

# ENFORCED SELF-REGULATION: A NEW STRATEGY FOR CORPORATE CRIME CONTROL

John Braithwaite\*

The criminal justice system's failure to control corporations<sup>1</sup> has been well documented.<sup>2</sup> Piecemeal reforms or modest increases in enforcement budgets are unlikely to remedy this failure; indeed, under the easygoing regulatory approach of the Reagan Administration,<sup>3</sup> it could become worse. Consequently, scholars studying corporate crime should adopt the long view. Radical approaches are needed in the hope that some of them might blossom into control strategies more potent than our forlorn existing armory of weapons against corporate crime. Outstanding recent examples of such innovation have been Coffee's proposal for the equity fine<sup>4</sup> and Fisse's suggestion that community service orders could be used as a sanction against corporations.<sup>5</sup> It is unimportant that these proposals lack

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\* Research Criminologist, Australian Institute of Criminology. B.A. 1972, University of Queensland; Ph.D. 1977, University of Queensland. — Ed. I wish to thank Brent Fisse, Donna Randall, Ross Cranston, Gil Geis, and the Socio-Legal Group at Northwestern University for helpful comments.

1. Corporate crime is defined here as conduct of a corporation, or of individuals acting on behalf of a corporation, that is proscribed and punishable by law. Following Sutherland, *see* E. SUTHERLAND, *WHITE-COLLAR CRIME* (1949), I take the view that to exclude civil violations from a consideration of corporate crime is an arbitrary obfuscation because of the frequent provision in law for both civil and criminal prosecution of the same corporate conduct. In considerable measure, the power of corporations is manifested in the fact that their wrongs are so frequently punished only civilly. However, conduct subject only to damage awards without any additional punishment (*e.g.*, fines or punitive damages) is not within the definition of corporate crime adopted here.

2. *See, e.g.*, M. CLINARD & P. YEAGER, *CORPORATE CRIME* (1980); R. NADER, M. GREEN & J. SELIGMAN, *TAMING THE GIANT CORPORATION* (1976); J. REIMAN, *THE RICH GET RICHER AND THE POOR GET PRISON* (1979); Geis, *Upperworld Crime*, in *CURRENT PERSPECTIVES ON CRIMINAL BEHAVIOR* (A. Blumberg ed. 1974).

3. *See, e.g.*, Hudson, *SEC May Be Losing Its Former Toughness, Some Observers Think*, Wall St. J., Mar. 22, 1982, at 1, col. 6; Taylor, *Antitrust Enforcement Will Be More Selective, Two Big Cases Indicate*, Wall St. J., Jan. 11, 1982, at 1, col. 1.

4. Coffee, *"No Soul To Damn: No Body To Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 413-24 (1981) (hereinafter cited as Coffee, *Corporate Punishment*); Coffee, *Making the Punishment Fit the Corporation: The Problems of Finding an Optimal Corporation Criminal Sanction*, 1 N. ILL. U. L. REV. 3, 14-21 (1980). Under an "equity fine" approach the corporation would be forced to issue new equity securities to the value of the fine. For example, if a corporation had five million shares outstanding, a 10% equity fine would see 500,000 shares handed over to the state's crime victim compensation fund.

5. Fisse, *Community Service as a Sanction Against Corporations*, 1981 WIS. L. REV. 970.

fine tuning, or that their authors have not suggested a politically realistic strategy for their legislative adoption, for they have enlivened the intellectual landscape. Such ideas should not be prematurely discarded because of their deficiencies or impracticalities. The study of corporate crime needs a period when a thousand flowers are allowed to bloom if it is to break out of the straight-jacket of the failed strategies of the past. This Article advocates another "impractical" idea for corporate crime control — government enforced self-regulation of illegal corporate conduct.

Part I outlines the concept of enforced self-regulation, sketches its theoretical underpinnings, and illustrates its application in the context of corporate accounting standards. Part II argues the merits of enforced self-regulation. Part III dispels notions that the proposal is a radical departure from existing regulatory practice and points to areas in which necessary empirical research could be conducted by discussing incipient manifestations of partial enforced self-regulation models in the aviation, mining, and pharmaceutical industries. Part IV considers in some detail the weaknesses of the proposed model. The final Part considers the importance of determining an optimal mix of regulatory strategies; it concludes that enforced self-regulation could play an important role in such an optimal combination.<sup>6</sup>

## I. CONTROLLING CORPORATE CRIME THROUGH ENFORCED SELF-REGULATION

### A. *The Theory of Self-Regulation*

Self-regulation, whether or not fortified with the refinements proposed by this Article, is an attractive alternative to direct governmental regulation because the state simply cannot afford to do an adequate job on its own. Fiscal pressures invariably prevent governmental inspectors from regularly checking every workplace for occupational safety offenses, environmental quality lapses, crooked bookkeeping, or faulty product design.<sup>7</sup> The uniformly abysmal inspection programs in these areas and others can and should be im-

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6. During the past four years, I have been undertaking a rather large empirical research program on corporate crime and business regulation, partly alone and partly in collaboration with Professor Brent Fisse. Over 200 senior executives in fifty transnational companies, as well as many government officials, have been interviewed. Throughout this Article, points will be illustrated by reference to data gleaned from these interviews. Confidentiality was often promised in these discussions as a condition for obtaining more candid information. As a result, these sources will not be cited. Within the next year, two books providing more detail on much of the data will appear (J. BRAITHWAITE, *CORPORATE CRIME IN THE PHARMACEUTICAL INDUSTRY* (forthcoming); B. FISSE & J. BRAITHWAITE, *BUSINESS REGULATION THROUGH PUBLICITY* (tentative title) (forthcoming)).

7. See M. CLINARD & P. YEAGER, *supra* note 2, at 95-97.

proved, but they will never reach a satisfactory level.<sup>8</sup>

A program of self-regulation can dramatically expand coverage. Under the terms of Section 15A of the Securities Exchange Act of 1934,<sup>9</sup> for example, the National Association of Securities Dealers (NASD) inspects the offices, books, and records of its members for violations of SEC regulations. In 1968 forty-five percent of NASD members were inspected under this program.<sup>10</sup> In 1969, by way of contrast, SEC inspectors surveyed only five-and-a-half percent of the dealers who were not members of the NASD.<sup>11</sup>

Self-regulation can also achieve greater inspectorial depth. In the international pharmaceutical industry, for example, a number of the more reputable companies have corporate compliance groups, which send teams of scientists to audit subsidiaries' compliance with production quality codes. In one Australian subsidiary of an American firm that I visited, inspections by the headquarters compliance group were conducted twice yearly and were normally undertaken by three inspectors who spent over a week in the plant. The government health department inspection, on the other hand, consisted of an annual one-day visit by a single inspector. While employees had advance warning of the government inspection, the corporate compliance group arrived unannounced.

Corporate inspectors also tend, at least in the pharmaceutical industry, to be better trained than their government counterparts.<sup>12</sup> Corporate inspectors' specialized knowledge of their employer's product lines also make them more effective probers than government inspectors, who are forced to be generalists. Their greater technical capacity to spot problems is enhanced by a greater social capacity to do so. Corporate compliance personnel are more likely than government inspectors to know where "the bodies were buried," and to be able to detect cover-ups. One American pharmaceutical executive explained in part why this is so:

Our instructions to officers when dealing with FDA inspectors is to only answer the questions asked, not to provide any extra information, not to volunteer anything, and not to answer any questions outside

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8. Clinard and Yeager note that even if regulatory agency enforcement budgets were doubled, "they would probably still be grossly inefficient to meet inspection and prosecution needs." *Id.* at 97.

9. 15 U.S.C. § 78-3 (1976).

10. Katz, *Industry Self-Regulation: A Viable Alternative to Government Regulation*, in *PROTECTING CONSUMER INTERESTS* 161, 167 (R. Katz ed. 1976).

11. SECURITIES AND EXCHANGE COMMISSION, 35TH ANNUAL REPORT 87-88 (1969).

12. Many internal inspectors, for example, have Ph.Ds. See J. BRAITHWAITE, *supra* note 6 (forthcoming).

your area of competence. On the other hand we [the corporate compliance staff] can ask anyone anything and expect an answer. They are told that we are part of the same family, and, unlike the government, we are working for the same final objectives.<sup>13</sup>

The power of corporate inspectors to trap suspected wrongdoers is often greater than that possessed by government investigators. One quality assurance manager told me of an instance where this power was used. His assay staff was routinely obtaining test results showing the product to be at full strength. When they found a result of eighty percent strength, the manager suspected, the laboratory staff would assume that the assay was erroneous, simply mark the strength at 100%, and not recalculate the test. The manager's solution was to periodically "spike" the samples with understrength product to see whether his staff would pick out the defects. If not, they could be dismissed or sanctioned in some other way. Government inspectors do not have the legal authority to enter a plant and entrap employees with a spiked production run.<sup>14</sup>

We have seen that corporations may be more capable than the government of regulating their business activities. But if they are more capable, they are not necessarily more willing to regulate effectively. This is the fundamental weakness of voluntary self-regulation. A voluntary program will stop many violations that cost the company money and others that are cost-neutral; it will even halt some violations that benefit the company financially in the short-term, for the sake of the long-term benefit of fostering employee commitment to compliance.<sup>15</sup> Recommendations that involve consequences beyond the cost-neutral or short term, however, commonly will be ignored.

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13. Perhaps this statement exaggerates the good will between company employees and internal compliance inspectors. I asked the production manager of the Guatemalan subsidiary of another company: "Do you think of the internal quality auditors from headquarters a part of the same team as you?" His answer probably grasped the reality: "I think of them as a pain in the ass."

14. Another example of the greater effectiveness of internal inspectors concerns a medical director who suspected that one of his scientists was "graphiting" safety testing data. His hunch was that the scientist, whose job was to run 100 trials on a drug, instead ran 10 and fabricated the other 90 so they would be consistent with the first 10. The medical director possessed investigative abilities that would have been practically impossible for a governmental investigator. He could verify the number of animals taken from the animal store, the amount of drug substance that had been used, the number of samples that had been tested, as well as other facts. His familiarity with the laboratory made this easy. As an insider, he could probe quietly without raising the kind of alarm that might lead the criminal to pour an appropriate amount of drug substance down the sink.

15. One pharmaceutical quality control director showed me that his firm had failed a batch of drugs for being slightly overstrength, even though the FDA would have been unlikely to detect the variation. The director said that the batch was sacrificed to stress to employees the importance of unswerving adherence to specifications.

*Enforced* self-regulation, on the other hand, can ensure that internal compliance groups will not be lightly overruled. Under the model proposed by this Article, a compliance director would be *required* to report to the relevant regulatory agency any management overruling of compliance group directives. A director who neglected this duty would be criminally liable. Such a provision would be the strongest method<sup>16</sup> of ensuring that compliance unit recommendations would be followed by management. Companies that regularly ignored such directives would fall under the regulatory agency's special scrutiny. The agency could concentrate its limited prosecutorial resources on companies that continually and irresponsibly disregarded compliance group recommendations. Enforced self-regulation thus combines the versatility and flexibility of voluntary self-regulation, but avoids many of the inherent weaknesses of voluntarism.

### B. *The Model*

The concept of enforced self-regulation is a response both to the delay,<sup>17</sup> red tape,<sup>18</sup> costs,<sup>19</sup> and stultification of innovation<sup>20</sup> that can result from imposing detailed government regulations on business, and to the naiveté of trusting companies to regulate themselves.<sup>21</sup> Under enforced self-regulation, the government would compel each company to write a set of rules tailored to the unique set of contingencies facing that firm. A regulatory agency would either approve these rules or send them back for revision if they were insufficiently stringent. At this stage in the process, citizens' groups and other interested parties would be encouraged to comment on the proposed

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16. Other, weaker, reporting options exist. The compliance group could be statutorily mandated to report instances of management overruling to the board of directors or to an audit committee of outside directors.

17. See, e.g., M. WEIDENBAUM, *THE FUTURE OF BUSINESS REGULATION* (1979); Alexander, *It's Roundup Time for the Runaway Regulators*, *FORTUNE*, Dec. 3, 1979, at 12(b).

18. One author, after pointing out that 786 million hours a year are spent in filling out forms to meet U.S. government reporting requirements, suggested that regulatory agencies have a "paperwork budget," whereby they submit each year an estimate of the person-hours of reporting they will impose on the private sector. Neustadt, *The Administration's Regulatory Reform Program: An Overview*, 32 *ADMIN. L. REV.* 157 (1980).

19. One estimate placed the costs of regulating American business in 1979 at \$4.8 billion. The costs to industry for complying with regulations was estimated to be nearly \$100 billion. M. WEIDENBAUM, *supra* note 17, at 22-23.

20. See generally D. SCHWARTZMAN, *INNOVATION IN THE PHARMACEUTICAL INDUSTRY* (1976); Wardell, *The Impact of Regulation on New Drug Development*, in *ISSUES IN PHARMACEUTICAL ECONOMICS* 145 (R. Chien ed. 1979); Stewart, *Regulation, Innovation, and Administrative Law: A Conceptual Framework*, 69 *CALIF. L. REV.* 1256 (1981).

21. See R. CRANSTON, *CONSUMERS AND THE LAW* 61-64 (1979).

rules.<sup>22</sup> Rather than having governmental inspectors enforce the rules, most enforcement duties and costs would be internalized by the company, which would be required to establish its own independent inspectorial group. The primary function of governmental inspectors would be to ensure the independence of this internal compliance group and to audit its efficiency and toughness. Such audits would pay particular attention to the number of violators who had been disciplined by each company.<sup>23</sup> Naturally, old-style direct government monitoring would still be necessary for firms too small to afford their own compliance group.

Governmental involvement would not stop at monitoring. Violations of the privately written and publicly ratified rules would be punishable by law. This aspect of the enforced self-regulation model, while perhaps sounding radical, is actually not as extreme as it first might seem. Regulatory agencies would not ratify private rules unless the regulations were consonant with legislatively enacted minimum standards.<sup>24</sup>

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22. Citizen participation in the rulemaking process, under the aegis of the Administrative Procedures Act, is a current feature of the direct governmental regulation process. See 5 U.S.C. §§ 553-557 (1976). Public input can be either in the form of comments submitted to an agency or hearing testimony. This Article advocates retention of such a feature in a system of enforced self-regulation. There are, however, costs involved, especially in the delays that can be expected in receiving and assessing public input. Cf. Noll, *Breaking Out of the Regulatory Dilemma: Alternatives to the Sterile Choice*, 51 IND. L.J. 686, 687 (1976) (noting that in 1973, the Atomic Energy Commission took an average six months to approve nuclear power plant construction permits when no one but the applicant participated in the process; the average delay was 29 months when an intervenor was granted full standing).

23. This would include a statistical monitoring of the relative frequency with which sanctions of different severity (dismissal, demotion, fine, suspension of bonus, referral for criminal prosecution) were imposed by each company.

24. To say that rules would be rejected if they failed to meet a minimum standard is not to say that the goal of the approval process ought to be standards as uniform as possible.

It can be argued that striving for uniformity of standards under enforced self-regulation would not be desirable. Viscusi and Zeckhauser, in *Optimal Standards with Incomplete Enforcement*, 27 PUB. POLY. 437 (1979), have developed the following persuasive rationale for nonuniformity. People normally assume that the higher the standards set by government for pollution, safety, and the like, the better will be industry's performance in meeting these criteria. Viscusi and Zeckhauser show formally that this is not the case. It is not so because whenever a standard is set, some firms will decide that the costs of compliance with it are greater than the costs of noncompliance (the probability of detection multiplied by the costs if detected). As standards are made more stringent, the costs of compliance increase steeply while the costs of noncompliance remain more or less constant. Hence, as standards become more stringent, the performance of firms that comply improves, but additional firms choose to risk penalties for noncompliance. Viscusi and Zeckhauser thus demonstrate that at some point, further tightening of a standard may lower overall performance. But this point will be different for different types of firms. For firms with enormous sunk costs in old plants, the costs of compliance will be greater than for firms about to construct their factories.

Because of economies of scale in pollution control, the point at which further tightening of standards will increase the output of pollution may be higher for large firms than for small ones. In other words, the environment and the public may be better protected by nonuniform standards. Hence, nonuniformity under enforced self-regulation could be an advantage. More stringent rules could be demanded of firms with lower compliance costs. In some ways, EPA

There are a number of ways that a legislature could frame broad statements that were not at the same time platitudinous. Consider, for example, an act to set guidelines for the Federal Mine Safety and Health Administration to follow in approving rules written by coal companies. The Act might recognize in its preamble that the minimum level of safety guaranteed by the Federal Coal Mine Safety and Health Act of 1977 was unsatisfactorily low and instruct the Administration not to approve any corporate safety rules that do not guarantee better safety performance than that ensured by the 1977 Act. Recognizing that American coal miners are three times more likely than British miners to be killed at work,<sup>25</sup> the Act might further instruct the Administration not to accept the existing "state of the art" in safety standards. As a third option,<sup>26</sup> the Administration could be directed to structure its approval process so as to halve coal mine fatality and injury rates by a certain year.

The government need not, moreover, adopt this performance target approach to setting overarching standards. In empowering the Securities and Exchange Commission to ratify accounting rules for individual companies, for example, Congress might list a number of criteria that all sets of accounting rules must satisfy. For environmental rulemaking, the legislature might define a level of ecological threat that is intolerable under all circumstances. The standards could even specify a range of cost-benefit or cost-effectiveness ratios for proposed rules. These examples are not presented to evaluate the many ways in which the ultimate authority of the legislature might limit private rulemaking; they are presented only to show that such

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already accepts this principle by requiring more stringent emission controls on new automobiles than on those already on the road, and by requiring pollution control technology to be installed in new plants, controls not demanded of old ones. Theoretically, enforced self-regulation makes possible nonuniform optimal standards which would give greater protection than any (stricter or more lenient) uniform standard.

25. The most recent comparable statistics are for "fatalities per thousand employed" in underground mining in 1974. The British fatality rate was 0.19 compared with 0.75 for the United States. Lewis-Beck & Alford, *Can Government Regulate Safety? The Coal Mine Example*, 74 AM. POL. SCI. REV. 745, 755 n.7 (1980).

26. Other possible approaches exist. For example, the preamble to the standards might draw attention to the variable performance of different companies to give broad guidance. Westmoreland Coal was found by the President's Commission on Coal to have an injury rate of 21 lost workday cases per 200,000 hours in its 29 underground mines. In contrast, United States Steel maintained an injury rate of 3 in its 28 underground mines. Five of the largest 20 coal producers maintained rates lower than 6 lost workday injuries per 200,000 work hours. THE PRESIDENT'S COMMISSION ON COAL, STAFF REPORT: THE ACCEPTABLE REPLACEMENT OF IMPORTED OIL WITH COAL 42 (1980). Hence, the legislation could point to the safety performance of these five companies as a more appropriate yardstick: The regulatory agency would be instructed to satisfy itself that company rules, and the enforcement of them, were sufficiently stringent to cause it to expect an average attainment of fewer than 6 lost workday injuries per 200,000 work hours.

authority can be exercised in a variety of ways, depending on the circumstances of the regulated industry.

C. *An Illustration: Regulating Corporate Accounting Standards*

To illustrate the advantages of enforced self-regulation, let us examine the problems inherent in regulating one important aspect of business practice — corporate accounting. Recognizing that companies can use misleading accounting practices and conceal their assets to evade taxes, most nations provide for the prosecution of firms that fail to report “true and fair” accounts or to use “accepted accounting standards.”<sup>27</sup> To call such bland admonishments “standards” is to stretch meaning. Their very amorphousness hinders prosecution. Defendant corporations have little difficulty in finding eminent accounting experts to pronounce their practices professionally acceptable because every accountant has a different conception of what is “true and fair” or what constitutes an “accepted accounting standard.”<sup>28</sup>

Unhappy prosecutors can appeal to the legislature for more tightly defined standards, but this may lead to overspecification. No single set of detailed government-imposed standards will satisfy the efficiency requirements of backyard businesses and transnational corporations, banks and manufacturers, or holding companies and operating concerns. A company's accounts are a vital tool in evaluating investments and in making other management decisions. Accounts made too subservient to public purposes will be less efficient for private purposes. When required to develop standards to govern accounts, therefore, legislatures around the world have generally opted for the unenforceability of blandness rather than for the inefficiency of overspecification.<sup>29</sup>

How can enforced self-regulation resolve this dilemma? Each company would be required to write its own accounting rules. These rules should enable the company to meet its operational requirements while ensuring public accountability and acceptable comparability with the accounts of other companies. Once these rules had been ratified by the appropriate agency and made available to investors, any violation of them would, by definition, constitute an unacceptable accounting practice and be punishable by law. By tying the specificity of the rules to the unique circumstances of the company

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27. See International Standards of Accounting and Reporting, 4 U.N. Commission on Transnational Corporations (Agenda Item 9(b)), U.N. Doc. E/C.10/33 (1977).

28. See A. BRILOFF, UNACCOUNTABLE ACCOUNTING 6 (1972).

29. See International Standards, *supra* note 27.



for which they were written, fairness in accounts would be rendered enforceable. Specificity can replace blandness without the over-specification inherent in universalistic standards. In addition to the familiar practice of holding outside audits, internal audit groups would be mandated. Enforced self-regulation might therefore produce simple specific rules which would make possible both more efficient, comparable accounting and easier conviction of violators.

## II. STRENGTHS OF THE ENFORCED SELF-REGULATION MODEL

### A. *Rules Would Be Tailored To Match the Company*

An efficient system of corporate regulation would acknowledge the social risks and social benefits associated with the activities of each regulated company and provide rules appropriate to those characteristics. Under direct governmental regulation, such adaptability over the wide spectrum of business types and sizes is impossible. Government has responded to this problem in two radically different ways: It has either tried to obtain specificity by generating rules that are gargantuan in length and complexity, or written rules for the lowest common denominator of proscribed behavior, as exemplified by the bland platitudes of corporate accounting standards.<sup>30</sup> The resulting universalistic rules often impose unnecessary strictures on some companies and overly lax restrictions on others. Regulations mandating a certain hazard-reducing technology, while forcing less responsible companies to upgrade to this standard, can also cause industry leaders to adopt this fix when, left to their own devices, they would have installed a technology superior in both hazard reduction and economy of scale.<sup>31</sup> Rules that strive for universal applicability cannot avoid some particularistic irrationality.<sup>32</sup>

Legal institutions are designed to be stable and predictable, while economic entities ideally are rapidly adaptable to changing economic and technological trends. Universalistic laws cannot be quickly altered to reflect changing events lest some critical circumstance be ignored among the infinite array of possible conditions to which the rules might be applied. But enforced self-regulation is by

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30. See text at notes 27-28 *supra*.

31. Executives of the companies that are leaders in quality control and toxicological methodology in the pharmaceutical industry have complained to me that the FDA's Good Manufacturing Practices and Good Laboratory Practices regulations at times forced them to adopt what they considered second-best control techniques.

32. For an account of how the national imposition of a particular pollution abatement technology resulted in some companies' switching to high sulfur coal, so that their aggregate output of pollution actually increased, see Ackerman & Hassler, *Beyond the New Deal: Coal and the Clean Air Act*, 89 YALE L.J. 1466 (1980).

definition tailored to the particular needs and functions of each corporation.<sup>33</sup> The rules written need relate only to a limited set of economic and structural circumstances rather than to a vast, incoherent range of business activities. The environmental protection regulations to be followed by a self-employed chemicals wholesaler, for example, need not be as complex as those governing a Dow or a duPont. Because rules under a system of enforced self-regulation are particularistic, an agency charged with approving those rules need not account for all of the loophole-opening strategies used by different companies to duck their regulatory responsibilities.<sup>34</sup>

In short, under enforced self-regulation, rules could be both simpler and have greater specificity of meaning. The dangers of complexity and blandness are easily avoided when rules relate to a finite and known set of circumstances rather than to an infinite and unknowable range of business activities.

### B. *Rules Would Adjust More Quickly to Changing Business Environments*

A primary reason for the failure of law to control corporate crime is that legal institutions are made to last, while economic institutions are designed for rapid adaptation to changing economic and technological realities. Universalistic laws cannot, or at least should not, be rushed through lest they are later found to create more problems than they solve through having failed to consider some critical circumstance among the infinite array of possible conditions to which they might be applied.

Because particularistic rules have less profound ramifications than universalistic rules, they can be tinkered with more frequently. When a new threat is perceived to the public interest (*e.g.*, research discovers a new industrial carcinogen), years of delay can be expected as universalistic rules are drafted and redrafted to meet objections from the disparate types of industries which would be differentially affected by the proposed rule.<sup>35</sup> Lengthy consideration

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33. See Fisse, *The Social Policy of Corporate Criminal Responsibility*, 6 ADEL. L. REV. 382-85 (1978), for a discussion of various reasons why internal rulemaking presents advantages in simplicity and enforceability over external rulemaking. See also Amsterdam, *Perspectives on the Fourth Amendment*, 58 MINN. L. REV. 349, 417-39 (1974), in which Prof. Amsterdam argues that rules of conduct written by police departments themselves are likely to be more refined than rules conferred externally because they are drawn up and modified by people in touch with the day-to-day realities of implementation.

34. For example, legislation rushed through to close one loophole might be used by sharp corporate attorneys to justify a principle which enables them to open a new loophole elsewhere.

35. The classic illustration of such regulatory paralysis is the National Highway Traffic

must be given to the now almost inevitable pleas by some firms that they would be forced out of business by the new rules. In contrast, under enforced self-regulation, as immediately as the threat was perceived, all companies would be required to write new, more stringent rules to meet the threat. Of course, companies which feared the financial repercussions of the new controls could be expected to write rules insufficiently stringent to satisfy government requirements. A lengthy process of redrafting and negotiation would commence with those firms. But while this was going on, the majority of firms which were willing and able to introduce satisfactory protections would be following their new rules. Under traditional regulation, these firms would be waiting until the final form of the regulations was decided before investing in new controls. Even those firms which chose to write rules insufficiently stringent might be giving improved protection during the negotiating period if they were following their improved, but still inadequate, standards.

Probably the most important factor enabling particularistic rules to be adjusted more rapidly is that precedent would not be as important as it is under universalism. A pharmaceutical company which abandoned a quality control test in favor of a completely new, more effective, in-process approach to building in quality could be permitted to immediately change its rules to accommodate this innovation under enforced self-regulation. Under traditional regulation, in contrast, the regulatory agency would be slow in deliberating whether allowing this company to abandon the old test would lead to a flood of demands from other concerns that they too be allowed to do away with it (even though they had not introduced any alternative controls). The regulatory agency would have to consider whether any pending court cases turning on the validity of the old rule might be lost if the defendants could show that the agency had selectively waived the rule. Under enforced self-regulation, where companies are prosecuted only for violations of their own rules, this kind of precedent would not be an issue.

### C. *Regulatory Innovation Would Be Fostered*

It has already been implied that governments freed of anxiety over allowing dangerous precedents would be more permissive of radical new approaches to the control of harmful practices or

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Safety Administration, established in 1966 to set standards. By 1981, only two had been established: one in 1972 on side impacts, and another in 1977 on gasoline tank safety. See DeGeorge, *Ethical Responsibilities of Engineers in Large Organizations: The Pinto Case*, 1 BUS. & PROF. ETHICS 9 (1981).

processes. Regulations written in 1982 will tend to ossify control techniques, be they environmental or financial, at the state of the art as of 1982. Enforced self-regulation, in comparison, would tap the managerial genius within top corporations to design custom-made regulatory systems. At all times it would be possible for cheaper and more effective modes of control to emerge. Ultimately, more effective approaches to such problems as reducing pollution and assuring product and workplace safety will result from depending on the creative expertise of the private sector, rather than on the more limited reservoir of talent in the bureaucracy. If innovation is encouraged, however, there is also a price to be paid; some technological and managerial "improvements" will prove less effective than existing techniques. A combination of regulatory vigilance and civil liability for damages to victims would have to be counted on to control the excesses of experimentation.

#### D. *Rules Would Be More Comprehensive in Their Coverage*

Three empirical studies<sup>36</sup> of internal rulemaking and enforcement in fifty large companies have convinced me that internal corporate rules invariably cover a much wider range of industrial hazards and corporate abuses than do governmental regulations. While large companies manage to write rules regulating a substantial proportion of the most serious harms or wrongs that could occur in their business, governments simply do not. They fail because they lack the time, research resources, and political will necessary to build consensus around a comprehensive set of rules. Instead of dealing forthrightly with their failure to achieve broad regulatory coverage, governments trust firms to regulate themselves voluntarily under the tens of thousands of nongovernmental standards written by trade associations, professional and technical societies, and similar bodies.<sup>37</sup> By giving public recognition to private corporate rules, enforced self-regulation could extend the law to cover a wider range of highly dangerous practices.

The failure of government consensus-building to reconcile conflicts over rules can also subject companies to the demands of two agencies with conflicting goals. This can be demonstrated by the di-

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36. The studies will be published as J. BRAITHWAITE, *supra* note 6 (forthcoming); J. BRAITHWAITE, *COST-EFFECTIVE BUSINESS REGULATION* (1981); B. FISSE & J. BRAITHWAITE, *supra* note 6 (forthcoming).

37. See Hamilton, *The Role of Nongovernmental Standards in the Development of Mandatory Federal Standards Affecting Safety or Health*, 56 TEXAS L. REV. 1329 (1978); Page, *Self Regulation and Codes of Practice*, J. BUS. L., Jan. 1980, at 24.

lemma faced by some Australian meat packing houses. The companies are trapped in a dispute over how often floors should be washed. Health authorities, concerned only with the cleanliness of the food being processed, require regular wash-downs. Occupational safety officials, worried about the safety of workers carrying sharp instruments on wet floors, want the surfaces kept dry. While the agencies bicker over their regulatory authority, the resulting stalemate benefits neither the consuming public nor workers. Under enforced self-regulation, each slaughterhouse could be given wide discretion to write (in consultation with employee representatives) its own floor-washing rules. Though the respective agencies could still disagree on the relative importance of dry floors versus clean floors, less political will would be required to grant the company discretion to suggest their own way out of the stalemate than would be needed to force consensus between the agencies. As mentioned above, regulatory agencies at present have no choice but to vigilantly guard against compromises which set dangerous precedents; under enforced self-regulation they can be more flexible because precedents will not come back to haunt them. In too many areas, necessary regulations gather dust in the "too-hard" basket because of the consensus-building demands of the direct regulation model.

E. *Companies Would Be More Committed  
to Rules They Wrote*

As John Kenneth Galbraith has noted, "[n]othing in American business attitudes is so iniquitous as government interference in the *internal* affairs of the corporation."<sup>38</sup> If business is responsible for writing and enforcing its own code of conduct, the notion of regulation may become more palatable.

Many corporations are currently alienated from a sense of social responsibility. In highly regulated industries, there can be an attitude of unconcern about corporate abuses that government inspectors do not discover. A senior Australian executive of an international drug company, for example, claimed that "it is the responsibility of the Health Department to work out whether research results have been cheated on. Maybe if we do fudge some result, it's the job of the Health Department to find that out. It's not our responsibility. That's their job." Or, to quote an American counterpart:

Often our people use the FDA to get out of making a decision them-

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38. J.K. GALBRAITH, *THE NEW INDUSTRIAL STATE* 77 (1967) (emphasis in original).

selves on a drug. We find it very hard to reach consensus among ourselves on the safety of a product and often there are strong disagreements among us. So sometimes we get out of making our own decision by putting it to the FDA and letting them decide for us.<sup>39</sup>

Irresponsible companies are frequently pleased to hand over incomplete facts to facilitate the government's regulatory decision; if the agency gives them a green light, they delightedly claim, "It's within the rules, so let's go ahead."

Such abdication of responsibility could be minimized by the joint participation of company and government in a rulemaking program. When the company writes the laws it is more difficult for it to rationalize illegality by reference to the law's being an ass. Considerable evidence indicates, moreover, that participation in a decision-making process increases the acceptance and improves the execution of the decisions reached.<sup>40</sup> As company and government work together to design workable rules, mutual suspicions may diminish. Of course, commitment to self-generated rules will be less pronounced when an agency vetoes the initial rules proposed by a company and ultimately approves regulations that the company views as less than optimal.

*F. The Confusion and Costs That Flow from Having Two Rulebooks (the Government's and the Company's) Would Be Reduced*

Under enforced self-regulation, it would be no longer necessary for a company to undergo the costs and confusion of having to follow two rulebooks — the government's and its own. This problem is particularly acute in transnational subsidiaries, where the host government's rules may be framed in fundamentally different terms from the rules imposed by corporate headquarters. Obviously the fusing of corporate and host government rules would rarely be painless; in many situations governments would insist that corporate regulations be modified to conform to local requirements. But governments should concede the validity of totally different approaches to control developed in other countries. Japanese pharmaceutical companies, for example, have adopted an approach to toxicology testing for dangerous side-effects of drugs that differs rad-

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39. Statements made during interviews with the author.

40. Professor Vroom has reviewed the empirical evidence from organizational research showing that, other things being equal, "the participation of individuals or of groups in decisions which affect them appears to be positively related to their acceptance of decisions and to the efficiency with which decisions are executed." Vroom, *Industrial Social Psychology*, in 5 HANDBOOK OF SOCIAL PSYCHOLOGY 196, 237 (G. Lindzey & E. Aronson 2d ed. 1969).

ically from the Western toxicology tradition. Enforced self-regulation might permit a Japanese company operating in the United States to follow its worldwide drug safety standards instead of Western requirements that are thoroughly incompatible with its corporate rules. By allowing the company to preserve the integrity of its total quality assurance and safety testing package, enforced self-regulation might better protect the public.

G. *Business Would Bear More of the Costs of Its Own Regulation*

Enforced self-regulation, by placing the principal inspectorial burden on internal-compliance groups, also allocates most of the costs for such regulation to private industry. This is only equitable. If industry profits from its misdeeds, why should it not bear the costs of controlling them? Economic efficiency is also furthered by forcing companies to internalize regulatory costs. If such costs are not included in the price of its products, the price will not fully reflect the social cost of producing it, and the demand for the product will exceed that which would optimize social utility.<sup>41</sup>

H. *More Offenders Would Be Caught More Often*

In the above section on "The Theory of Self-Regulation," a variety of reasons were advanced to explain why self-regulation results in broader inspectorial coverage by inspectors with a greater capability for discovering violations.<sup>42</sup> Though internal compliance groups can be expected to catch more offenders than government inspectors, they cannot be counted upon to send the offenders to courts of law for prosecution with the frequency which we expect of government inspectors. Reasons exist, however, to believe that internal discipline would not be less effective.

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41. Professor Mishan has explained the economic rationale for making firms assume the burden of externalities:

The operations of firms, or the doings of ordinary people, frequently have significant effects on others of which no account need be taken by the firms, or the individuals, responsible for them. Moreover, inasmuch as the benefits conferred and the damages inflicted - or 'external economies' and 'external diseconomies' respectively - on other members of society in the process of producing, or using, certain goods do not enter the calculation of the market price, one can no longer take it for granted that the market price of a good is an index of its marginal value to society.

... It follows that an apparently efficiently working competitive economy, one in which outputs are quickly adjusted so that prices everywhere tend to equal *private* marginal cost, may lead the economy very far indeed from an optimal position as defined. Such an optimal position in fact requires that in all sectors production be such that prices are equal to social marginal cost.

E. MISHAN, *THE COSTS OF ECONOMIC GROWTH* 82-83 (1969).

42. See notes 7-16 *supra* and accompanying text.

I. *Offenders Who Were Caught Would Be Subjected To Internal Discipline In a Larger Proportion of Cases Than Under Traditional Government Regulation*

Under enforced self-regulation, companies with strong records of disciplining their employees would be rewarded as showing up well in government audits of the toughness of internal compliance systems; existing public enforcement, in contrast, gives companies incentives to cover up and protect their guilty employees. Internal discipline is in many ways more potent than government prosecution because internal enforcers do not have to surmount the hurdle of proof beyond reasonable doubt, and do not have to cut through a conspiracy of diffused accountability within the organization.<sup>43</sup> Corporations in the past have protected their individual members from prosecution by presenting a confused picture of the allocation of responsibility to the outside world. My research on the pharmaceutical industry concluded, however, that companies have two kinds of records: those designed to allocate guilt (for internal purposes), and those for obscuring guilt (for presentation to the outside world). When companies want clearly defined accountability they can generally get it. Enforced self-regulation would compel companies to use this capability in the public interest. Direct government regulation provides *disincentives* for nominated accountability, because nominated accountability puts heads on the prosecutor's chopping block; enforced self-regulation provides *incentives* for nominated accountability because corporations which cannot demonstrate that they are conducting their own executions would be singled out for inquisition.

J. *It Would Be Easier For Government Prosecutors To Obtain Corporate Crime Convictions*

It has been concluded under sections II-H and II-I that the greatly increased number of discovered violations under enforced self-regulation would be regularly the subject of internal disciplinary action but rarely of public prosecution. Even though internal compliance groups would not "call the cops" in normal circumstances, there are other features of the enforced self-regulation approach which would make it reasonable to expect more potent public as well as private enforcement. Essentially, there are three reasons for predicting that more suspects would be convicted under enforced self-regulation than under direct regulation.

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43. See, e.g., note 14 *supra*.



- (i) Because bland and meaningless rules (e.g. that accounts be 'true and fair') would be replaced by precise and particularistic rules,<sup>44</sup> acquittals would be more difficult to secure by appeal to the vagaries of the wording.
- (ii) Universalistic rulemaking tends to complexity because the rules must evolve to deal with the infinity of circumstances encountered throughout the entire economy. The more complex the law becomes, the more will powerful organizations exploit that complexity by finding loopholes, protracting proceedings and otherwise evading the spirit of the law.<sup>45</sup> Under simple particularistic rules, this capacity of company lawyers to exploit complexity would be diminished.
- (iii) In cases where the recommendations of the internal compliance group were defied this fact would be communicated to the regulatory agency. Their reports would then be powerful ammunition for the prosecutor to put before the court. The contents of the compliance group report would also direct the prosecutor to the most valuable insiders to subpoena.

#### K. *Compliance Would Become the Path of Least Corporate Resistance*

Requiring compliance directors to report management refusals to heed their recommendations would pressure executives to comply with those recommendations. For most offenses, the cost of yielding to the compliance director would be less than the costs of fighting the investigation, prosecution, and adverse publicity that would almost certainly follow rejection of the compliance group's recommendations.<sup>46</sup> And if the agency succeeded in its action, the courts would

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44. See notes 33 & 34 *supra* and accompanying text.

45. The more complex the web of law becomes, the more possible it is for company lawyers to use the doctrines implicit in one part of the law as a justification for actions that evade other parts of the same body of law. For a general discussion of rule complexity and its exploitation, see Sutton & Wild, *Corporate Crime and Social Structure*, in *TWO FACES OF DEVIANCE* 177 (P. Wilson & J. Braithwaite eds. 1978); Braithwaite, *Inegalitarian Consequences of Egalitarian Reforms to Control Corporate Crime*, 53 *TEMP. L.Q.* 1127, 1136-40 (1980).

46. Consider, for example, one of the most significant environmental prosecutions in the United States — the Kepone water pollution case against Allied Chemical. If an internal compliance group had been in place, had told top management about the violations, and had threatened to report them to the EPA, there can be little doubt that remedial action would have been taken. Kepone earned its maker only \$600,000 in profits a year; its unlawful dispersal into the James River ultimately cost Allied almost \$30 million in fines, legal fees, settlements, and voluntary restitutive efforts. See B. FISSE & J. BRAITHWAITE, *supra* note 6.

The other reason that an enforced self-regulation scheme would have resulted in immedi-

compel the company to comply with the recommendations originally suggested by the compliance unit. Large corporations have an almost obsessive desire to prevent their dirty linen from being washed in public.<sup>47</sup> Even when top management believes that it could prevail in court, it might still yield to the compliance group rather than display a rift between the two sections of the company in full view of shareholders, financial institutions, and other key reference groups. On the debit side, then, the compliance directors' statutory obligation to report a failure to rectify could conceivably give them so much clout as to lead to an "over-compliance" whereby management allowed itself to be pushed further than the rules ever intended.

### III. INCIPIENT MANIFESTATIONS OF THE ENFORCED SELF-REGULATION MODEL

Two key elements underlie the enforced self-regulation concept: (a) public enforcement of privately written rules; and (b) publicly mandated and publicly monitored private enforcement of those rules. Each element already exists in a variety of regulatory areas, but there is no manifestation of both in a comprehensive enforced self-regulation scheme.

Every country in the world publicly enforces private rules in its regulation of civil aviation safety.<sup>48</sup> Before an airline flies a new route, the altitude of its approaches, the flight path, survival equipment to be carried on board, and other operating procedures must be approved by the national civil aviation authority concerned. The rules are not universal but are tailor-made for the particular flight; the company writes them, and the government ratifies them and

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ate rectification is that top management only became aware of the violations late in the game. Allied's chief executive officer, for example, did not know so much as what Kepone was until the scandal broke. (Information based on private interview data). This points up an additional reason why middle managers would submit to the compliance director: Once a regulatory agency had commenced a prosecution, with its attendant public disclosure, the attention of top management would be drawn to those middle-level executives. Their jobs would not long be secure. For a discussion of the greater costs involved in publicly fighting cases rather than quietly settling (even when the corporation is innocent), see Coffee, *Corporate Punishment*, *supra* note 4, at 402-03.

47. See generally B. FISSE & J. BRAITHWAITE, *supra* note 6; Fisse, *The Use of Publicity as a Criminal Sanction Against Business Corporations*, 8 MELB. U. L. REV. 107 (1971).

48. On the regulation of civil aviation, see, e.g., AVIATION STATISTICS CENTRE, TRANSP. & PUB. UTIL. DIV., STATISTICS CANADA, AVIATION IN CANADA 1971, at 34-37 (1972); BUSINESS AND DEFENSE SERVICES ADMINISTRATION, U.S. DEPT. OF COMMERCE, WORLD SURVEY OF CIVIL AVIATION: CONTINENTAL EUROPE AND IRELAND (1965); D. HOCKING & C. HADDON-CAVE, AIR TRANSPORT IN AUSTRALIA 75 (1951). The violation of such privately written and publicly ratified rules concerning minimum safe altitudes was a major issue in the inquiry into the crash of an Air New Zealand plane with 257 people aboard in Antarctica. See *Incompetent Administrative Procedures Cited in Crash Report*, AVIATION WEEK & SPACE TECH., July 6, 1981, at 34.

punishes deviation from their strictures. Violations of such rules in Australia, for example, are punishable by imprisonment as well as by fines or license revocation.<sup>49</sup>

Perhaps the most highly developed version of this aspect of enforced self-regulation can be found in the Federal Mine Safety and Health Act of 1977.<sup>50</sup> Section 101(c) of the Act provides:

Upon petition by the operator or the representative of miners, the Secretary may modify the application of any mandatory safety standard to a coal or other mine if the Secretary determines that an alternative method of achieving the result of such standard exists which will at all times guarantee no less than the same measure of protection afforded the miners of such mine by such standard, or that the application of such standard to such mine will result in a diminution of safety to the miners in such mine.<sup>51</sup>

Since 1977, about 600 petitions for modification (some of them involving packages of standards) have been granted by the Mine Safety and Health Administration. In a few instances, civil fines have been assessed against companies that violated the particularistic standards approved under a petition for modification. However, officials believe that citations for such violations are rare because of the companies' commitment to rules that they have sought themselves. The program is not without regulatory cost; each petition consumes roughly three-person days for investigation and approval.<sup>52</sup>

The Mine Safety and Health Administration regulations<sup>53</sup> also permit mine operators to submit their own plans for ventilation<sup>54</sup> and dust control,<sup>55</sup> and roof support<sup>56</sup> for the agency's approval. The latter is particularly significant since roof falls are the leading cause of fatal accidents in mines.<sup>57</sup> In setting down the criteria to be followed in approving roof control plans, the regulations separately de-

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49. See 1981 Austl. Stat. R., §§ 212-14, 312 (as amended Sept. 4, 1981) (regulations under the Air Navigation Act, 1920-74) 1 ACTS. AUSTL. P. 143.

50. 30 U.S.C. §§ 801-23, 824-902, 921-924, 925-34, 936-60 (Supp. I 1977, Supp. II 1978 & Supp. III 1979) (as amended).

51. Federal Mine Safety and Health Act of 1977, Pub. L. No. 95-164, § 101(c), 91 Stat. 1294 (codified at 30 U.S.C. § 811(c) (Supp. I 1977)).

52. Information gleaned from interviews conducted by the author with mine safety officials.

53. 30 C.F.R. §§ 70.1-90.301 (1981).

54. 30 C.F.R. § 75.300-.330-1 (1981).

55. 30 C.F.R. § 75.400-.404 (1981).

56. 30 C.F.R. § 75.200-.205 (1981).

57. U.S. DEPT. OF LABOR, MINE SAFETY AND HEALTH ADMINISTRATION, ANNUAL REPORT AND ACHIEVEMENTS (pt. 1) 27 (1978).

fine standards for seven different types of roof support techniques.<sup>58</sup> Additionally, mine owners are free to devise their own unique roof control plans.<sup>59</sup> These regulations constitute an impressive example of how firm criteria to limit administrative discretion can be designed in the face of a variety of technologies, the appropriateness of which depends on the circumstances of a particular mine.

Since December 1979, companies have been criminally convicted in several cases that turned in part on deviations from approved roof control plans.<sup>60</sup> In one of these cases, a mine official of the Vanhose Coal Company was sentenced to sixty days imprisonment for failing to comply with a roof control plan that the Labor Department had approved.<sup>61</sup> This offense was responsible for a roof fall in which one Vanhose miner died and another was injured. It is to the best of my knowledge the only case in which an executive has been imprisoned for noncompliance with privately written, publicly ratified rules.

The appropriateness of enforced self-regulation to coal mine safety is patent. As one coal mining official suggested: "The last four major disasters in this country could be attributed to a weak plan." While violations of specific standards were a problem, the fundamental cause of the disasters was poor execution of a total safety plan. Enforced self-regulation would focus attention on the overall plan, and not simply on the quality of single standards.

Some of the Environmental Protection Agency's (EPA) enforcement activities also approach the enforced self-regulation model. Indeed, in one important respect, the agency has gone beyond the approach envisaged by this Article. The Clean Water Act<sup>62</sup> authorizes civil penalties of \$5000 per day for deviations from privately written oil spillage rules that have *not* been publicly ratified.<sup>63</sup> The

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58. The categories of roof support plans are: full roof bolting, 30 C.F.R. § 75.200-07; conventional roof control, 30 C.F.R. § 75.200-08; combination roof control, 30 C.F.R. § 75.200-09; spot roof bolting, 30 C.F.R. § 75.200-11; special roof control, 30 C.F.R. § 75.200-12; and temporary support, 30 C.F.R. § 75.200-13.

59. Roof control plans which do not conform to these criteria [*see note 58 supra*] may be approved providing the operator can satisfy the District Manager that the resultant roof conditions will provide no less than the same measure of protection to the miners. 30 C.F.R. § 75.200-06 (1981).

60. *United States v. Wyatt*, CR 81-00029 (W.D. Va. *plea entered* Apr. 29, 1981); *United States v. Vanhose Coal Co. Inc. No. 1 Mine*, CR 81-4 (E.D. Ky. *plea entered* Apr. 15, 1981); *United States v. United Castle Coal Co. No. 1 Mine*, CR 80-00093 (W.D. Va. *plea entered* Apr. 9, 1981); *United States v. J. & P. Coal Co.*, CR 80-0060 (W.D. Va. *plea entered* Sept. 8, 1980).

61. *United States v. Vanhose Coal Co. No. 1 Mine*, No. 81-4 (E.D. Ky. *plea entered* Apr. 15, 1981).

62. Codified in scattered sections of 33 U.S.C. (1976).

63. 40 C.F.R. § 114.1 (1981).

EPA regulations require companies involved in the production, distribution, or storage of oil to prepare a Spill Prevention Control or Countermeasure Plan.<sup>64</sup> The companies must follow agency guidelines in preparing the plan, but their plans are reviewed by the EPA only if a spill actually occurs. In normal circumstances, the plan need only be certified by a Professional Engineer, who must attest that the plan accords with good engineering practices.<sup>65</sup>

In another area of EPA regulation, the District of Columbia Circuit has upheld civil penalties imposed on the Chrysler Corporation for violating the terms of a certificate of conformity with emission controls under the Clean Air Act.<sup>66</sup> The certificate is, in effect, a license to sell vehicles issued after approval of an application listing vehicle parameters and specifications that reasonably may be expected to affect emissions. Chrysler was penalized for violating some of these specifications. The corporation appealed, claiming that regardless of the breach of the certificate's terms, the emissions of its vehicles remained within federal standards. In finding against the corporation, the court upheld an important principle: The integrity of particularistic standards must be sustained even when full compliance with them proved unnecessary to attain the overarching standards that gave them birth.

In short, then, there are already powerful examples of public enforcement of privately written rules. But the full enforced self-regulation model requires more; it also mandates governmentally monitored internal enforcement of the internally written rules. The closest incipient approximation is governmentally monitored internal enforcement of *externally* written regulations. The leading illustration is the enforcement of Good Laboratory Practices (GLP) rules imposed on pharmaceutical companies by the Food and Drug Administration.

GLPs were first promulgated in 1978<sup>67</sup> after it was alleged that pharmaceutical companies replaced animals that developed unhealthy conditions during drug-testing experiments. The regulations seek to render fraud more difficult by requiring strict record keeping<sup>68</sup> and unswerving adherence to scientific protocols.<sup>69</sup> Most interestingly, the GLPs require each drug testing laboratory to have a

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64. 40 C.F.R. § 112.1-07 (1981).

65. 40 C.F.R. § 112.3(d) (1981). The criteria can be found in 40 C.F.R. § 112.7 (1981).

66. *United States v. Chrysler Corp.*, 591 F.2d 958 (D.C. Cir. 1979).

67. *See* 43 Fed. Reg. 60,013 (1978).

68. 21 C.F.R. § 58.185-.195 (1981).

69. 21 C.F.R. § 58.120-.130 (1981).

Quality Assurance Unit (QAU) that acts as an internal compliance policeman.<sup>70</sup> This feature was designed to shift the financial burden of regulation from government to the companies. Quality Assurance Unit status reports must routinely be placed before the study director and management of the company.<sup>71</sup> This ensures that management can not plead ignorance when it fails to act on reports of violations. If management does not know about the discovered violations, the company is guilty of an offense for not knowing. The regulations thus enforce a self-regulatory mechanism to prevent underlings from filtering bad news before it reaches responsible ears.<sup>72</sup>

The decision to throw the major burden of regulation onto an internal QAU raised some thorny issues, however. Industry argued that if QAUs had to make their findings available to the FDA, then their effectiveness as a management tool to ensure the quality of research would be undermined. A QAU which knew that its comments would be read by FDA officials (and by consumer groups, which could get the comments from the FDA under the Freedom of Information Act) would be less than frank in its reports to management. QAU reports would become a public relations function of the company rather than a compliance function. The FDA was persuaded by this argument and decided that, as a matter of administrative policy, inspectors would not request reports of findings and problems uncovered by the QAU or records of corrective actions recommended and taken.<sup>73</sup> FDA inspectors still audit the QAU to ensure that it has effective compliance systems in place and to check certain objective compliance criteria. But the records available for

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70. 21 C.F.R. § 58.35 (1981).

71. 21 C.F.R. § 58.35(b)(4) (1981).

72. [T]here is a natural tendency for "bad news" of any sort not to rise to the top in an organization. A screening process takes place, such that if a company has been touting a new drug, and the drug begins "experiencing difficulties" in the lab, lab employees and their supervisors just "know" that information about this is to be passed upward, if at all, only in the vaguest terms. If an automobile company has retooled and is geared to produce 500,000 units of some car, a test driver or his supervisor knows that information suggesting that the car turns over too easily is not going to be welcomed "upstairs." Worse still, certain sorts of wrongdoing of a more serious sort — for example, price-fixing or other criminal activity — is not just screened out casually; it becomes the job of someone, perhaps the general counsel, to intercept any such information that could "taint" his president or board chairman, divulging his suspicions only in private, if at all. In this way, the law not only fails to bring about the necessary internal flow of information, it may systematically operate to keep information of wrongdoing away from the very people who might best do something about it.

C. STONE, *WHERE THE LAW ENDS* 45 (1975).

73. See 43 Fed. Reg. 59,998 (1978). The decision to immunize the reports from FOIA access was made after members of industry, associations, educational and other groups reviewing the proposed rules criticized the original plan to provide full access to the QAU report. 43 Fed. Reg. at 59,998.

regular inspection are separated from reports of findings and problems and corrective actions recommended. While the latter QAU reports are treated as confidential company documents by the FDA, this does not prevent a court from requiring the disclosure of any report, just as a judge can demand other types of company documents which are confidential for routine inspectorial purposes.

In this Article, a different resolution to this very knotty problem has been suggested. Under the enforced self-regulation model, the routine reports of internal compliance groups would not be available to regulatory agencies. However, when the compliance group discovered a violation of law and management decided to continue the violation or to ignore a recommendation that the offenders be disciplined, this fact would be put before the agency. The company would be granted the privilege of secrecy only so long as it followed the advice of its internal compliance group. Unrectified violations which were kept secret would not be immune from government prosecution. If these offenses were independently discovered by government inspectors they could and should be prosecuted. The retention of a limited direct government inspection capacity is important under enforced self-regulation to keep internal compliance groups on their toes. Nevertheless, governments face an ethical dilemma in deciding to treat as confidential compliance group reports that may reveal violations of law. But the need for frank reporting of offenses by compliance groups, the fact that most offenses would rarely become known to anyone (let alone prosecuted) in the absence of such frankness, and the government's retained ability independently to investigate and convict, all suggest that the solution to the dilemma suggested by this Article is reasonable.

Government-mandated internal enforcement procedures are used in other areas as well. Under the Mine Safety and Health Act regulations, specially designated miners conduct pre-shift examinations of the mine for hazards to safety.<sup>74</sup> Pre-shift examiners are required to record violations of mandatory health and safety standards and in fact do so regularly. But in practical terms, they are not expected systematically to audit the mine operators' compliance with the law. Rather, their goal is to check quickly every working section of the mine for serious hazards. Inspectorial practice is to check the

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74. Three hours before the beginning of any shift, and before any miner enters a working area of the mine, the pre-shift examiner checks the atmosphere, roof supports, conveyers and other travelways, and other actual or potential safety hazards. If a hazardous condition is discovered, the examiner, a miner himself, posts a "danger" sign, reports the hazards to a mine official, and notes the condition in a book kept at the site for inspection. 30 C.F.R. § 75.303 (1981).

violations recorded in the pre-shift examination book and to cite the violation if it still exists but ignore it if it has been rectified. There do not seem to have been any prosecutions of pre-shift examiners for failure to report serious violations, though this would seem to be theoretically possible. Similarly, the Toxic Substance Control Act<sup>75</sup> authorizes the Administrator of the EPA to order manufacturers to test suspect chemical substances,<sup>76</sup> internally to monitor compliance with Act procedures,<sup>77</sup> and to indicate proposed quality control protocols.<sup>78</sup> The Administrator can also order revisions of protocols that he finds inadequate.<sup>79</sup>

Courts and commissions have also imposed monitored internal enforcement on single companies. Solomon and Nowak<sup>80</sup> have reviewed a number of Federal Trade Commission cases in which companies guilty of consumer misrepresentation have been ordered to (a) institute certain new policies to prevent a recurrence of the offense, (b) establish an internal monitoring function to ensure compliance with these new policies, and (c) establish a record-keeping system for this monitoring so that the FTC could review and verify future compliance. Similar interventions have also been common in consent decrees negotiated by the SEC.<sup>81</sup> The Swedish Market Courts and the Market Court in the Australian State of Victoria are also empowered to impose special rules on individual companies to protect consumers; failure to comply with these particularistic rules is a criminal offense.<sup>82</sup>

In addition to monitored internal enforcement of externally imposed standards, there is at least one example of monitored internal enforcement of *unspecified* standards, as demonstrated by the Fed-

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75. 15 U.S.C. §§ 2601-2629 (1976 & Supp. IV 1980). The inclusion of this example was suggested by Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 144 n.167 (1980).

76. 15 U.S.C. § 2603(a) (1976).

77. 15 U.S.C. § 2605(a)(4) (1976).

78. 15 U.S.C. § 2605(b)(1) (1976).

79. 15 U.S.C. § 2605(b)(2)(A) (1976).

80. See Solomon & Nowak, *Managerial Restructuring: Prospects for a New Regulatory Tool*, 56 NOTRE DAME LAW. 120 (1980).

81. See Herlihy & Levine, *Corporate Crisis: The Overseas Payment Problem*, 8 LAW & POLY. INTL. BUS. 547, 577-94 (1976); Sommer, *The Impact of the SEC on Corporate Governance*, LAW & CONTEMP. PROBS., Summer 1977, at 115, 127-34; Comment, *Corporate Self-Investigations Under the Foreign Corrupt Practices Act*, 47 U. CHI. L. REV. 803, 806-11 (1980).

82. See Duggan, *Consumer Redress and the Legal System*, in CONSUMER PROTECTION LAW AND THEORY 220-21 (A.J. Duggan & L.W. Darvall eds. 1980). For a discussion of consumer protection legislation in American states which approaches this situation, see Bernstine, *Prosecutorial Discretion in Consumer Protection Divisions of Selected State Attorney General Offices*, 20 HOW. L.J. 247, 276-77 (1977).



eral Communications Commission's interesting solution to the problem of regulating the broadcast of popular records whose lyrics promote illegal drug use. Instead of writing rules to specify what constitutes an unacceptable insinuation that drug use is desirable, the Commission required broadcasters to ensure that a responsible station employee reviewed all questionable records before they were aired.<sup>83</sup>

These examples serve two useful purposes. First, they illustrate that the enforced self-regulation model proposed in this Article is not radical; instances of all key elements of the model can be found in current enforcement practices. Second, they can provide the raw data for much of the empirical research needed to answer troubling questions about the model. By studying examples of elements of the model in operation, investigators may be able to evaluate its efficacy and to increase its effectiveness and practicality.

#### IV. WEAKNESSES OF THE ENFORCED SELF-REGULATION MODEL

##### A. *Regulatory Agencies Would Bear Costs of Approving a Vastly Increased Number of Rules Each Year*

The actual process of rulemaking involves considerable costs. It might be objected that what is being suggested is a multiplication of these costs by the number of companies which participate in an enforced self-regulation scheme. Such an objection must be scrutinized carefully. Government rulemaking is at present such an agonizing and costly process primarily because of the difficulties of writing universalistic rules which do not hinder efficiency. Particularistic rulemaking would be cheaper because the environmental contingencies to be considered would be finite rather than infinite. The regulatory agency would no longer have to undertake such steps as playing simulation games to assess how different industries might use the same set of rules to open different loopholes. A rule to close a gap for one company opens a loophole for another. Every word in every regulation must be carefully vetted lest the agency leave itself open to new and dangerous precedents. As argued above, precedent would not be a worry with particularistic rulemaking because each set of company rules would be, by design, unique. In short, the factors which are crucial to making universalistic rulemaking such a time-consuming business are absent from particularistic rulemaking. This claim could be tested empirically by observing particularistic

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83. See Stone, *The Place of Enterprise Liability in the Control of Corporate Conduct*, 90 YALE L.J. 1, 44-45 (1980).

rulemaking in action with air safety<sup>84</sup> and other regulatory areas.

There is already some evidence to suggest that particularistic rules may not demand a much greater effort by regulatory officials. In the area of roof control, dust control, and ventilation plans written by coal mining companies, Mine Safety and Health Administration officials indicated that while the approval process was time-consuming when first introduced, most plan approvals now can be finished with only a couple of person-days of agency time. With dust control plans, the process has become so routinized that about ninety percent of submissions are simply agency-supplied questionnaires completed by the company. Innovative plans, of course, require a lengthy narrative submission as well, and approval of these may consume up to thirty person-days of time. Plan approval has certainly not turned out to be a bureaucratic nightmare; company representatives hold informal discussions with government officials to ascertain whether a new approach is likely to be acceptable before formally submitting it.

Company rules need only be as individualized as the companies themselves choose. One would undoubtedly find that companies participating in enforced self-regulation would adopt large blocks of rules from other companies, or would adapt model rules suggested by their industry trade association or the regulatory agency. Much of the ratification work of the regulatory agency would be routine. Even so, it must be conceded that the increased costs of scrutinizing thousands of sets of rules might outweigh the savings from the greater simplicity of particularistic rules. My guess is that they would not, given that the ratification of routine particularistic rules could be entrusted to relatively junior civil servants following guidelines handed down to them, while universalistic rules of necessity must be debated by many senior civil servants and politicians.<sup>85</sup>

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84. What one might expect to find from such empirical work is a fairly routine, perfunctory approval of standard rules for common flight paths (*e.g.*, New York-London) and one hopes, very painstaking scrutiny of out-of-the-ordinary routes (*e.g.*, Auckland-Antarctica). It was the failure of this special regulatory scrutiny which was partially responsible for the Mt. Erebus DC-10 crash in Antarctica. *See* note 48 *supra*. In other words, the problem was that the regulatory costs being shouldered were less than they should have been.

85. It could be suggested that the relatively junior civil servants to whom power over approving rules would have to be decentralized would be less formidable adversaries to corporate might than the senior bureaucrats who currently control rulemaking. My experience of regulatory agencies, however, is that employees who are anti-business firebrands tend to remain in junior positions, while bureaucrats who have a "cooperative relationship" with industry make it to the top. As support for this view, note many of the findings of the Dorsen investigation into allegations of victimization of adversarial employees of the Food and Drug Administration. *See* U.S. DEPT. OF HEALTH, EDUC. & WELFARE, REVIEW PANEL ON NEW DRUG REGULATION, FINAL REPORT 17 (1977).

Even if the rulemaking costs were greater, this would be more than counterbalanced by the reduced costs of enforcement pointed to earlier. Since enforcing a rule always costs more than writing it, enforced self-regulation would save taxpayers more money in the enforcement area than it would cost them in the rulemaking domain.

*B. Cooptation of the Regulatory Process by Business  
Would Be Worsened*

Universalistic rulemaking, it might be argued, draws out broader resistance to the will of business than could be expected of particularistic rulemaking. Ralph Nader or the Friends of the Earth are more likely to organize against a more lax nationwide effluent standard than they are to oppose an effluent permit for one factory. On the other hand, local citizens who would never be activists at a national level might protest effluent standards which allowed discharges into their neighborhood fishing hole.

One of the issues to be considered in weighing the relative advantages of particularism and universalism for a given problem is the extent to which the prospects for popular participation are national versus local. With regulation of mine roof control plans, for example, more interest can be expected from the miners who will be covered by a particular roof plan than from any national activism over coal mine roof safety. And in fact, federal mine safety officials told me of examples where protests by local miners had forced the Mine Safety and Health Administration to reverse its approval of roof control plans. In certain circumstances, particularism can harness democratic participation more effectively than universalism.

In other cases, national debate is obviously more appropriate in determining regulatory goals. For example, in setting maximum allowable limits for dust concentration in coal mines, not only should mine owners and miners have a say, but also insurance companies, epidemiologists, and others. Here, the dangers of cooptation at a local level are too immense to be countenanced; we simply do not want a situation where local agreements are being negotiated. The maximum allowable coal dust level should be national and nonnegotiable, and any mine which cannot meet that requirement should go out of business.

There are many areas where the dangers of cosy local agreements would be intolerable. However, cooptation can be controlled in many cases by a particularism severely constrained by overarching standards which were themselves products of national debate.

C. *Companies Would Bear Increased Costs in Delay and Paperwork from Getting New Company Rules Approved*

At the outset, it must be noted that requiring companies to write the private rules which would be the basis of public enforcement should not impose new costs on them. If companies are not presently writing and enforcing their own rules on safety, environment, accounting, and other regulatory areas, then there is something very wrong. The only new costs to a reputable company would come in the delay and paperwork required in submitting these rules for government approval. As with governmental costs, the costs to business of enforced self-regulation could be counterbalanced by savings from having to learn, communicate, and follow one set of rules instead of two (government and corporate); from following rules which were simpler than existing government regulations; from being able to innovate in new and cheaper control methods; and from no longer having to follow universalistic rules which were particularistically irrational or cost-ineffective.

D. *Western Jurisprudence Might Not Be Able to Accommodate Privately Written Rules Being Accorded the Status of Publicly Enforceable Laws*

A detailed legal feasibility study would be premature for a new model such as this, which is yet to be evaluated and criticized by others for its conceptual flaws. While broadly drawing attention to the fact that legal tradition could pose some practical difficulties for the implementation of enforced self-regulation,<sup>86</sup> it must also be pointed out that the proposal runs with the tide of growing judicial recognition of privately written rules. William Evan has described the increasing tendency

for the norms of private legal systems to be judicially recognized, as for example, in a medical malpractice suit in which the code of ethics of the American Medical Association is invoked; in a suit involving the internal relations of a trade union in which the union's constitutional

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86. See *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936), in which the Court struck down federal legislation allowing coal producers to set prices for bituminous coal and to fix wages, hours, and working conditions for miners. However, the Court has since declined to review an opinion upholding the National Association of Securities Dealers' regulation of the over-the-counter securities market. *First Jersey Sec., Inc. v. Bergen*, 605 F.2d 690 (3d Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980). See also Note, *Rethinking Regulation: Negotiation as an Alternative to Traditional Rulemaking*, 94 HARV. L. REV. 1871, 1880-83 (1981) (discussing the constitutional limits of delegating regulatory authority to private entities). The Note suggests that much of the antipathy to private delegation stems from due process concerns about companies being regulated by competitors; on the other hand, laws that placed ultimate regulatory authority in the government have been upheld. See *First Jersey Sec., Inc. v. Bergen*, 605 F.2d 690 (3d Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980).

provisions are accorded legal status by the court; or in a suit by a student against a college or university in which the institution's disciplinary rules are judicially recognized. . . . The adoption, as it were, of the norms of private legal systems by public legal systems is functionally equivalent to the conferral of rights on private legal systems.<sup>87</sup>

Moreover, we have seen that quite developed examples of enforced self-regulation have evolved already in the United States without constitutional challenge. Indeed, we have discussed one instance where a person was imprisoned under public enforcement of privately written law.<sup>88</sup> Imprisonment being provided for violations which are particularistic rather than universalistic is not novel. Permits under the Clean Water Act regulating the amount of effluent which can be discharged from a source vary enormously in stringency, depending upon the part of the country in which the source is located in, whether the plant is new or old, the economic viability of the industry, and whether pollution reduction is being achieved at a particular time. Even though this is a law which is applied in a calculatedly unequal fashion, there is provision for imprisonment for any person who willfully or negligently violates a permit condition.<sup>89</sup> The American legal system has already demonstrated that it will tolerate a law enforcement mode which rejects universalism in favor of particularism.

E. *Particularistic Laws Might Weaken the Moral Force of Laws That Should Be Universal*

Allowing companies to write their own rules could replace absolute standards with a moral relativism, making the rule of law seem an arbitrary matter. Whether the authority of law would be enfeebled would depend on how firmly regulatory agencies insisted that important absolute standards be reflected in *all* sets of particularistic rules. It would depend also on how firmly the legislature dealt with regulatory agencies that ignored the overarching standards governing self-regulation plans.

Ultimately, however, the law derives most of its moral force from the stigma of conviction. More stigma would attach to corporate crime if more corporate criminals were prosecuted and convicted. If, as this Article has suggested, enforced self-regulation would improve the current dismally low conviction rate of corporate criminals, then

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87. Evan, *Public and Private Legal Systems*, in *LAW AND SOCIOLOGY* 165, 176 (W. Evan ed. 1962).

88. See text at note 61 *supra*.

89. 33 U.S.C. § 1319(c)(1) (Supp. I 1977).

adoption of the concept could strengthen, not weaken, the moral authority of corporate criminal law.

F. *The Model Would Encourage the Trend to  
"Industrial Absolutism"*

Sixty years ago, Justice Louis Brandeis testified to the Commission on Industrial Relations that as corporations became larger and more powerful, the threat of "industrial absolutism" became more profound.<sup>90</sup> Corporations can be as powerful as governments, yet lack the checks and balances against abuses of that power to which governments are subject. Employees do not vote in the private government of corporations. When the corporation sanctions an employee, there is no obligation for a public hearing, no observance of a right to silence, no due process. Giving the corporation power over lawmaking, it could be argued, would surely take us one large step closer to the industrial absolutism Brandeis warned us against.

This line of attack on enforced self-regulation can be easily dismissed. It is not as if corporations do not already have policies under which employees are dismissed, demoted, and sanctioned in other ways. Enforced self-regulation would in some measure control industrial absolutism by requiring that corporate policies be made subject to veto by a democratically constituted government.<sup>91</sup> This is not to deny that industrial absolutism is a problem; it is simply to say that enforced self-regulation would not contribute to it. Indeed, it should be hoped that the formalization of corporate compliance policies which would come with enforced self-regulation would be accompanied by a formalization of due process protections for employees.

G. *Companies Would Write Their Rules in Ways Which Would  
Assist Them To Evade the Spirit of the Law*

Companies have a long history of deviousness at finding ways of evading their public responsibilities.<sup>92</sup> By giving them control over

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90. Quoted in R. EELLS, *THE GOVERNMENT OF CORPORATIONS* 210 (1962).

91. The democratic ideal is not strengthened only by holding the unelected government of corporations accountable to the elected government of the state, but also by grass roots participatory possibilities under enforced self-regulation. Already, American regulatory agencies which have opted to give public recognition to privately written rules have provided for public comment on such recognition. For example, the Mine Safety and Health Administration gives notice to miners and their representatives of agreements it has made with mining companies on ventilation and roofing plans, and of petitions for modifications to the regulations for particular mines.

92. For illustrations, see generally M. CLINARD & P. YEAGER, *supra* note 2; M. GREEN, *THE OTHER GOVERNMENT* (1975).

the rule-writing process, one might give full reign to their ingenuity at pulling the wool over the eyes of governments. For a start, companies could evade liability by simply failing to write required rules (though this could be dealt with by making the penalties for not having rules more severe than those for breaking them). Many companies would surely manage to sneak provisions into their rules without the regulatory agency realizing the full implications of the provisions. One can be assured that company lawyers would spend more time working over their rules with a fine tooth comb than would any government employee.

There can be no satisfactory answer to this criticism of enforced self-regulation except to say that, in one way or another, the business community's resourcefulness at law evasion will be cause for weakness in any system of control. As has been argued above, the opportunities for evasion and exploitation of loopholes are endemic in universalistic laws controlling business practices. I strongly suspect that simple, particularistic rules over which business had considerable control would not be more susceptible to evasion than complex rules over which business had less control<sup>93</sup> because the whole inherited wisdom from the study of corporate crime is that it is complexity which makes conviction so often impossible. Ultimately, however, this question can only be answered empirically.

#### H. *Companies Cannot Command Compliance as Effectively as Government*

While most of the other objections to enforced self-regulation turn on the presumed capacity of the corporation to control its environment in ways that would evade the impact of regulation, this objection looks to the ineffectiveness of control in large organizations. In a provocative essay, Thomas Schelling has argued that the managers of large organizations are rarely in a position simply to issue instructions and expect that they will be carried out.<sup>94</sup> Moreover, in some cases the only way that executives can secure compliance with their instructions is when government backs those instructions.

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93. It would also be wrong to assume that business has no control over existing governmental rulemaking. Joseph Stetler, former president of the American Pharmaceutical Manufacturing Association, once commented: "As I look back over three or four years, we have commented on 60 different proposed regulations. At least a third were never published in final form. And every one, without exception, picked up a significant part of our suggestions." R. HUGHES & R. BREWIN, *THE TRANQUILIZING OF AMERICA* 229 (1979). An official of the Association of the British Pharmaceutical Manufacturing Industry told me that many British government regulations were written in their offices.

94. Schelling, *Command and Control*, in *SOCIAL RESPONSIBILITY AND THE BUSINESS PRECIPITANT* (J. McKie ed. 1974).

Hence, the board cannot fight resistance from the ranks to affirmative action until the government mandates affirmative action and the directors can plead that the matter is beyond their control. Similarly, corporate policies which require the wearing of safety helmets or air-filter masks are notoriously hard to enforce; compliance works best when management can say that the government insists upon it.<sup>95</sup>

The Schelling argument does not pinpoint a weakness of enforced self-regulation, but of voluntary self-regulation. Corporate power and the sense of legitimacy<sup>96</sup> needed to command compliance may be weak when such orders do not have the force of law. Because self-generated rules have legal force under enforced self-regulation, however, the state can be seen as backing the corporate command. In fact, a strength of enforced self-regulation is that it summons the legitimacy of both state and corporate power to entice compliance while the alternative regulatory models rest on the legitimacy of corporate power alone or of state power alone.

I. *The Independence of the Compliance Group Could Never Be Fully Guaranteed*

An independent internal compliance group is essential to the success of an enforced self-regulation scheme. There are two principal threats to the compliance unit's independence. The first is internal. The group, through a sense of corporate loyalty, might itself subordinate regulatory zeal to the attainment of the firm's productivity goals. My study of the pharmaceutical industry<sup>97</sup> concluded that this threat may be somewhat overstated. In that industry, prestige, promotion, and job satisfaction for compliance group personnel were generally a function of their competence at discovering and correcting regulatory problems. Their professional commitment was aimed at ensuring compliance rather than at making profits, and their careers were oriented more to their subunit's goals than to the overall profit goals of the company. Indeed, companies themselves encouraged the compliance groups to strive uncompromisingly for excellence in ensuring compliance, lest defective products slip through, creating legal problems and customer dissatisfaction.

In the field of occupational safety, moreover, the divided-loyalties problem can be somewhat reduced by including worker or union representatives in the compliance group. Presumably, union mem-

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95. *Id.* at 86.

96. "Legitimacy" is being used here in the sociological sense; as a condition of general acceptance by the public as authorized by, or in accord with, prevailing values.

97. To be published in J. BRAITHWAITE, *supra* note 6 (forthcoming).



bers or nonmanagement personnel would generally be less willing to subordinate their personal safety to profit goals. To minimize further the chance of cooptation by management, worker representatives can be given only a short tenure in the compliance unit.<sup>98</sup>

The second threat to the compliance group's independence emanates from the corporation itself; despite an overall commitment to regulatory goals, the compliance groups would be compromised when management determined that the unit's recommendations were not in the company's long-run best interests. Here, independence can be strengthened by having directors of compliance report directly to the chief executive or a board audit committee. My interviews with pharmaceutical industry executives revealed the importance of such independence from middle-management pressure. There are occasions when it is economically rational temporarily to suspend commitment to quality standards. If a product is in short supply and major customers are complaining to the marketing manager, that executive may pressure the quality control manager to pass an almost-acceptable batch as acceptable. This pressure can be particularly acute when major customers threaten to switch to a competitor unless continuity of supply is guaranteed. An individual plant manager can also request the quality control director to reverse a regulatory decision, as when the plant had to achieve certain production goals.

These opportunities for meddling can be limited if the corporation is structured so that the quality control director does not have to answer to manufacturing or marketing vice-presidents. In some American pharmaceutical companies, the quality control director makes an independent written decision on each drug batch, which he then signs. Only the president can overrule this judgment, and he must do so in writing. The potential for chief executive overruling is far lower than it would be for a veto by a marketing or manufacturing manager. People become corporation presidents in part because they exhibit a modicum of caution. Imagine the consequences for a president if customers are seriously injured because he personally overruled a quality control decision. No matter how low the chances of this event occurring were perceived to be, it would be a foolish risk for a corporation president to take for the sake of one batch of

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98. The leading example of worker participation in OSHA self-inspection programs is the so-called Bechtel plan. At Bechtel Group Inc.'s nuclear power plant at San Onofre, California, OSHA blessing has been given to monthly labor-management safety inspections as an alternative to government inspections. Under this plan management must explain its reasons for not adopting the recommendations of the inspection team. See Lublin, *OSHA Head Wants to Cut Regulation, Using Labor-Management Inspections*, Wall St. J., Mar. 26, 1981, at 8, col. 4.

product. While the destruction of a batch might be a major aggravation to the marketing or manufacturing manager, to the president it is a minor matter. Effectively then, organizational structure lessens the chances of quality control being formally overruled.

In multiple-division corporations, compliance heads within each division or subsidiary, in turn, should have only a dotted-line reporting relationship with the chief executive officer of their subsidiary and a firm line to their immediate superior within the compliance group. It should be their compliance boss who hires and fires them, and who determines their yearly bonuses, not the subsidiary chief executive. Their future should be linked to their performance in securing compliance, not with their success in pleasing a chief executive.<sup>99</sup>

The best guarantee of compliance group independence is external: making the failure to report unrectified violations a crime. Regulatory agencies would continually audit to determine whether the group was discovering and reporting violations as it should. Once an offense had been discovered, the agency would subpoena the relevant compliance unit reports and uncover any failure of the compliance director to report an unrectified violation. Even a small number of prosecutions for this offense would probably be sufficient to encourage compliance directors to put the company's head on the chopping block — instead of their own. The directors could be further required to sign a quarterly declaration that all violations of law uncovered by the compliance group during that quarter had been rectified or reported to the government, and that all compliance group recommendations for disciplinary action against culpable individuals had also been acted on or reported.

Under any set of independence guarantees, however, top management could still find subtle and not-so-subtle ways to bend the will of the compliance staff. End top management control through reporting relationships, and executives would try to control the compliance unit through budget allocations. If budgetary controls were removed, fewer travel approvals, poor allocation of offices, staff reshuffles, and similar steps to make the work life of employees miserable could be attempted by management to assert its control. This is not to denigrate independence-giving strategies such as granting control of budgets for subsidiary and divisional compliance units to the corporate compliance group rather than to subsidiary or divisional

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99. It might also be desirable to require companies to notify the regulatory agency of the dismissal of a compliance director and to give reasons for such dismissal.

chief executives. It is just to say that eliminating all threats to compliance group independence is impossible. Nevertheless, if the major incentives (promotion and budget allocation) are controlled by other compliance people, then, in spite of residual disincentives, compliance executives will derive the *greatest* rewards from success at ensuring that the rules are obeyed.

The impossibility of assuring independence for the compliance group was the greatest concern of readers of earlier drafts of this essay. My response to them was at two levels. The first response is empirical; I had seen many companies in the pharmaceutical industry with tough, independent compliance groups which frequently won internal battles against executives who wished to put profits ahead of safety. Or I would suggest to the cynics that they go to any coal mine in the United States and read preshift examiners' reports which regularly record serious violations of law law for further consideration by government inspectors. Undoubtedly preshift examiners fail to report all they should, but they do report a lot.

My second response goes to what I believe are mistaken presumptions as to corporate structure. The assumption that internal compliance groups will be impotent is based upon too monolithic a conception of corporations, one which assumes that they are totally controlled from the top down.<sup>100</sup> If subunits such as compliance groups develop enough momentum within the organization, in practical terms it can be difficult for the chief executive officer to bend them to his will. Chief executives are, in many senses, politicians who cannot afford continually to antagonize significant corporate constituencies, lest they refuse to cooperate with him when their help or loyalty is really needed. This is true whether one is talking about the president of a university trying to restructure the geography department or the president of a coal company trying to trim the safety staff. Politicians, in short, are never omnipotent. And if internal compliance groups are set up in a way that gives them organizational clout (*e.g.*, with a senior vice-president at the helm or direct access to an audit committee of outside directors), their effectiveness will rarely be totally compromised.

## V. FOR A MIX OF REGULATORY STRATEGIES

Not all of the foregoing problems with enforced self-regulation can be lightly dismissed. Certainly there is consolation in comparing

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100. Cf. Schelling, *supra* note 94, at 80 (noting that corporations are not "unitary entities" but are "small societies comprising many people with different interests, opportunities, information, motivations, and group interests").

them to the even more profound pitfalls of voluntary self-regulation and government regulation. Enforced self-regulation can never be a panacea to the well-documented problems encountered under the other two models. To regulate effectively and efficiently the widest spectrum of corporate behavior, we must seek some optimal mix of regulatory strategies.

Enforced self-regulation has more bite than voluntary self-regulation organized by a trade association. But the latter still has an important place, particularly in areas of business regulation where the public interests threatened by corporate conduct are not great and where industry does not have a lot to lose or something to gain, by toeing the line.<sup>101</sup> Voluntary self-regulation is the most attractive option here because, lacking government-industry adversariness, it is the cheapest option. Even in areas where the consequences of corporate misconduct are quite profound, voluntary self-regulation can usefully supplement governmental control (though never be an alternative to it). Had a self-regulation program run by the Pharmaceutical Manufacturers Association complemented direct regulation by the FDA, for example, the MER/29 drug disaster might have been averted.<sup>102</sup> Here, two competitors of Richardson-Merrell, the makers of MER/29, had conducted tests on the drug and found it dangerous. Since there was no industry self-regulatory body to which test results could be forwarded, these companies were content merely to report their warnings to Richardson-Merrell, which promptly ignored them. In highly competitive industries, the desire of companies to prevent competitors from gaining an edge can be harnessed to serve the public interest by a voluntary self-regulation program run by a trade association.

Even though enforced self-regulation would be more cost-effective than direct government regulation in many areas involving the conduct of big business, it could never totally replace the latter. For businesses below a certain size, a viable and independent compliance unit is impossible. Direct government inspections must be retained for small businesses. In particular, government inspectors would continue to have a vital role in catching fly-by-night operators who calculatedly operate on the fringe of the law. Medium-sized businesses perhaps could be given a choice of opting in or out of en-

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101. Examples of situations where voluntary self-regulation may be used most effectively include the regulation of toy durability (as opposed to safety) by a toymaker trade association, or the regulation of product labels that falsely create the impression they were made by another, better known manufacturer.

102. Details of the MER/29 disaster can be found in Ungar, *Get Away With What You Can*, in *IN THE NAME OF PROFIT* 106 (R. Heilbroner ed. 1972).

forced self-regulation. Small and medium-sized businesses which could not sustain a viable and independent compliance unit would have to be monitored for law observance directly by government inspectors. Nevertheless, the laws being observed could still be laws privately written and publicly ratified according to the enforced self-regulation model. Smaller companies which could not be bothered writing their own rules could choose one of a number of standard packages for companies of different types made available by the regulatory agency. Or, more simply, they could copy another company's rules from the public register of company rules.

Even for big business, a modicum of direct inspection must be retained. This would keep the internal compliance group on its toes. At this point, I can envision business people throwing their hands up in horror, and exclaiming, "so the bottom line is to keep the old government inspections while adding just another regulatory layer onto them—" Not so. What is being suggested here is a reallocation of regulatory resources, not a multiplication of them, a shift from expenditures on direct inspection to expenditures on audits of corporate compliance groups. It happens to be my belief that in general, governments should increase their budgets for business regulation, but such a belief is not relevant to the present proposal.

A fundamental principle for the allocation of scarce regulatory resources ought to be that they are directed away from companies with demonstrably effective self-regulatory systems and concentrated on companies which play fast and loose. In addition to providing incentives for self-regulation, such a policy would tend to channel enforcement toward the companies most likely to offend. Regulatory agencies at the moment often provide disincentives for effective self-regulation. SmithKline executives drew one example to my attention. In 1979, the company conducted a detailed in-house examination which discovered contaminants in two of its nasal sprays. Instead of hushing up the problem, SmithKline treated the employee who discovered the contaminant as something of a hero. Her efforts were held up as an example of the kind of vigilance required for the sake of product purity. SmithKline notified FDA that 1.2 million bottles of nasal spray were being recalled from drug stores and supermarkets around the country. According to the executives, they felt terribly discouraged when the government issued a press release which created the impression that the FDA had discovered the problem and forced SmithKline into the recall.

## CONCLUSION

This Article has suggested that enforced self-regulation could play an important role in a fundamental redeployment of governmental expenditures for regulating business. Under enforced self-regulation, each company would write its own rules. Once these rules had been ratified by the government, a violation of them would be an offense. The company would be required to establish an internal compliance group to monitor observance of the rules and recommend disciplinary action against violators. If management were to fail to rectify violations or to act on recommendations for disciplinary action, the director of compliance would be statutorily required to report this fact to the relevant agency. The role of the regulatory agency would be to determine that the company rules satisfied all of the guidelines set down by government policy, to ensure that the compliance group was independent within the corporate bureaucracy, to audit the performance of the compliance group, to conduct occasional spot inspections of operating units as an independent check that the compliance unit was detecting violations, and to launch prosecutions, particularly against companies that subverted their compliance groups.

Many very important details of how enforced self-regulation might work in practice have not been discussed in this Article. How would the legislature set penalties for offenses? How would legislation deal with the question of intent, so as to ensure that companies could not also write their own *mens rea* standards? How would an enforced self-regulation scheme pass constitutional muster? Again, it must be emphasized that the purpose of this Article is not to present a packaged legislative proposal, ready for implementation.

The ideas presented here may sound complex. They are not. The Article has attempted to show that one of enforced self-regulation's virtues is greater simplicity than direct governmental regulation. Approaches that are new always seem more complex than they in fact are. Should the reader be asked to explain how the existing American regulatory system works to a Martian (or even an Australian), it too would seem extremely complicated.

Whether the strengths of enforced self-regulation outweigh its weaknesses depends on what area of regulation is being considered. This Article has stressed that there can be strength in the convergence of weaknesses. The challenge is to find an optimal mix of self-regulation and governmental regulation — a mix that will cover the gaps left by one approach with the strengths of another approach. By exploiting the advantages and recognizing the weaknesses of en-

forced self-regulation, voluntary self-regulation, and direct governmental regulation, we might strike a mix that is more effective and less expensive than any one- or two-dimensional approach.

#### APPENDIX: THE CORPORATE CASE LAW APPROACH

Rules have their limits. In a technologically complex industry, rules cannot be written to cover every environmental contingency that poses a risk of social harm. To be sure, an advantage of self-regulation is that the rules can more quickly adapt to changing environmental realities or newly perceived threats than can laws imposed by the state. Even so, however, my research on the pharmaceutical industry suggests that an accumulation of many minor acts of social irresponsibility (or of many technical breaches) all too frequently does greater harm than grossly illegal acts.<sup>103</sup>

The most effective method of combatting minor acts of irresponsibility is through a corporation's identitive power — the use of symbols to control behavior.<sup>104</sup> The culture of a corporation more than anything else determines the safety of its products and the extent to which workers are needlessly injured or the environment needlessly harmed.<sup>105</sup> If top management tolerates an atmosphere in which the quick fix is accepted, in which rule bending and corner cutting are not frowned upon, then both socially irresponsible and illegal acts will flourish.<sup>106</sup> The strength of identitive power is that it reaches beyond compliance with written rules. Corporations that indoctrinate their employees with an attitude that "the responsible way is the company way," that "the spirit of the rules is as important as the letter of the rules," should be rewarded by regulatory agencies with lower levels of governmental intervention.

The most effective way to inculcate a corporate identity with socially responsible positions may not be through rulemaking, internal

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103. See J. BRAITHWAITE, *supra* note 6 (forthcoming).

104. This power is one of three suggested by Professor Etzioni. In addition to identitive power, rewarding with prestige, esteem, acceptance, (pointing out "that's not the sort of thing an IBMer does,"), there is coercive power, the use of physical means for control purposes (*e.g.* torture, imprisonment, removal from the organization); and utilitarian power, the use of material means for control purposes (*e.g.* promotion, payment of bonuses, allocating capital for expansion). Etzioni, *Organizational Control Structure*, in *HANDBOOK OF ORGANIZATIONS* 650, 651 (J. March ed. 1965).

105. See C. STONE, *supra* note 72, at 228-48.

106. The SEC-mandated internal reports of 1976 regarding foreign bribery at Lockheed and Gulf both reached this conclusion — that the tone set by top management is the critical determinant of illegal corporate conduct. See Baumart, *How Ethical Are Businessmen?*, in *WHITE-COLLAR CRIMINAL* 119, 125-27 (G. Geis ed. 1968); Brenner & Molander, *Is the Ethics of Business Changing?*, *HARV. BUS. REV.* Jan.-Feb. 1977, at 57.

or external, but rather through the development of a corporate case law. A senior executive of one of Australia's largest companies indicated in a recent interview that his firm was moving toward a "corporate case law approach." In the executive's view, rules could not be codified to cover the ever-changing situations that confront executives with ethical dilemmas. His company, therefore, was beginning to attempt to formalize "corporate case law." The fundamental requirement of the concept is that when executives encounter an ethical dilemma, the problem should be written down. It should then be passed up through the organization until it reaches a person who knows the existing case law with respect to this class of problems. If existing case law decides the issue, the problem goes no further. But if an important precedent could be established, it could go to the "supreme court": the firm's chief executive officer.

A second fundamental requirement of the concept is that any decision be put in writing and sent back down the line.<sup>107</sup> A senior executive must take responsibility for collating, conceptualizing, cross-referencing, and drawing out general principles from the case law. Communicating corporate case law to employees is no greater a problem than communicating case law handed down by public courts. Corporations have coped admirably with disseminating in digestible form the case law in such complex areas as antitrust. Anyone who has read the antitrust compliance guides provided to employees by some large American corporations must be impressed by the lucid use of examples to inculcate the "dos and don'ts" of competitive conduct.<sup>108</sup>

When the corporate case law becomes widely communicated and understood within the organization, the need to pass ethical dilemmas up the line decreases because they are simply no longer dilemmas. The case law can build a corporate culture in which gray issues become black and white. Minimizing the incidence of ethical dilemmas is important because of the potential for delay. Corporations often make the right decisions at the wrong time because they prevaricate while dilemmas are passed up the line. Authority must be

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107. Exxon has exemplary policies in this regard. When an individual reports a rule violation up the line, the executive to whom the report is made has an obligation to report back to the person who made the report what action has been taken. If the latter does not receive this feedback, he or she knows that somewhere the bad news has been blocked. He or she then has an obligation to report the breakdown directly to the audit committee of the board. This builds in a strong disincentive against orchestrated communication blockages to cover up a violation. See B. FISSE & J. BRAITHWAITE, *supra* note 6 (forthcoming).

108. Outstanding examples of such manuals include IBM's BUSINESS CONDUCT GUIDELINES and DATA PROCESSING DIVISION GENERAL MARKETING GUIDELINES (Sept. 1980), and General Electric's POLICY ON COMPLIANCE WITH THE ANTITRUST LAWS 20.5 (1970).



devolved if corporations are to maximize their capacity to seize upon opportunities when they present themselves.<sup>109</sup> Hence it is essential that corporate case law be proactive rather than simply reactive.

The formalized organization and reporting of corporate case law would benefit both the regulators and the regulated. A formalized case law would render corporate decision-making processes more vulnerable to criticism. Criticizing unexplicated rules is of less value than reading and responding to actual key decisions. The corporate case law approach could never do away with the need for rules. It could, however, reduce their number and diminish the perennial bureaucratic problem of rules hamstringing action when they are not really apposite to the specific situation. For top management, formalized corporate case law can tighten management control and reduce the risk of wild, idiosyncratic decisions. Costs would not be great. Executives do not encounter ethical dilemmas every day of the week; when they do, a more senior person who has encountered problems of this type before should be able to resolve the dilemma rapidly. If the company is criticized for the ethical stance it has taken on a particular issue, the board of directors can be provided with a definitive summary of the relevant case law. The cases are in the files for them to inspect. Criticism can be directed not only at the wording of rules, but at the managerial judgments underlying the resolution of specific dilemmas that set important precedents.

How would enforced self-regulation be adapted to a compliance system based more on case law than on statute law? It would work by giving the regulatory agency direct access to the written case law. Instead of devoting their time to monitoring rules, regulators would read the cases to ensure the critical ethical dilemmas were not being decided without recourse to this case law. The inspectors would also be charged with ensuring that the decisions reached were in accord with governmental standards.

Persuading jurists to recognize private case law in public courts could be an even greater task than obtaining such recognition for privately written rules.<sup>110</sup> Under enforced self-regulation, however, the case law would be ratified by the state and would thus, in essence, be only semi-private. Periodic review of the case law by the regulatory agency could result in the overturning of decisions and

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109. This is particularly true with larger organizations. The larger the organization, the greater the devolution of decision-making power. This was demonstrated empirically by Milet, Gillespie & Eitzen, *Structure and Decision Making in Corporate Organizations*, 63 *SOCIOLOGY & SOC. RESEARCH* 723 (1979).

110. See Part IV-D *supra*.

principles that failed to conform to the government's overarching standards. Aggrieved consumers, competitors, or employees could also appeal to the agency for such relief.

In conclusion, let me state that I am not an advocate of the corporate case law approach, at least not in any immediate or practical sense. Important details must be worked out before the concept can be seriously considered. It does, however, present an alternative or complementary method to rule-based enforced self-regulation that bears further study.