July 29, 2016

Dear Colleagues,

I am currently working on what I envision to be a three-part series of articles addressing compliance programs within private organizations. During SEALS, I would like to focus on the second article in the series, but to give you a bit of context I will begin by outlining the first project and how the second project is related. I will leave the discussion of the third article for a SEALS session next summer!

Article 1: Coordinating Compliance

After conducting a small case study, I found that if a corporation violates the False Claims Act today, the Foreign Corrupt Practices Act (“FCPA”) next year, and the antitrust laws two years from now, the corporation is not treated as a recidivist or repeat offender. If, however, the corporation violates the FCPA today and the FCPA two years from now it is treated as a recidivist and receives a heightened sanction. As a result, federal regulators and prosecutors have created a regime of piecemeal compliance where a company engaged in misconduct has a strong incentive to implement reforms in discrete areas of its compliance program instead of conducting a systematic overhaul of its firm’s entire compliance program. This is true even when there are strong indications, in the form of multiple compliance failures, which indicate that the corporation’s global compliance program is deeply flawed.

The article argues that efforts to improve corporate compliance would benefit from regulatory mechanisms that (i) recognize when an institution is engaged in recidivist behavior across diverse regulatory areas and (ii) aggressively sanction institutions that are repeat offenders. By employing an enforcement strategy that detects when an institution is suffering from a systemic compliance
failure and holding corporations responsible for being repeat offenders across diverse regulatory areas, federal regulators can encourage corporations to implement more robust reforms to their compliance programs, which could ultimately lead to improved ethical conduct and more effective compliance programs within public companies.

An issue that I acknowledge, but do not fully address in this paper, has to do with whether to treat parent companies and subsidiaries as the same or separate entities when attempting to identify recidivist behavior. In this paper, I plan to (i) identify the issue, (ii) acknowledge that it is a tricky question, (iii) suggest that this may be something that should be dealt with on a case-by-case basis via prosecutorial discretion, and (iv) flag the issue as something that would benefit from additional research.

*Article 2: Complex Compliance & Collateral Consequences*

The second article in this series will address the issue of parent/subsidiary misconduct head-on. I am early in my research, so I do not have a concrete thesis or solution yet, but I do have a few goals in mind for the project. I welcome any and all feedback on these goals.

**Goal 1: Concretely and interestingly lay out the problem of parent/subsidiary misconduct.**

For this project, I plan to conduct a new case study using the banks that participated in the LIBOR scandal. My plan is to demonstrate that the banks engaged in the LIBOR misconduct (i) had a history of engaging in misconduct, albeit of a different underlying type, (ii) violated laws since their participation in LIBOR came to light, (iii) have capitalized on regulators’ willingness to permit subsidiaries to plead guilty, and (iv) have not been treated as repeat offenders by federal regulators.
The goal of this case study, which will likely include twelve banks, is to bring the problem of parent versus subsidiary liability to the forefront of the readers’ attention. The SEC has been criticized by politicians and the media for allowing banks involved in the LIBOR misconduct to plead guilty in a way that protects the parent company, and I think that the criticism paired with the significance of the LIBOR misconduct may serve as an interesting way to frame the issues the paper is addressing.

• Goal 2: Explain why it matters whether a parent or subsidiary is held responsible, because of the resulting collateral consequences.

After finishing the case study, I plan to do an analysis of the collateral consequences that institutions can sometimes avoid by allowing a subsidiary, as opposed to a parent company, take responsibility for misconduct. For example, the SEC allowed Deutsche Bank’s London subsidiary to plead guilty to participating in LIBOR,¹ which left the SEC with discretion to grant the bank’s parent company a “bad actor” waiver.² The significance of the waiver is that Deutsche Bank can continue to utilize “Well Known Seasoned Issuer” privileges.

• Goal 3: Develop a normative framework for determining when a parent company should be held responsible for the conduct of its subsidiaries when determining whether to treat a firm as a recidivist and levy a heightened sanction.

This is the real aim of the paper, although I think I have to accomplish Goals 1 and 2 to effectively complete Goal 3. Here are a couple tentative thoughts.

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Similar Underlying Misconduct – One thought I have is that if the subsidiary and parent company have engaged in similar underlying misconduct, then the entire corporate entity should be treated as one offender for purposes of making a recidivist determination. When working on Coordinating Compliance, I found a category of institutions that repeatedly engaged in similar misconduct, say for example bribery, in a manner that violated different statutory schemes, yet were not treated as repeat offenders unless bribery occurred multiple times within the same statutory scheme. I’m curious to see if I will find similar results in the financial regulation context. If I do, I think that one potential argument may be that institutions engaged in similar underlying misconduct should receive a heightened sanction even when the offenses technically violate diverse laws.

Subsidiary Misconduct + Willful Blindness by Parent Company – In cases where the subsidiary, on its own, engaged in misconduct, there is a question about whether the parent company should be held liable. This is tricky, because the two entities may really function as independent entities, which might make it seem inappropriate to hold the parent responsible for the actions of the subsidiary. That said, there do seem to be cases where one can find improper conduct by a subsidiary plus what looks to be willful blindness on the part of the parent company. In this context, I am using the term willful blindness to mean a parent company that has strong indications/awareness of misconduct at the subsidiary, yet the parent company does nothing to attempt to stop or remedy the subsidiary’s misconduct. Wal-Mart’s handling of bribery by a subsidiary operating in Mexico provides a
good example of this, but I will have to see whether my research into banking institutions will provide similar examples.

I look forward to your comments and suggestions!

Sincerely,

Veronica Root