-abate>. USB AG will soon follow. *Id.* Credit Suisse is already using twenty robots to answer employees’ questions about compliance. Victor Golovtchenko, *Credit Suisse Deploys Robots to Answer Compliance Questions*, FIN. MAGNATES (Feb. 5, 2017), <https://www.financemagnates.com/institutional-forex/brokerage/credit-suisse-deploys-robots-answer-compliance-questions>.

organizations.⁵³⁴ Many of the teacher reporting statutes help outline the proper place of procedures in aiding rather than in suppressing reports.

In addition, we should be challenging internal controls that become abusive. The difficult position of middle management inside VW, Wells Fargo, and Uber is not unique.⁵³⁵ A 2017 study reveals that “employees in mid-level organizational positions ha[ve] higher rates of depression and anxiety than employees who occup[y] positions nearer either end of the hierarchy.”⁵³⁶ These findings and pressures “can be added to the long list of reasons why middle managers are so unhappy.”⁵³⁷

Exercising abusive levels of internal control not only impedes a company’s success, but it is an expense that businesses should not want. Our ‘don’t ask, don’t tell’ system drives the need for extreme internal controls to avoid organizational liability. A significant advantage of ‘easier ask, let individuals tell’ reforms for businesses would be the chance to invest these resources elsewhere in producing the next generation of products and innovations for the marketplace.

A final objection to ‘easier ask, let individuals tell’ reforms may be that cases could be harder to litigate without reams of disclosures signed off by compliance personnel. As noted above, it is often easier for prosecutors to charge misrepresentation in statements than to present underlying facts.⁵³⁸ But with ‘easier ask, let individuals tell’ reforms, prosecutors will have these facts, and they should become the proper bases for prosecutions. With ‘don’t ask, don’t tell’ prosecutions failing, prosecutors should be welcoming new communication with individuals who want to help them as well as the opportunity to more effectively improve corporate behavior.

Conclusion

Despite hanging a banner on its Wolfsburg factory in November 2015 that reads in translation “We need transparency, openness, energy and courage,”⁵³⁹ VW has not in practice embraced any of these ideals. The lesson that the public should learn from repeat large-scale scandals is that we must rethink our ‘don’t ask, don’t tell’ system for corporate crime.

Insulating mid-level managers below the level of disclosure representatives allows them to coordinate wrongdoing under and across corporate forms, enables the expanding scale of wrongdoing, and inflicts enormous damage on the public.

We cannot rely on the current ‘don’t ask, don’t tell’ system to keep the public safe. We need ‘easier ask, let individuals tell’ reforms for employees to come forward at every level.⁵⁴⁰ These changes will ultimately impose fewer costs on companies, and permit regulators to collect the information they need across the marketplace to identify the broad patterns of misconduct that are increasingly inflicting harm. Reforming our ‘don’t ask, don’t tell’ system through ‘easier ask, let individuals tell’ changes is an important first step to curtail future large-scale corporate wrongdoing.

⁵³⁴ Joseph Guinto, *A Look at Southwest Airlines 50 Years Later*, D CEO (May 2017), <https://www.dmagazine.com/publications/d-ceo/2017/may/southwest-airlines-50-year-anniversary-love-field-dallas>.

⁵³⁵ See *supra* pp. 16, 63–66, 93.

⁵³⁶ Eric M. Anicich & Jacob B. Hirsh, *Why Being a Middle Manager Is So Exhausting*, HARV. BUS. REV. (Mar. 22, 2017), <https://hbr.org/2017/03/why-being-a-middle-manager-is-so-exhausting>.

⁵³⁷ *Id.*

⁵³⁸ See *supra* pp. 44, 53–56, 95.

⁵³⁹ David Shepardson, *Kentucky Attorney General Sues Volkswagen Over Diesel Emissions*, REUTERS (Mar. 22, 2016), <http://www.reuters.com/article/us-volkswagen-emissions-kentucky-idUSKCN0WO2PS> (graphic in translation).

⁵⁴⁰ See [***Redacted**], *supra* note 290 (describing interaction with abusive internal corporate control).