LATHAM & WATKINS

Client Alert Commentary

Latham & Watkins White Collar Defense & Investigations Practice January 17, 2020 | Number 2579

Prioritizing Corporate Culture: Lessons for Companies from the Major League Baseball Sign-Stealing Investigation

The MLB Commissioner held senior leadership accountable for illegal sign stealing — even though the conduct generally involved players and low-level operations employees.

On January 13, 2020, Major League Baseball (MLB) Commissioner, Robert D. Manfred, Jr., handed down significant punishment to the Houston Astros organization (the "Ballclub" or "team"), its General Manager Jeff Luhnow and Field Manager A.J. Hinch following MLB's investigation into sign-stealing by the Ballclub during the 2017 season and playoffs, a year in which the team won the World Series. The Commissioner determined that the Ballclub will forfeit their regular first and second round draft selections in the 2020 and 2021 player drafts and pay a US$5 million fine (the maximum allowed under the Major League Constitution). The General Manager and Field Manager were both suspended without pay effective immediately through the completion of the 2020 World Series in October, meaning they would miss a full season of baseball. Shortly after the Commissioner announced his decision, the team's owner, Jim Crane, fired both the General Manager and Field Manager, stating that "I have higher standards for the city and the franchise, and I am going above and beyond MLB's penalty," and that while "[n]either one of them started this, [] neither one of them did anything about it. … We will not have this happen again on my watch."

Although the matter involves sports, it has lessons relevant to all institutions, companies and corporate leaders. Notably, the Commissioner's decision emphasizes the General Manager's and Field Manager's accountability for failing "to adequately manage the employees under their supervision, to establish a culture in which adherence to the rules is ingrained in the fabric of an organization, and to stop bad behavior as soon as it occurred." The Commissioner's emphasis on the importance of culture in setting the tone for an organization is not a unique message from governing authorities. A growing number of prosecutors and regulators in the United States and around the world, particularly in the United Kingdom, have been stressing the importance of corporate culture in establishing the values for an organization and helping to prevent conduct inconsistent with those values. Indeed, authorities have stressed not only the importance of instituting a positive culture, but also *measuring* and *monitoring* it to ensure the institution moves in the right direction. The MLB investigation and other recent corporate crises provide companies of all types the timely opportunity to take practical steps to proactively and meaningfully assess their culture to help prevent crises from arising in the first place.[1]

The MLB Investigation

As set forth in the Commissioner's statement, in November 2019, a former player for the Ballclub publicly alleged that the team violated MLB rules by engaging in prohibited sign-stealing methods in 2017.[2] MLB's Department of Investigations interviewed 68 witnesses and reviewed tens of thousands of emails, communications, text messages, video clips, and photographs.[3]

Getting into the findings, the Commissioner explained that in 2017, employees in the team's "video replay review room began using the live game feed from the center field camera to attempt to decode and transmit opposing teams' sign sequences (*i.e.*, which sign flashed by the catcher is the actual sign) for use when an Astros runner was on second base. Once the sign sequence was decoded, a player in the video replay review room would act as a 'runner' to relay the information to the dugout, and a person in the dugout would notify the players in the dugout or sign the sign sequence to the runner on second base, who in turn would decipher the catcher's sign and signal to the batter from second base."[4]

Once the replay-review-room sign stealing system was implemented, approximately two months into the season, the players discussed improving the process. Bench Coach, Alex Cora, "arranged for a video room technician to install a monitor displaying the center field camera feed immediately outside the Astros' dugout." Then, "[o]ne or more players watched the live feed of the center field camera on the monitor, and after decoding the sign, a player would bang a nearby trash can with a bat to communicate the upcoming pitch type to the batter."[5]

Notably, the Commissioner's decision explained that the "new scheme [w]as player-driven, and with the exception of Cora, non-player staff, including individuals in the video replay room, had no involvement in the banging scheme. However, witnesses made clear that everyone proximate to the Astros' dugout presumptively heard or saw the banging."[6]

Additionally, the decision explained how MLB warned teams in 2017 against engaging in prohibited sign-stealing. In August 2017, the Boston Red Sox were fined for "transmitting sign information from their replay review room to individuals in the dugout wearing smart watches," and, in a press release, the Commissioner emphasized that MLB regulations "prohibit the use of electronic equipment during games and state that no such equipment 'may be used for the purpose of stealing signs or conveying information designed to give a Club an advantage.'"[7] The Commissioner also issued a memorandum to all teams reiterating the rules "and putting all Clubs on notice that future violations would be taken extremely seriously by my office," including that "the General Manager and Field Manager of Clubs would be held accountable for any violations of the rules in the future."[8]

The Commissioner's decision states, "[n]otwithstanding the publicity surrounding the Red Sox incident, and the September 15 memorandum that [the Commissioner] sent to all Clubs, the Astros continued to both utilize the replay review room and the monitor located next to the dugout to decode signs for the remainder of the regular season and throughout the Postseason." Prior to the 2018 season, the Commissioner's office issued a memo to all teams regarding illegal sign stealing, which emphasized, "'**To be clear, the use of any equipment in the clubhouse or in a Club's replay or video rooms to decode an opposing Club's signs during the game violates [MLB regulations].**'"[9]

Subsequent to their World Series victory in 2017, the investigation found no evidence that the team's trashcan-banging scheme continued during the 2018 season, but the replay room continued to decode signs using the live center field camera and sent them to the dugout until at some point the scheme stopped "because the players no longer believed it was effective."[10] In 2019, "the Commissioner's Office issued a revised policy governing sign stealing, which, among other things, included the placement of individuals retained by the Commissioner's Office in the Club's replay review rooms to ensure that no rules violations occurred."[11]

The Commissioner's Decision

In evaluating culpability, the Commissioner explained that the team's illegal sign stealing was "not an initiative that was planned or directed by the Club's top baseball operations officials." Rather, the banging scheme was "with the exception of [Bench Coach] Cora, player-driven and player-executed" and the replay-review-room scheme was "originated and executed by lower-level baseball operations employees working in conjunction with Astros players and Cora."[12] Significantly, regardless of the fact that the conduct generally involved players and low-level operations employees, the Commissioner held senior leadership accountable: "Regardless of the level of [the General Manager's] actual knowledge, the Astros' violation of rules in 2017 and 2018 is attributable, in my view, to a failure by the leaders of the baseball operations department and the Field Manager to adequately manage the employees under their supervision, to establish a culture in which adherence to the rules is ingrained in the fabric of the organization, and to stop bad behavior as soon as it occurred."[13]

The Commissioner ultimately did not hold any players accountable, many of whom admitted "they knew the scheme was wrong."[14] The Commissioner noted that "[p]layers stated that if [the Field] Manager [] told them to stop engaging in the conduct, they would have immediately stopped." The Commissioner also found that he was not in a position to evaluate whether the scheme helped the team or impacted on-field results, but regardless, it "created the appearance of unfairness, and for that, it necessitates severe discipline."[15]

The Commissioner further emphasized that "the Club's General Manager and Field Manager are responsible for ensuring that the players both understand the rules and adhere to them."[16] In these circumstances, the Commissioner explained, "because the Club's Bench Coach was an active participant in the scheme, and the Club's Manager was aware of the scheme and did nothing to stop it, I recognize that some players may have understood that their conduct was not only condoned by the Club, but encouraged by it."[17]

Setting aside whether the General Manager had personal knowledge of either scheme, the Commissioner determined to hold him personally accountable for the team's conduct. The Commissioner stated that it is the General Manager's job "to be aware of the activities of his staff and players, and to ensure those activities comport with both standards of conduct set by Club ownership and MLB rules," and that despite the General Manager's knowledge of the Red Sox incident and receipt of both memoranda from the Commissioner's office, he "failed to take any adequate steps to ensure that his Club was in compliance with the rules."[18]

The Commissioner went on to make observations regarding the culture of the Ballclub's baseball operations department. Although acknowledging the General Manager's success as a baseball executive, he found it "very clear" from the investigation that "the culture of the baseball operations department, manifesting itself in the way its employees are treated, its relations with other Clubs, and its relations with the media and external stakeholders, has been very problematic. At least in my view, the baseball operations department's insular culture — one that valued and rewarded results over other considerations, combined with a staff of individuals who often lacked direction or sufficient oversight, led, at least in part, to the [] incident [involving the Assistant General Manager], the Club's admittedly inappropriate and inaccurate response to the incident, and finally, to an environment that allowed the conduct described in this report to have occurred."[19]

Regarding the Field Manager, the Commissioner found that he had not devised or participated in either scheme. Indeed, the Commissioner acknowledged that the Field Manager had “attempted to signal his disapproval of the scheme by physically damaging the monitor on two occasions, necessitating its replacement.”[20] However, the Field Manager did not tell his players he disapproved of the scheme or direct them to stop the conduct. The Commissioner therefore concluded that “[a]s the person with responsibility for managing his players and coaches, there simply is no justification for [the Field Manager’s] failure to act. If [the Field Manager] was unsure about how to handle the situation, it was his responsibility to bring the issue to the attention of [the General Manager].”[21]

Lessons from the Commissioner’s Statement

The MLB investigation and the Commissioner’s statement provide lessons for companies and corporate leaders that can help prevent future crises from occurring.

First, **institutional culture matters not only because it reflects an organization’s values, but also because regulators are watching**. The Commissioner did not merely describe the conduct and impose a sanction. He chose to highlight culture as an issue that mattered in his assessment of culpability. Prosecutors and regulators around the world have given culture a similar emphasis. The US Department of Justice (“DOJ”) has emphasized the importance of a “culture of ethics and compliance” in its guidance on the Evaluation of Corporate Compliance Programs (April 2019) and set out detailed questions prosecutors should ask when evaluating corporate compliance programs. The former Chief of Staff at the US Securities and Exchange Commission noted in a 2016 address, using language similar to the Commissioner’s statement, “I can’t stress enough the critical role a firm’s culture has on its corporate compliance program and its effectiveness. A culture of always doing the right thing, not tolerating bad practices or bad actors is essential. The culture should encourage people to ask questions and to discuss openly what is the proper response to a particular issue and how conflicts should be resolved.”[22] Regulators outside the United States have similarly highlighted their focus on culture. The UK Financial Conduct Authority (FCA), for example, has issued numerous pronouncements and initiatives regarding culture, making clear to regulated entities that its focus on culture and governance is “permanent and continuing.”

Although culture has often been regarded as an inherently nebulous concept and a “soft” skill solely within the province of a company’s human resources department, it is increasingly recognized as something that is institution-defining and the responsibility of all corporate leaders. Whether culture is understood as how a company does things, how employees behave when nobody is looking, the habitual behaviors and mind-sets of the organization, or the shared commitment to how it conducts business, it reflects the conduct and behaviors influenced by the company’s values and ethics. It is certainly more than a set of written policies and procedures.

The Commissioner’s statement also provides an example of a regulator emphasizing a deficient culture as a main cause of an organization’s misconduct. It further shows that when misconduct is attributed to cultural failings rather than a rogue actor’s deviation from an otherwise robust culture, the penalties, financial and otherwise, can be harsh.

Second, **corporate managers must adequately supervise their employees, set the right tone, and demonstrate rigorous adherence to high standards.** The Commissioner’s decision holds the General Manager and Field Manager accountable for failing to adequately supervise their employees and players and ensure they understood and adhered to the rules. The case here follows a familiar fact pattern: the illegal sign stealing was not devised or initiated by senior management, but at least one middle manager (the Bench Coach) was involved, and other, more senior managers, like the Field Manager, were found to have been essentially willfully blind and allowed it to continue. The case is a reminder to companies of the importance of the tone from the top, and also the "tone from the middle"—*i.e.*, how middle managers, who most directly interact with line employees, must similarly model high standards and set the tone for the organization.

The DOJ's guidance on corporate compliance programs emphasizes the need for "a high-level commitment by company leadership," including the board and executives, and says corporate leaders "demonstrate[] rigorous adherence by example."[23] The guidance directs prosecutors to ask how senior leaders "through their words and actions, encouraged or discouraged compliance," what "concrete actions have they taken to demonstrate leadership in the company's compliance," and "how they have modelled proper behavior to subordinates." It further instructs prosecutors to ask whether "managers tolerated greater compliance risks in pursuit of new business or greater revenues." These are important questions for companies to ask themselves in assessing and then measuring their cultures.

Third, **corporate managers must stop bad behavior as soon as it occurs, with the knowledge that mild objections may be seen not only as condoning but also effectively encouraging misconduct.** The Commissioner imposed significant sanctions on the Field Manager, even though he expressed some disapproval of the sign stealing by breaking the monitors used for the scheme twice. However, the Commissioner found that the Field Manager did not direct the Bench Coach or players to stop the misconduct, nor did he elevate the matter to his supervisor, the General Manager, or further to the team owner. The Commissioner found that this non-action provided players with tacit approval if not encouragement. In a statement following the Commissioner's decision, the Field Manager accepted his responsibility in allowing the conduct to persist, stating, "As a leader and Major League Manager, it is my responsibility to lead players and staff with integrity that represents the game in the best possible way. While the evidence consistently showed I didn't endorse or participate in the sign stealing practices, I failed to stop them and I am deeply sorry." These facts are a reminder that corporate managers have a responsibility, as part of modelling the company's culture and values, not only to raise issues but see that they are heard and resolved.

Fourth, **companies should work to develop not only a "speak up" culture, but also a "listen up" culture.** The MLB investigation began when a former pitcher for the Ballclub publicly discussed his former team's practices, indicating the possibility that at least some in the organization were not in favor of the sign-stealing scheme. The Commissioner's decision does not reveal whether anyone else raised objections during the 2017 or 2018 seasons (other than the Field Manager physically damaging the monitor near the dugout), and the Commissioner's criticism of the team's culture included reference to "the way [] employees are treated." The case is a reminder why a culture in which employees feel safe raising concerns is so important. Just as important (and sometimes less of a focus for companies) is that companies work to develop a "listen up" culture in which corporate managers really listen and respond to concerns raised in a way that helps remove the potential stigma from speaking up.

Fifth, **institutions that lose sight of their values and prioritize short-term results while discounting the future, frequently run into problems**. Whether leaders overemphasize short-term financial results or employees cut corners on quality or safety considerations to meet tight deadlines, when company personnel lose sight of the long-term best interests of the company, or discount the likelihood of future adverse consequences from the short-term decisions, companies often run into trouble.

The Commissioner's decision states that many of the players knew what they were doing was wrong. It also states that during the season when players were concerned a White Sox pitcher appeared to notice the trash-can banging, "there was a sense of 'panic'" in the dugout and prior to the game's conclusion, "players removed the monitor from the wall in the tunnel and hid it in an office."[24] When misconduct occurs, there is often evidence of employees knowing what they were doing was wrong, a failure to consider the organization's integrity or best interests, and discounting the likelihood of getting caught and suffering adverse consequences. Indeed, experience shows that in the absence of the right tone and values, there is enhanced risk people will do foolish things. Whether it is writing emails that could cause public embarrassment, improper workplace relationships or harassment, or players banging on a trashcan, where companies do not devote sufficient attention to their culture, there is the risk employees will take unnecessary risk that can tarnish the company's brand and results.

A hard-charging culture or pressure to meet goals or deadlines is not necessarily bad; indeed, it may be entirely appropriate. However, it is important that the company's values, behaviors and mind-sets are positively ingrained in the organization and that employees' conduct remains consistent with those values. A culture that focuses on (and rewards) winning at all costs creates greater risk. For this reason, companies should have a clearly articulated corporate declaration of purpose that is widely communicated and encourages employees to focus on the longer term impact of their activities and how it furthers that purpose.

Sixth, **when misconduct does occur, companies should impose meaningful sanctions.** In this case, the Ballclub's owner decided that what occurred was not consistent with the culture the organization should have, and decided to go beyond the Commissioner's penalties by firing the General Manager and Field Manager. He made clear that he expected more for the organization and the city of Houston.[25] Rather than letting senior leaders off-the-hook with nominal sanctions, the owner sent a powerful message that more was expected of them because of their positions and, as a consequence, the sanctions were more severe.

Taking the Next Step: Measuring Culture

Deciding upon and implementing values and a corporate purpose to develop a positive corporate culture is a critical first step, but it is not the end of the cultural journey. Companies are recognizing—and prosecutors and regulators are emphasizing—that *measuring* and *monitoring* culture is necessary. In its April 2019 guidance, the DOJ highlighted not only the importance of culture generally, but how and how often "the company *measures* its culture …." And, "[w]hat steps has the company taken in response to its measurement of the compliance culture?" In other words, culture is not a static concept and it is important for organizations to ask themselves whether their culture is moving in the right direction.

Although prosecutors and regulators have identified the need to measure culture, there is little practical guidance for companies on *how* to do that. Fortunately, many companies are already collecting helpful metrics and information that allows them to evaluate their cultural trajectory and review matters through a "culture lens." For example, internal staff surveys now commonly ask employees questions directed at ascertaining whether the firm's values ring true in reality, and many companies conduct exit interviews in which they ask departing employees to comment on the working environment. Similarly, companies will typically collect quantitative data measuring corporate culture, such as training completion levels, employee turnover, absentee rates, and hotline reporting information. Using such data, along with other sources, to assess a company's culture can be instructive.

Latham & Watkins recently published Culture – A Practical Framework for Sustainable Change, a first-of-its-kind framework that draws on the firm's experience over the past decade advising institutions on their culture change and conduct initiatives, as well as other culturally-rooted problems. The framework seeks to bridge the theory-practice divide by outlining an array of practical measures and techniques that companies can usefully adopt in their quest to institute a meaningful, objectively monitorable, and operationally workable culture change program. The framework:

- Is a practical lens through which firms can constructively approach culture in the workplace;
- Bridges theory with practice through a practical toolkit;
- Has been informed by recent insights, trends, and real-life case studies; and
- Is a useful resource to help measure and monitor culture;

To register your interest in receiving a copy, email Natasha.Kraus@lw.com.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Nathan H. Seltzer
nathan.seltzer@lw.com
+44.20.7710.1020
+1.202.637.2206
London / Washington, D.C.

David Berman
david.berman@lw.com
+44.20.7710.3080
London

Christopher D'Agostino
christopher.d'agostino@lw.com
+1.202.637.2132
Washington, D.C.

Nell Perks
helennell.perks@lw.com
+44.20.7710.4749
London

You Might Also Be Interested In

DOJ Announces Revised Guidance for Corporate Cooperation Credit

Compliance Remains a Key DOJ Priority

SEC Investigations: A Guide for Public Company Directors, Officers, and In-House Counsel

Department of Justice Revises Policy Regarding Voluntary Disclosures of Export Control and Sanctions Violations

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's *Client Alerts* can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit https://www.sites.lwcommunicate.com/5/178/forms-english/subscribe.asp to subscribe to the firm's global client mailings program.

Endnotes

[1] Culture — A Practical Framework for Sustainable Change.

[2] *See* Commissioner's Statement at 1.

[3] *Id*.

[4] *Id*.

[5] *Id.* at 2.

[6] *Id.*

[7] *Id.* at 2.

[8] *Id.* at 3.

[9] *Id.* at 4 (quoting March 2018 Memorandum from Joe Torre) (emphasis in original).

[10] *Id.*

[11] *Id.*

[12] *Id*.

[13] *Id.* at 4-5

[14] *Id.* at 5.

[15] *Id.* Then Bench Coach Cora — at least in part related to the Astros' success in 2017 — was hired as Field Manager of the Boston Red Sox in 2018, and the Red Sox won the World Series in 2018. The Commissioner's decision states that it is withholding determining the appropriate level of discipline until after the DOI's investigation of allegations that the Red Sox engaged in "impermissible electronic sign stealing in 2018 while Cora was the manager." *Id.* at 7. Notwithstanding the ongoing investigation, 24 hours after the Commissioner's decision, the Red Sox and Cora "mutually agreed to part ways."

[16] *Id.*

[17] *Id.* at 5-6.

[18] *Id.*

[19] The incident referenced by the Commissioner involved the then-Assistant General Manager who boasted of the team's acquisition of a player who served a 75-game suspension for violating MLB's domestic-violence protocol, in front of a female reporter who wore a purple bracelet recognizing domestic violence and had tweeted contact information for women's services when the player pitched in 2018. The Ballclub initially denied her reporting of the incident, but ultimately fired the Assistant General Manager and the owner sent a letter personally apologizing to the reporter and retracting the team's initial denial.

[20] *Id.* at 7.

[21] *Id.*

[22] Andrew J. Donahue, Remarks at Keynote Speech at Rutgers Law School Center for Corporate Law and Governance – 2016 (May 20, 2016), https://www.sec.gov/news/speech/donohue-rutgers-new-directions-corporate-compliance-keynote.html.

[23] Page 9.

[24] *Id.* at 5.

[25] Within a day of the Commissioner's decision, moreover, the Red Sox "mutually agreed to part ways" with Alex Cora as their Field Manager, even while MLB's investigation into the Red Sox conduct in 2018 is still pending. The Red Sox statement refers to the "findings and the Commissioner's ruling," and states that "we collectively decided it would not be possible for Alex to effectively lead the club going forward and we mutually agreed to part ways." The Red Sox ownership did not directly address the team's culture or expectations for leaders.